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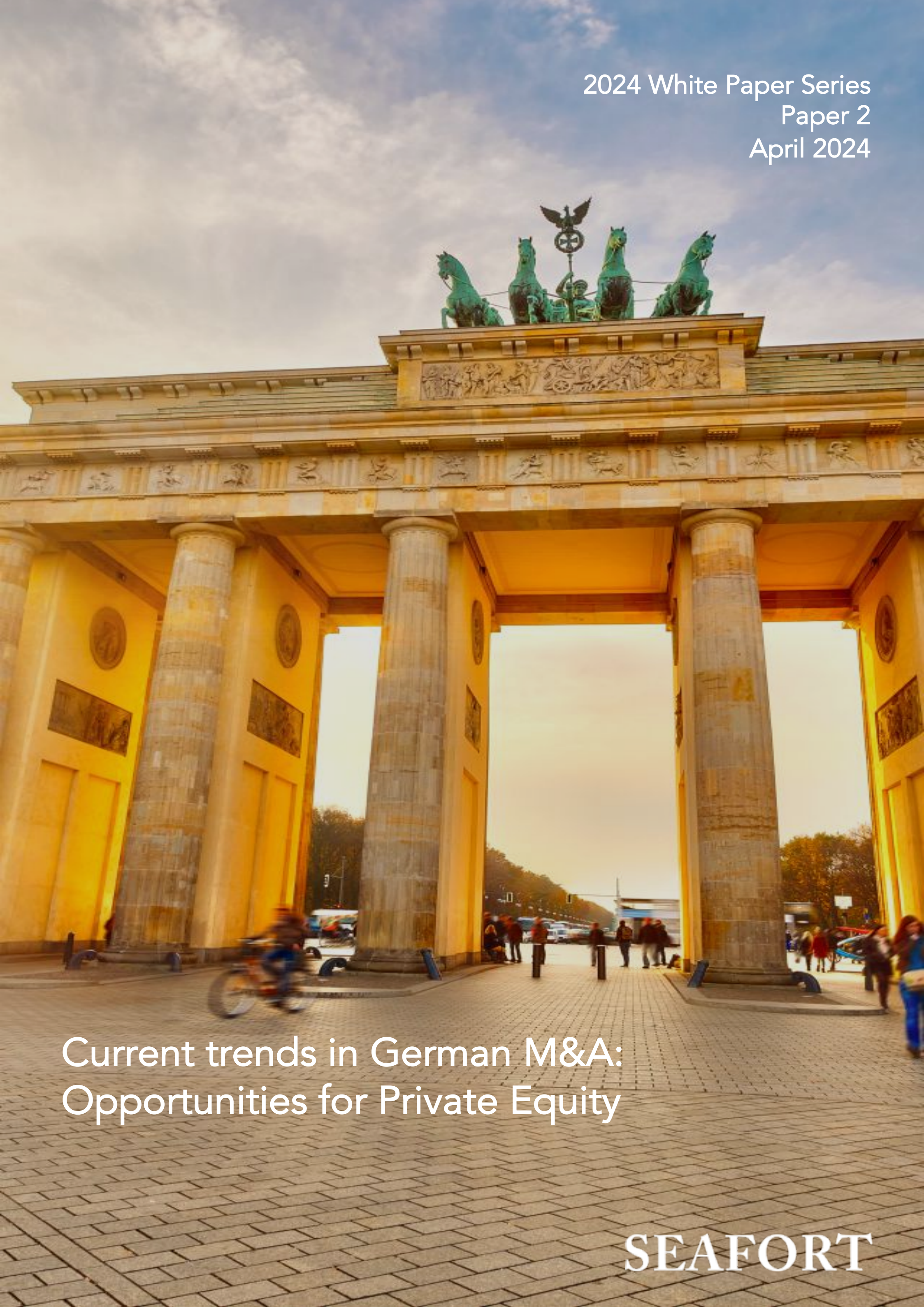

Current trends in German M&A: Opportunities for Private Equity

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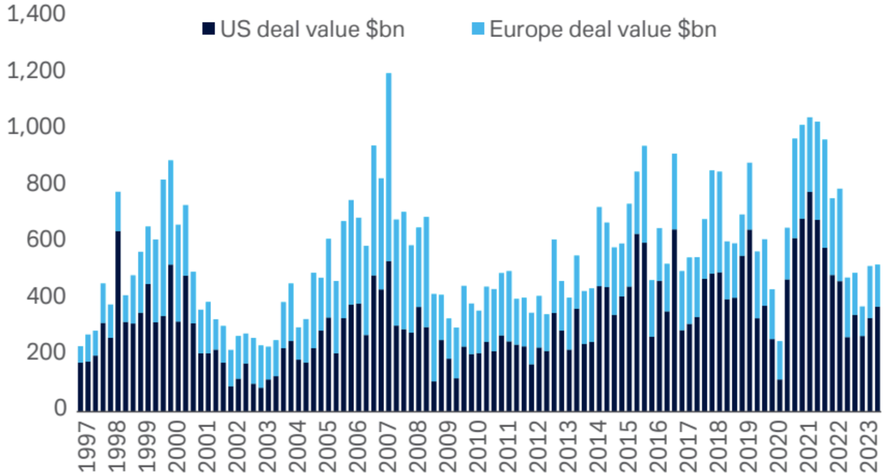
Despite recent economic challenges Germany overtook Japan last month to become the third largest economy in the world. Germany's M&A market is similarly conflicted: while it is still the largest in continental Europe, the volume and value of M&A transactions in Germany have fallen to the lowest levels in years. At the moment dealmakers seem divided when looking into the future, but optimism prevails. There is significant pent-up energy in the German M&A market, where the pace of IPOs and private equity-driven deals has slowed over the last two years, thanks in part to inflation and rising interest rates, as well as concerns over Russia's invasion of Ukraine. Many companies are now sitting on sizeable cash reserves and debt financing is more readily available. Companies and deal-makers are ready to get back into the M&A market, and the cadence of deals is starting to pick up. Moreover, if you look at the M&A opportunities that companies are chasing these days, you will see where the market is headed: technology and renewable energy companies are driving deal activity, and private equity is playing a greater role.

M&A volumes remained subdued in 2023



Source: Dealogic, Deutsche Bank

Parties are closer on pricing

One of the main obstacles for German M&A deals in the last eighteen months has been persistent inflation and high financing costs, which created a pricing mismatch that stood in the way of deals and led to a refocus on core business models. One of the more notable examples of this is Lufthansa's many non-core divestments. Going forward there is far less uncertainty about the trajectory of interest rates, and inflation has fallen significantly from its peak in 2022. Bidders are factoring more modest inflation and interest rate constraints into their valuations given greater clarity on Germany's economic outlook, and sellers are recalibrating their expectations in response to the new higher-for-longer rate environment. This should create an uptick in deals.

Financing is more available

Debt financing is more easily available in Germany than it was six months ago, albeit at an elevated cost. Buyers are also tapping private credit for funding. Private credit funds – which typically offer more bespoke, flexible loan structures – have taken center stage in acquisition financing in the past eighteen months. And while financing costs may remain higher than in previous years, the market will adjust to these new realities and should provide a supportive environment for M&A activity.

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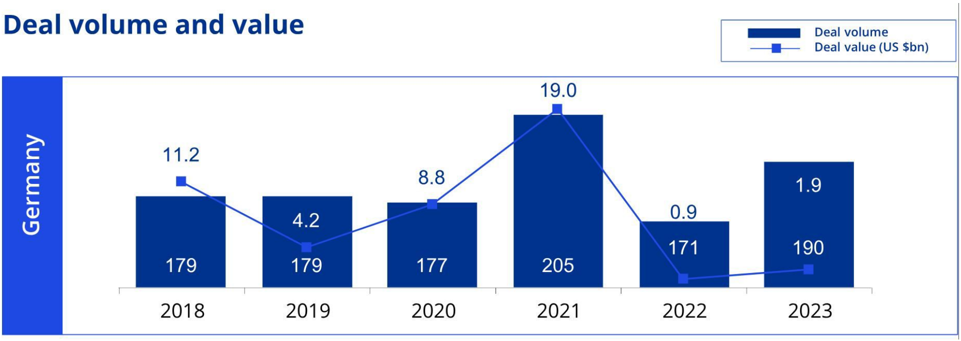
Deal volume and value



Focus on innovation, technology and renewable energy

The German economy is increasingly focused on innovation, which is driving the demand for deals in technology, green tech and other high-growth areas. The growing importance of digitization will also force companies to make strategic acquisitions.

The tech sector accounted for nearly 30% of Germany's total deal volume in 2023 (more than any other sector), including the €2.25 billion acquisition of Software AG. Securing or expanding access to software, automation capabilities and AI to gain a competitive advantage will continue to play an integral role in the race to digitize product portfolios, and bolster M&A activity in the technology sector.

The need for European energy independence and the transition to renewable energy will also drive deal activity.

Just look at the ongoing negotiations of the German government in its bid to acquire the local division of Dutch grid operator TenneT, a company that is central to the security of Germany's energy supply and the implementation of the energy transition. Germany's largest M&A deal of 2023 was in renewable energy, with the sale of Viessmann Climate Solutions to Carrier for €12 billion.

The role of Private Equity

Private equity investors will undoubtedly be a major source of support for deals going forward. PE investors were involved in thirteen of the top twenty German M&A transactions of 2023 (four times on both sides!), representing an aggravated transaction value of over €70 billion. Heightened regulatory scrutiny and an increasingly complex regulatory landscape may have a chilling effect on large M&A transactions, which could create opportunities for companies capable of executing a higher volume of small to mid-cap deals. Smaller-sized transactions and carve-outs are also more likely to make it across the finish line.

Looking ahead

The German M&A market has had a journey of remarkable ups and downs, consistently demonstrating its ability to recover from economic shocks. Its resilience to the dot-com bubble crash, the 2008 financial crisis and the COVID-19 pandemic demonstrates its fundamental strength. In the short-term its trajectory will depend on the outcome of current geopolitical tensions including Russia's war in Ukraine, but in the long-term it can rely on the continued strength of Germany's industrial, legal and financial institutions, as well as the EU marketplace. The areas of technology, green tech and renewable energies will offer unprecedented investment opportunities. The ability of companies and investors to navigate this complex environment, leverage technological innovations and adapt to regulatory changes will be critical to capitalizing on the next era of opportunities in Germany's M&A market.

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