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Who dares wins: European M&A Outlook 2020

A study of European M&A activity

In cooperation with:

September 2020

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Methodology

In the second and third quarters of 2020, Mergermarket surveyed senior executives from 170 corporates and 60 PE firms based in Europe about their expectations for the European M&A market in the year ahead.

All respondents have been involved in an M&A transaction over the past two years. All responses are anonymous and results are presented in aggregate.

Foreword

Stefan Brunnschweiler, Partner, Global Head of the CMS Corporate/ M&A Group

Welcome to the eighth edition of the CMS European M&A Outlook, published in partnership with Mergermarket

The last six months have been the most challenging for European dealmakers since the 2008 financial crisis. The COVID-19 pandemic and ensuing lockdowns have taken a heavy toll on the continent's economies and sent M&A activity tumbling.

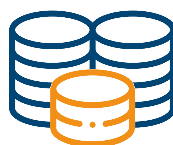
The European Commission is forecasting an 8.3% contraction in EU GDP for 2020. Year-on-year, H1 M&A activity in Europe was down 31% by volume and 29% by value.

However, there are some reasons for optimism. European economic growth is expected to rebound in 2021 and, at least for now, loosening lockdowns have allowed vendors, investors and advisers to meet and advance deals.

But the speed and sustainability of economic recovery will depend in great part on the development of a vaccine. Until one is distributed, uncertainty and volatility will weigh heavily on market sentiment. It is unsurprising, then, that respondents to this year's survey are cautious and readying themselves for a difficult and challenging period ahead.

Key findings from our research include:

M&A appetite weakens
74% of respondents say the pandemic has caused their dealmaking appetite to lessen. 65% of respondents are not considering M&A, against 45% in last year's survey. Uncertainty around future company earnings has widened pricing expectations between vendors and buyers. Dealmakers are nervous about paying full multiples for assets at a time of high volatility, while vendors are reluctant to crystallise lower valuations at the bottom of the cycle.



Financing conditions to tighten
79% of respondents expect financing conditions to become more trying in the coming year. Leveraged loan issuance is down year-on-year and, although corporates have been able to tap high-yield bond markets, lenders are focused on nursing current portfolios through COVID-19 disruption rather than funding new transactions. Debt for deals is expected to be more expensive and issued on tighter terms than were available pre-pandemic.

Distressed M&A, restructuring and corporate defaults to rise
All respondents anticipate an increase in distressed M&A, 90% say there will be an increase in restructuring activity, and 82% expect an increase in corporate defaults. The pandemic has already forced companies in sectors impacted directly by lockdowns – such as aviation, retail and leisure – into insolvency and restructuring. As government support mechanisms unwind, more businesses will encounter distress.

Market commentary

Intrepid M&A explorers will find rewards in the COVID-crisis tundra

Scott Moeller, professor and director of the M&A Research Centre of The Business School, City, University of London, analyses the key trends in European dealmaking

Scott Moeller, Professor and Director, M&A Research Centre of The Business School, City, University of London

In the early 20th century, Vilhjalmur Stefansson, the legendary Icelandic American explorer of the Canadian Arctic, said, "There are two kinds of Arctic problems, the imaginary and the real. Of the two, the imaginary are the most real."

The same might be said about the outlook for European M&A in late 2020. When we look at the first half of the year, the future looks dismal and we imagine worse is yet to come. Yet the in-depth analysis in this report – which surveyed more than 230 senior executives from corporates and private equity firms in Europe – goes beyond the commonly-heard superficial negative assumptions to reveal pockets of strength and reasons for considered optimism.

Part of that optimism comes from the relative strength of Europe vis-à-vis the rest of the world. Mergermarket data shows that, although Europe's share of global M&A deal volume has dropped commensurate with the rest of the world, in terms of value of deals in H1 2020, the percentage represented by Europe has risen to 29% of the global total from 19% in the same period last year. The report shows that this increased percentage should remain steady over the next year or so.

Europe is well-positioned to maintain this rising percentage because it is strong in many of the industries, where the experts surveyed found reason for optimism. This includes both the technology, media & telecoms (TMT) and pharma, medical & biotech (PMB) sectors. Indeed, very large deals, admittedly announced before the height of the pandemic but that remained on track to close despite those headwinds, drove much of that value.

It will be an upward climb, however, as almost two-thirds (65%) of the dealmakers contacted for this report said they were not considering M&A at this time, 20 percentage points worse than last year. Obviously, uncertainty due to COVID-19 is the principal reason given (by almost three-quarters of those contacted), but there are other drivers as well. The most important were the fear of a global recession and a reduction in cross-border activity due in part to the increased antitrust

regulatory scrutiny (including restrictions on cross-border acquisitions originating from certain countries, notably China). This has been partially offset by the increase in the percentage of intraregional deals done in Europe and thus not subject to the same regulatory reviews, representing more than 75% of all European deals in H1. And if they did want to venture outside of Europe, those European acquirers said overwhelmingly that North America would be their first choice.

In addition to an expectation of continuing strength in the TMT and PMB sectors, another sector expected to see growth was consumer/retail. This would seem to be one industry where distress and even insolvency will drive activity – one company's pain can be another firm's gain.

The experts surveyed identified divestments and carve-outs as strong deal drivers, with almost three-quarters of the cash-rich private equity firms noting their interest in distressed and turnaround opportunities, linked with the more favourable valuations currently available. In contrast to the private equity acquirers, 83% of corporates saw acquisition of new technologies as their principal deal driver, with much of this happening through their corporate venture capital investment arms.

As noted above with the slowdown of cross-border activity, only 5% of corporates surveyed would target new geographies. And the report provides advice for struggling companies, who shouldn't look to the corporate sector to bail them out: only 14% of corporates said they would consider acquiring distressed targets at this time. The report offers some interesting guidance for others who are on the sell side, as buyers, whether private equity or corporate, who were principally looking for targets that provided a lower cost base and/or access to new technologies and other intellectual property.

There are interesting trends as well for the debt and financing markets. As corporates shored up their balance sheets earlier this year, deal financing ground to a halt. For the first half of the year, M&A loan activity was down 39% from H1 2019. As had been widely reported, Europe's IPO market more than halved.

The outlook for these financing markets is, unsurprisingly, negative. Among survey respondents, 79% believe financing market conditions will be worse than last year. Within this context, private equity, credit funds and non-bank lenders were identified as the sources of funding that would be most readily available, though these too were expected to be both more expensive and with tighter covenants and terms. The areas of opportunity are expected to be distressed debt and special situations, and survey respondents predict that the most activity will come via deals related to distressed M&A, restructurings and corporate defaults. Those who are willing to be bold are clearly hoping to be rewarded.

The Arctic Ocean is not a frozen wasteland – Stefansson and subsequent explorers discovered a plethora of wildlife and sea life, and even vast amounts of minerals and oil below the seemingly impenetrable ice. Similarly, underneath a veneer of negativity, deal activity in Europe does have a strong foundation going into the closing months of 2020, according to the experts active today in the M&A market and surveyed for this report. But, as with those early Arctic pioneers, dealmakers not only need to know where to explore but, perhaps even more importantly, where to avoid adventuring.

Latin America offers a trove of opportunities for foreign investors

Senior CMS representatives from across Latin America report on the region's response to the COVID-19 pandemic and opportunities for investors from Europe

Juan Carlos Escudero, Managing Partner, CMS Peru

Jorge Allende D., Partner, CMS Chile

Juan Camilo Rodríguez, Managing Partner, CMS Colombia

Giancarlo Schievenini, Senior Associate, CMS Mexico

Latin America has been hit hard by the pandemic. But, in some ways, the crisis is opening up opportunities, mainly for equity investors who can capitalise on their strong currencies such as euros or dollars.

On top of that, valuations are falling for local companies, which creates more attractive targets. Activity is also rising. Since August, we've been able to see a light at the end of the tunnel.

We expect a lot of investment in the mining industries, in which the UK happens to be very concentrated. On the infrastructure side, Latin American governments are developing many projects – highways, energy, a little mining, even some airports – and will want to attract investment for those to move the economy forward. Spain could prove a very important country in that respect.

In Mexico, European investors were very active in the construction and the hospitality sectors pre-pandemic. That has of course changed, as nobody currently wants to enter the industry. Now European investment in Mexico is moving more towards pharmaceuticals and the fintech space, which was already very popular with private equity firms.

Where will investors find ideal opportunities?

Every crisis presents opportunities, and this is no exception. There will be an increase in distressed M&A and divestments, including in the tourist and real estate sectors. In some markets, like Chile, private equity and strategic investors can take advantage of falling valuations.

Nobody would like to sell their business at a very low valuation, but sometimes you do not have much of a choice. We are also seeing a lot of mergers and 'white knight' takeovers, as local entrepreneurs look for cross-border

and smart-money investors coming into the market.

Some countries face unique circumstances. In Chile, for example, the price of copper is returning to levels not seen for a while, even before the pandemic. That is down to China seemingly being back on track and needing resources for infrastructure projects.

All of the big players in the copper industry are already in Chile and Peru, which should also reap the benefits of renewed energy investment, so that's one area where we expect to see a lot of activity.

Mexico is beginning to feel the effects of the North American Free Trade Agreement, particularly for the automotive sector. A lot of investment is coming from European carmakers into Mexico, because, if they want to put their cars in the US, they have to do it through the region, and it's easier and cheaper for them to do it in Mexico rather than going directly to the US or into Canada.

What issues could be most challenging for dealmakers?
Leaving the COVID-19 pandemic to one side, the biggest near-term challenges facing Latin America are the various elections that are happening throughout the region between now and the end of 2021.

Peru has elections at the start of next year, which will create some uncertainty. Depending on which party takes control of the congress and who becomes president, that will send an important signal to private investors and potentially set a trend for the next five years.

Chile, too, is facing several elections and plebiscites, including a possible major constitutional change. So, while the post-pandemic economic forecast is still quite good for the country, foreign investors will need to contend with all these political and social developments.

Then there is the question of competition, particularly with investors from China.

For instance, in Colombia last year, Chinese companies won their bids for the Bogotá underground metro project as well as for a regional train project in the city's suburbs.

Latin America, in truth, is changing every day. It's not like Europe, where generally there is more certainty. European dealmakers coming into this market must also bear in mind this situation and protect properly their investments.

The great divide in energy M&A as renewable sector enters boom period

Charles Currier of CMS UK reports on the state of the EMU industry and the future of clean energy in Europe

Charles Currier,
Partner,
CMS UK

There are sub-sectors within the energy, mining & utilities space that are likely to do very well over the next several months. Others, though, are being very negatively impacted by COVID-19, including on the mining, oil & gas and energy supply sides. But Europe's renewables market is booming. A lot more funds and institutional money are being allocated towards clean energy generation.

In many renewables deals, the assets are underpinned by some kind of subsidy regime, which effectively means more revenue is guaranteed. Most of the investors who are looking at the sector are long term and thinking about the market with at least a 20-year timeframe, which is one reason why the space has been less susceptible to shorter-term COVID-19 issues.

In respect of face-to-face meetings in M&A transactions, in this space we are even seeing virtual site visits being conducted by drones, which is helping deals get done in the current environment.

Financial investors are interested in the offshore wind sector because it offers opportunities to deploy very significant amounts of capital in single transactions. They are getting ever more comfortable with the risks around the sector. More people are coming in at the construction phase, where previously they would have only invested in the operational phase. Several funds are buying their own platforms to develop projects. So now they are investing in the full lifecycle of renewable assets.

Oil & gas companies, too, are looking very seriously at this market; they realise the need to diversify. As the focus on climate change continues to grow in importance, a lot of the exploration and production companies are making public commitments around transitioning to net-zero targets. It's going to drive a lot of deal activity, which should begin with a lot of partnerships.

How is the European market performing now, several months into the pandemic?
The renewables sector is extremely busy with dealmakers adapting to the new environment.

In the renewables space, there's a lot of capital out there looking for opportunities to be deployed at the right returns with the right risk criteria, and renewable energy is in that sweet spot. There are lots of projects that need capital over the next 10, 15, 20 years, which is augmented by government policies to compel the transition to decarbonised-only energy generation. So there's a combination of factors driving a lot of M&A activity in this sector.

What challenges are dealmakers facing in the energy space?
Other than the pandemic, of course, the industry is still facing technological challenges. Most renewable technologies are moving very quickly to grid parity, or better than grid parity. That change raises the question of how long it can continue, and where and when renewable energy providers will hit the bottom in terms of pricing. And then you've got new and untested technology coming to market. All those sorts of factors can be added to the technology bucket.

And there is always risk. A lot of the oil majors have looked to invest in the past, made some investments, but then pulled back. It will be interesting to see if this really is the turning point where the market will see very significant investment by those entities. The sector also is not immune to other kinds of macro shocks. A worsening of the US-China trade war would inevitably drive up costs, particularly as a lot of manufacturing of components is done in China.

Considering the UK, a no-deal Brexit will have various material effects on the sector. Beyond the usual concerns about importing and exporting, there would probably be an impact on investor confidence and investing in the UK. Brexit was overtaken by other events over the past several months, but it is coming back into focus now.

The GP-led secondary: A new dawn or a flash in the pan?

Dr Eva Annett Grigoleit and Dr Igor Stenzel of CMS Germany report on a potential rising trend in continental Europe

Dr Eva Annett Grigoleit, Partner, CMS Germany

Dr Igor Stenzel, Partner, CMS Germany

The GP-led secondary has recently been introduced in the German market as an innovative transaction structure. There are good reasons for this new transaction structure to proliferate over the next several months. GP-led secondaries could provide a post-COVID-19 boost for the market in Germany, as groups look for innovative ways to hold on to good assets for longer and provide LPs with optional early liquidity. Here we explore the commercial background and special features of these transactions, and ask whether this could be the beginning of a new trend in continental Europe.

What is a GP-led secondary?
A secondary is the sale of a PE-owned portfolio company to another PE fund. The specific structure of a GP-led secondary compared with an ordinary secondary is that the same GP is managing both the seller fund and the buyer fund, the latter being a single-asset fund with the sole purpose of acquiring the portfolio company from the seller fund. The transaction is thus initiated on the seller's side and executed on the buyer's side by the same GP.

Typically, investors in the seller fund will be able to roll over into the buyer fund or to cash out. A partial exit combined with a partial rollover is also possible, to afford current investors maximum flexibility. To initiate and accelerate future growth of the portfolio company, new investors are given the opportunity to participate in the buyer fund alongside investors already invested in the seller fund.

What is the economic background of GP-led secondaries?
GP-led secondaries are used to raise new capital for a specific portfolio company and capitalise on its economic success beyond the stipulated term of the existing invested fund. By such means, the secondary can elevate the existing business to another level, such as by rolling it out in other geographies or expanding its product portfolio. This can occur before an exit, which would no longer enable investors in the seller fund to profit from later, successful steps.

What is the specific appeal of a GP-led secondary?
That the GP understands the portfolio company in question better than any new asset, and also reinvests funds of investors already invested in the existing fund, should inspire confidence in potential new investors. Especially in times of increasing economic and political uncertainty, investors and GPs may feel more comfortable investing in familiar assets over the term of the

existing fund. That GP-led secondaries have garnered a great deal of interest in the light of the COVID-19 crisis should therefore come as no surprise.

What are the special features of a GP-led secondary?

In usual exits of a PE fund the purchase price is determined by negotiations or via an auction process, but this differs in GP-led secondaries. Since the GP is on both the seller and buyer side, the purchase price must be determined via a complex bidding process which is part of the establishment of the new fund. The price determination leads to a considerably higher transaction complexity compared with less sophisticated exit-channels such as an ordinary secondary or a trade sale.

What is the outlook for GP-led secondaries in Europe?

In December 2019, Berlin-based PE fund capiton closed the first German GP-led secondary after completion of the bidding process by transferring its majority stake in KD Pharma Group from the capiton IV fund to a new single-asset fund launched by capiton specifically for this purpose.

Looking to the US and UK, where GP-led secondaries are better entrenched, the commercial need for and viability of these sorts of transactions is self-evident. More widespread adoption of GP-led secondaries, spurred at least in part by the economic implications of the COVID-19 crisis, should be anticipated in Germany and other continental European nations. In all likelihood, we will soon be looking back on capiton's GP-led secondary as a major trendsetter in the market.

COVID-19 reset: Need for high-quality upgrades clear as day

Niall McAlister of CMS UK and Mariano Bautista of CMS Spain report on the state of Europe's PMB industry

Niall McAlister, Partner, CMS UK

Mariano Bautista, Partner, CMS Spain

At the start of 2020, the expectations were for a busy year – then COVID-19 derailed that. But some sectors are faring better than others and pharma, medical and biotech (PMB) is one of those. The life sciences industry offers exciting returns if dealmakers can find the right company.

Governments have pumped economies with additional finances, and investors are looking for ways to get into businesses that have got much higher opportunities for return than the usual, bigger players that you would expect to see in the stock markets.

What types of deals will be struck?
The COVID-19 crisis has caused larger companies to look at their supply chains, indeed at the whole infrastructure behind the life science industry, and realise that it's actually very fragile. In response, there will potentially be a lot of M&A activity around services-related businesses those companies need to deliver their product. In addition, there's the digital side – the switch to remote working during lockdowns will likely speed up the uptake of digital services more generally in this sector.

In Spain in particular, the private hospital network is attracting many leading international firms and several deals have recently been closed. Due to an ageing population and the expectation of better quality services, healthcare companies are generally appealing targets for private equity firms. There is a need to increase accommodation capacity and, consequently, investment activity will increase in relation to care homes. Foreign funds are already investing, albeit timidly, in the Spanish market with buy-and-build strategies. Nevertheless, the problems pointed out during the pandemic may require the authorities to reconsider the model in the near future.

The pandemic has highlighted the poor state of many nations' healthcare businesses. The market sees that the government knows it must do more, so there is an interest in investing in the sector again, but doing so in a smarter way that takes advantage of new technologies and builds a higher-quality healthcare market.

How resilient is the European market?
In terms of life sciences generally, the European market is robust. There is also more money coming in from the US, much more than three or four years ago.

For big pharma and big medical device businesses, there is always a need to be buying up good assets. The sector is structured in such a way that research is outsourced to small companies that take it forward to a point where it then requires the heft of bigger companies to see it through or take it to market. European assets are cheaper relative to American ones, and there is a lot of money around, so conditions look reasonably good in Europe. Companies will probably focus more on mid- and lower-mid-market deals, and transactions where larger corporates go after single assets or small portfolios of assets, rather than megadeals.

What challenges will this sector have to navigate over the coming months?

Healthcare companies must embrace emerging technologies to stay relevant. I think these companies will soon be the target of the M&A deals. In terms of macro issues, the US political situation is challenging because it creates such unpredictability, although for now the industry has kept its head below the parapet while the politicians throw rocks at each other.

COVID-19 is an issue, beyond the obvious public health concerns, because ultimately it will be diverting a lot of capital from the big players in the industry. If they are putting the money into finding vaccines, then they're not putting it into other therapies and therapeutic areas. That could have an impact on existing programmes and on the funding of future programmes.

So COVID-19 is undeniably a big issue, even though the sector can benefit in some ways, and probably already has in terms of consumer sentiment. There is a feeling that the pharma companies have done very well to get up to speed with potential vaccines in a very short space of time. It remains a very uncertain situation, but PMB companies have responded very well to the crisis.

Chapter one

The M&A environment and expectations for the year ahead

The COVID-19 outbreak has disrupted European stock markets and forced economies across the continent into retreat

Top findings

74%
of survey respondents say their dealmaking appetite has diminished as a result of the pandemic

64%
don't expect the M&A market to return to pre-pandemic levels before at least 2023

56%
expect Europe to be the region most affected by the COVID-19 crisis

63%
predict North America will be the top non-European target region for European acquirers over the next 12 months

The European Commission is predicting an 8.3% decline in EU GDP in 2020 and the MSCI Europe, an index tracking more than 400 companies in 15 European countries, was down as much as 36% at the height of coronavirus uncertainty in March.

This macroeconomic upheaval has directly impacted European M&A, with deal volume and value declining steeply in H1. According to Mergermarket data, volume fell 31% to 2,800 transactions and aggregate value dropped by 29% to EUR 262.9bn compared to the same period last year. Volume and value figures for Q2 are the lowest for any quarter since 2013.

The dearth of large transactions reflects the degree to which confidence has drained from the market. Only 92 deals worth more than EUR 500m crossed the line in H1 2020, down almost 29% against the same period in 2019.

Moreover, many of the largest transactions – including the EUR 31.1bn merger between insurers AON and Willis Towers Watson, and the EUR 17.2bn private equity buyout of ThyssenKrupp Elevator by a consortium including Cinven and Advent International – were announced before lockdowns came into effect.

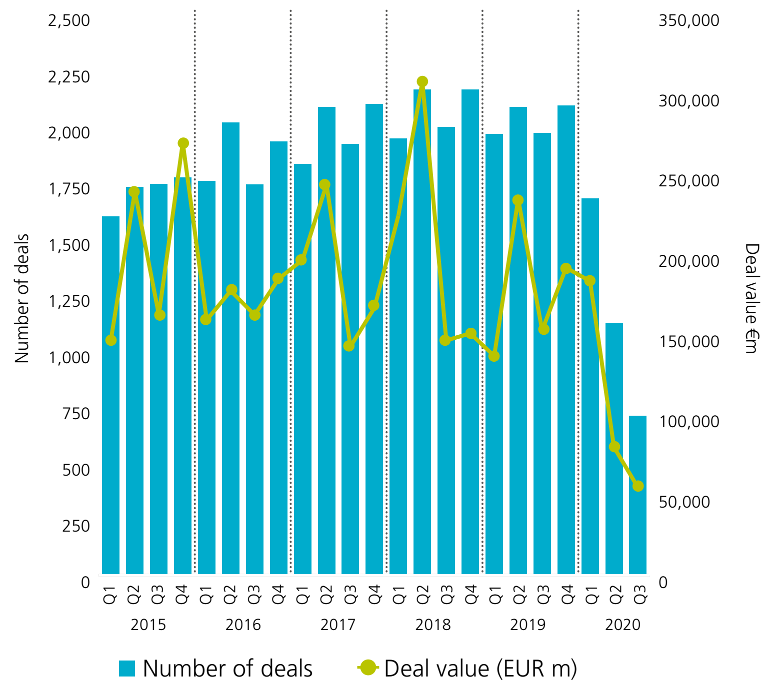
Buyers and sellers on guard
Although stock markets have rallied as lockdowns have eased, dealmaker sentiment remains bearish. Only 2% of respondents to our survey expect their deal activity to increase this year, compared to 26% in 2019. More than half (53%) expect activity levels to decrease significantly during the next 12 months.

The survey findings indicate that respondents are strapping in for a long and bumpy recovery. Almost two-thirds (64%) don't expect the M&A market to return to pre-pandemic levels before at least 2023. Most predict Europe, by a distant margin, will be the region most severely affected by the pandemic. Nearly three-quarters of respondents

M&A departments used the time freed up by COVID-19-induced lockdowns to reassess their strategies. Corporates are carving out non-core business, and that activity has been reinforced by slight increases in distressed M&A. Despite the pandemic, transactions still went ahead. In particular it triggered activity in the pharma, medical & biotech sector.

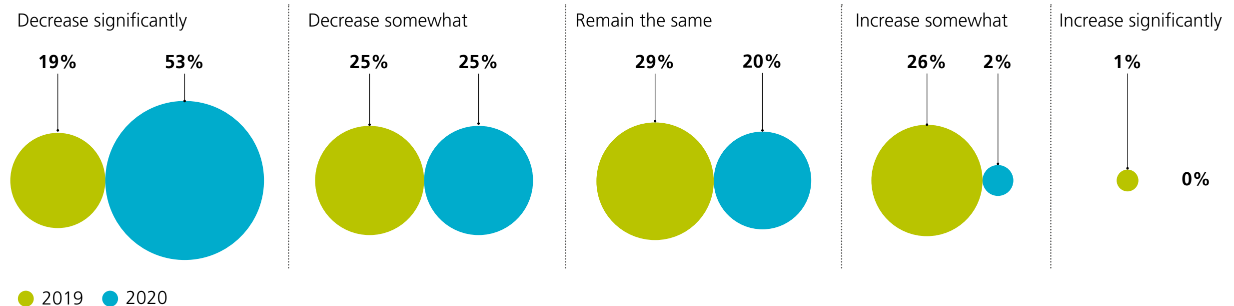
Dr Thomas Meyding, Partner, CMS Germany

European M&A trends 2015-2020 YTD*



Data correct as of 8 September 2020

What do you expect to happen to the level of European M&A activity over the next 12 months?



European M&A top deals, 2020 YTD*

Announced date	Target company	Target sector	Target country	Bidder company	Bidder country	Deal value EUR (bn)
09/03/2020	Willis Towers Watson Public Limited Company	Financial services	United Kingdom	Aon plc	United Kingdom	31.1
27/02/2020	ThyssenKrupp Elevator AG	Industrials & chemicals	Germany	Cinven Partners LLP; Advent International Corporation; RAG-Stiftung	USA	17.2
07/05/2020	Virgin Media Inc; Telefonica O2 Holdings Limited	TMT	United Kingdom	Virgin Mobile Inc./ Telefonica O2 Europe Plc JV	United Kingdom	11.5
03/02/2020	Ingenico Group S.A.	Business services	France	Worldline SA	France	9.2
17/02/2020	Bombardier Transportation GmbH	Industrials & chemicals	Germany	Alstom SA	France	7.6
12/08/2020	Sunrise Communications AG	TMT	Switzerland	Liberty Global Plc	United Kingdom	6.1
29/07/2020	CPA Global Limited	TMT	Channel Islands	Clarivate Analytics Plc	USA	6.0
12/03/2020	Borealis AG (39% Stake)	Industrials & chemicals	Austria	OMV AG	Austria	5.7
26/02/2020	iQ Student Accommodation Limited	Leisure	United Kingdom	Blackstone Group L.P.	USA	5.5
17/02/2020	UBI Banca S.p.A (99.92% Stake)	Financial services	Italy	Intesa Sanpaolo S.p.A.	Italy	5.5

**Data correct as of 8 September 2020*

say their dealmaking appetite has diminished as a result of the crisis.

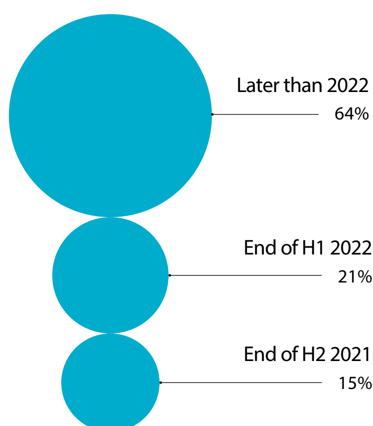
Several factors contribute to this guarded outlook. As stock markets have dipped, so have valuations for M&A assets. According to the Argos Index, which tracks the multiples paid for private European companies valued between EUR 15m and EUR 500m, average multiples fell to 9.2x Ebitda in Q2 2020, down from 10.3x at end-2019.

Private equity vendors, entrepreneurs and owner-managers have been reluctant to sell assets at lower prices in a falling market. Equally, buyers are reluctant to pay full valuations when there is still so much unpredictability in future earnings. Travel restrictions and social distancing measures, which

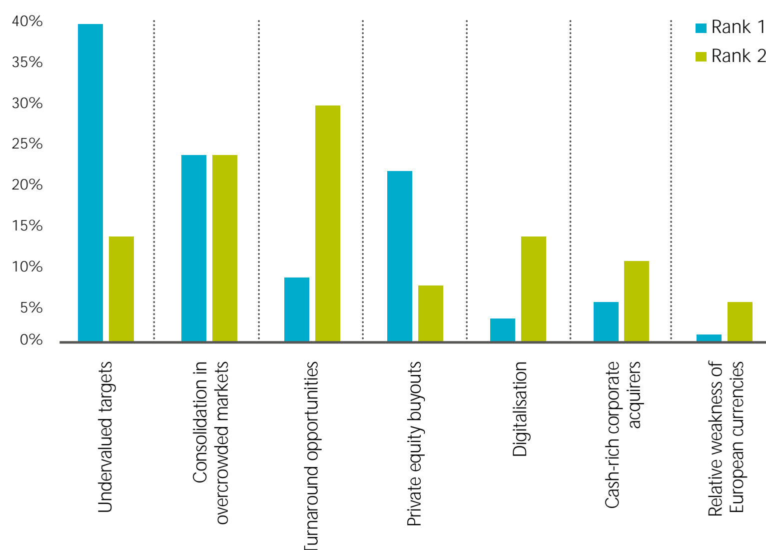
The markedly low levels of European M&A in Q2 have not been seen since early 1997. Beyond the pandemic and resulting recession, other factors have contributed to this, including the UK nearing the end of the Brexit transition phase, increasing regulatory intervention, and notably the current US and European relationship with China.

Mark Bertram, Partner, CMS UK

When do you expect European M&A to be back at (pre-COVID-19) 2019 levels?



What do you believe will be the greatest buy-side drivers of M&A activity in Europe over the next 12 months? (Please select top two)



have limited the scope for vendors, buyers and management teams to meet in person, have also made it difficult to advance deal pipelines.

Distress to dominate

As various government support initiatives and stimulus packages unwind, dealmakers have opted to step back and assess the full impact of the pandemic. Although several high-profile businesses have already gone into restructuring processes – UK department store Debenhams went into administration in April and is facing liquidation, and German payment processor Wirecard filed for insolvency in June – more financial distress is anticipated.

Credit insurer Euler Hermes expects insolvencies to peak at the end of 2020 and 2021. An insolvency index it compiles is projecting double-digit year-on-year increases in the number of companies going bust across Europe.

In addition to COVID-19 disruption, the upcoming US election in November, the end of the UK's Brexit transition period, and deteriorating relations between China and the West will intensify the headwinds M&A investors face.

Unsurprisingly, survey respondents believe this market dislocation and uncertainty to be a predominant source of deal flow in the coming months, with distress-driven M&A and the sale of non-core assets from larger companies expected to be the main drivers of sell-side activity. Most businesses, though,

> Many transactions in Q2 were cancelled or interrupted. Little by little, these are being reactivated, and financiers and existing shareholders are prepared to make extensive concessions because of the existing uncertainties. There besides, this year we have seen carve-out transactions almost untouched by the COVID-19 crisis.
>
> *Dr Alexandra Schluck-Amend, Partner, CMS Germany*

are only likely to transact when they have exhausted other options, depressing overall deal volumes.

Non-distressed deals that do proceed are expected to cluster around the few sectors that have proven most resilient through lockdown periods, including technology, media & telecoms (TMT), financial services, pharma, medical & biotech (PMB) and industrials. Businesses in these sectors have been able to sustain operations and continue serving customers through lockdowns, providing potential buyers with a clearer view of current and future earnings.

Companies in industries directly impacted by COVID-19 – including aviation, retail, leisure and restaurants – will find it difficult to gain traction with potential buyers unless they swallow rock-bottom valuations.

Financial pressure could also lead to an uptick in carve-out deals, as corporates look to focus resources on core business.

Regional review

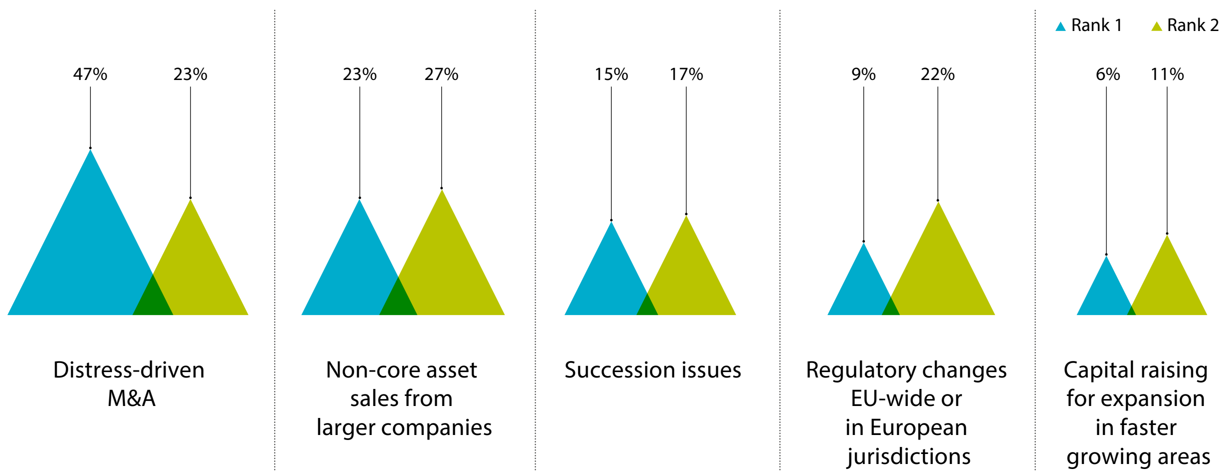
The UK logged the highest proportion of European deal activity in H1 (34% of total deal value and 20% of total volume), followed by Germany (19% and 13%, respectively) and France (12% and 11%, respectively).

UK figures were boosted in large part by a number of large transactions, such as the abovementioned Willis Towers Watson/AON merger and Liberty Global and Telefónica's EUR 11.5bn deal to combine Virgin Media and O2. German activity was enhanced by a strong showing in industrials deals, including the ThyssenKrupp Elevator transaction and French railway equipment firm Alstom's EUR 7.6bn acquisition of Berlin-based Bombardier Transport.

> The impact of the massive economic measures aiming at countering the effects of the COVID-19 pandemic remains uncertain. Accordingly, the current appetite for dealmaking seems limited to distressed assets, carve-outs and some more resilient sectors. Additionally, stricter foreign investment control regulations in the EU could also limit the appetite of certain non-EU investors.

Jean-Robert Bousquet, Partner, CMS France

What do you believe will be the greatest sell-side drivers of M&A activity in Europe over the next 12 months?



The impact of COVID-19

Pandemic-induced lockdowns and slumping stock markets put the clamps on new deal activity in late Q1 and early Q2

On March 13th, the number of COVID-19 cases in Europe had surpassed those in China, where the pandemic originated. A few days earlier, the whole of Italy entered a strict lockdown. Spain, Germany, the UK and France soon followed suit, shutting schools, ordering people to work from home and closing non-essential shops.

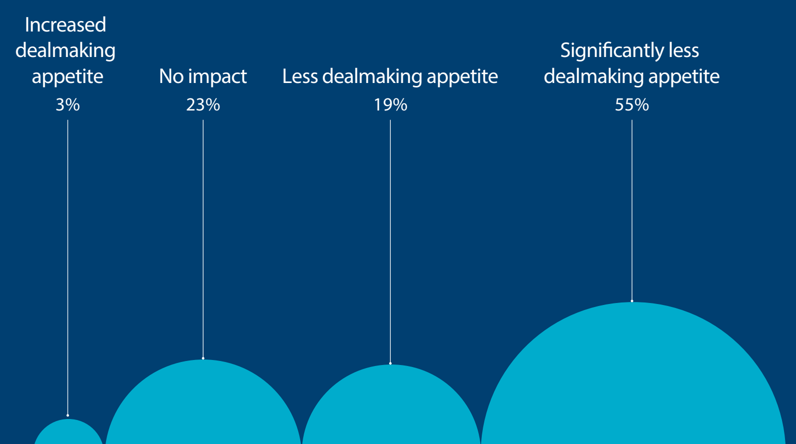
Stock markets had already started to price in coronavirus risk in February, when indices dipped for the first time. The full financial effects of the virus began to be felt in March, with the MSCI Europe index shedding just under 30% of its value in that month alone.

After a promising start to the year, lockdowns and plunging stock markets put deal activity on hold, with barely any deals announced in March and April. The impact of this tumultuous period on M&A markets is still being felt, with 74% of survey respondents saying the pandemic has caused their dealmaking appetite to lessen.

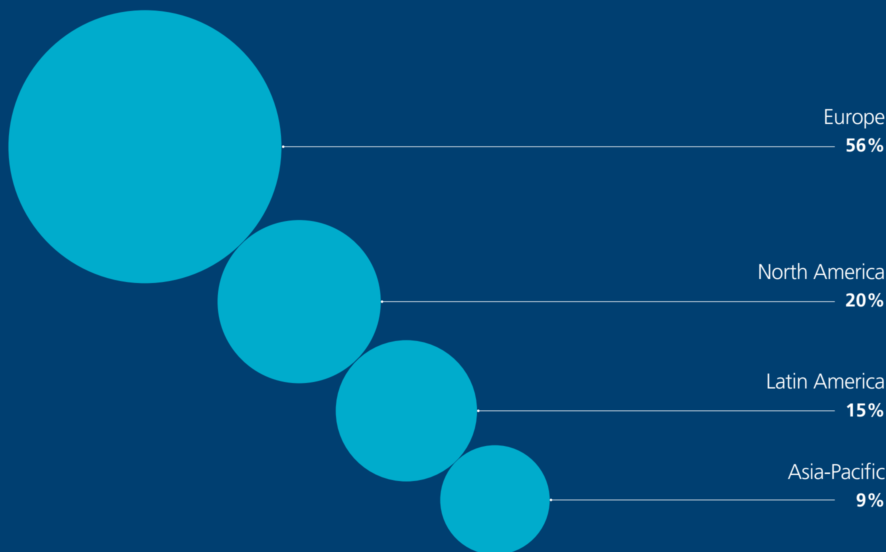
The COVID-19 pandemic has undoubtedly already created significant short-term change in the way we do business; more deals than ever are being done without lawyers or even principals meeting in person. Many of the behaviours we have had to adjust to will become entrenched, and travelling for business will become a rarity.

Frank Fowlie, Partner, CMS UK

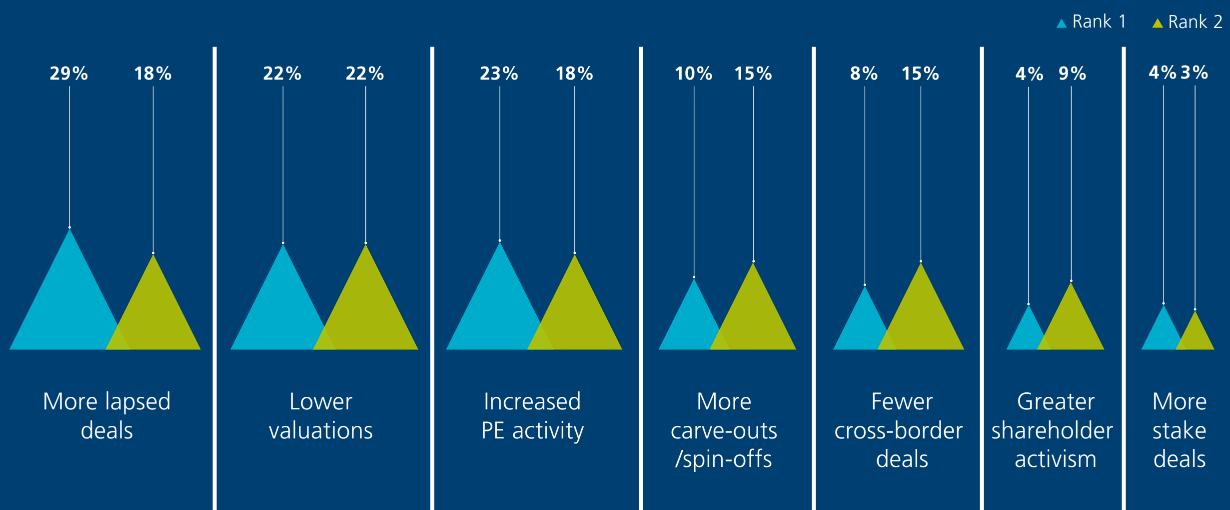
What impact will COVID-19 have on your dealmaking appetite? (Please select only one)



Which region do you think is going to be most affected by the crisis? (Please select one region from the list)



What trends do you expect to see in European M&A in the aftermath of COVID-19? (Please select the two most important, 1 = most important, 2 = second most important)



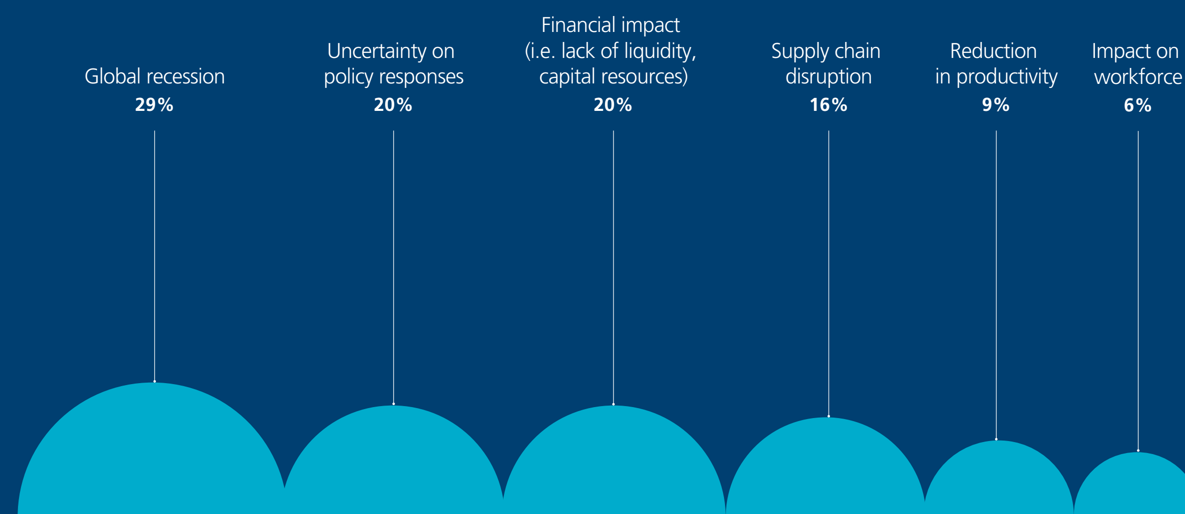
Although deals that were already in exclusivity generally went ahead when lockdowns were coming into force, more broken deals and chipped valuations are anticipated. 47% of respondents expect to see more lapsed deals following the crisis, while 44% expect to see lower valuations.

Respondents' greatest concern about the pandemic is the risk of global recession (identified by 29%) followed by uncertainty of policy responses (20%) and the possible financial impact (also 20%). When asked to identify the two sectors they believe will be most negatively impacted

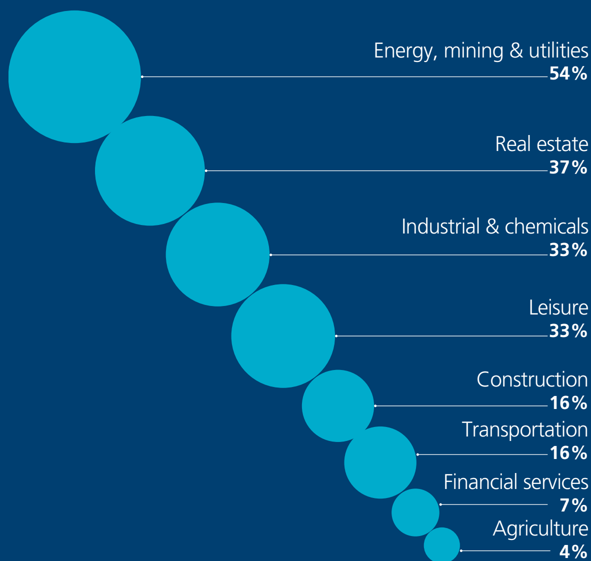
The pandemic has significantly changed consumer behaviour and created demand for new products and services. Dealmakers are looking for less obvious targets and are willing to spend time and money on reshaping the business if they see the potential to take advantage of the opportunities created by this change in the consumer behaviour and needs.

Sławomir Czerwiński, Partner, CMS Poland

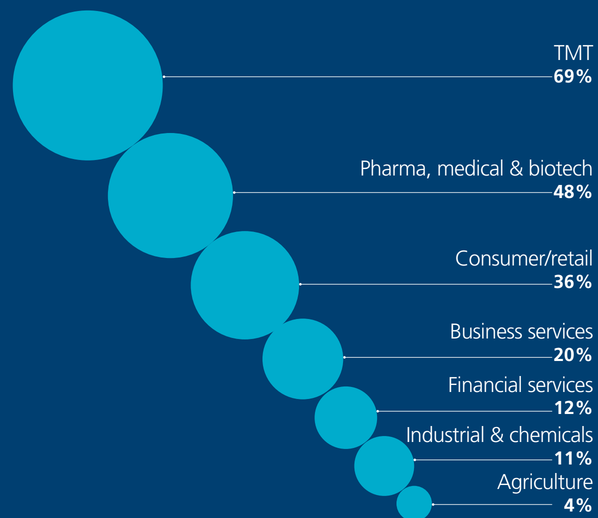
What is your company's main concern with regards to COVID-19? (please select only one)



Which sectors will be most negatively affected by COVID-19? (Please select the top two)



Which sectors are likely to see most growth post-COVID-19? (Please select the top two)



Whilst securing merger clearances will continue to be a focus for parties, a further deal risk has now emerged: foreign investment controls. COVID-19 has accelerated this trend. Many EU governments, as well as the European Commission, moved fast to impose enhanced controls. These are already creating timing and practical challenges to deals.

Caroline Hobson, Partner, CMS UK

by the crisis, respondents predominantly pointed to energy, mining & utilities (54%) and real estate (37%).

The energy industry suffered a sharp slump in demand as lockdowns coincided with the Russia-Saudi Arabia oil price war, at one point pushing oil as low as USD 12 per barrel. Prices have recovered somewhat, but the outlook for the industry remains extremely challenging.

Real estate, meanwhile, has been hard hit as leaseholders seek rent holidays and forbearance through the crisis. Real estate groups with large retail portfolios have been especially vulnerable, with UK shopping centre giant Intu succumbing to administration after a period of financial difficulty and mounting debts.

The TMT and PMB sectors, in contrast, are expected to enjoy the most growth post-COVID-19. Both industries have proven resilient through the lockdown period and, in some cases, managed to capitalise on the disruption and changed circumstances of individuals.

European outbound outlook

Lockdown restrictions and border closures have made outbound deal activity especially difficult for European dealmakers to pursue

In H1 2020, outbound deal value was down 68.1% year-on-year to USD 42.9bn, according to Mergermarket data. This was a steeper drop than for both inbound and overall deal value, and is the lowest year-to-date outbound deal value figure recorded since 2013.

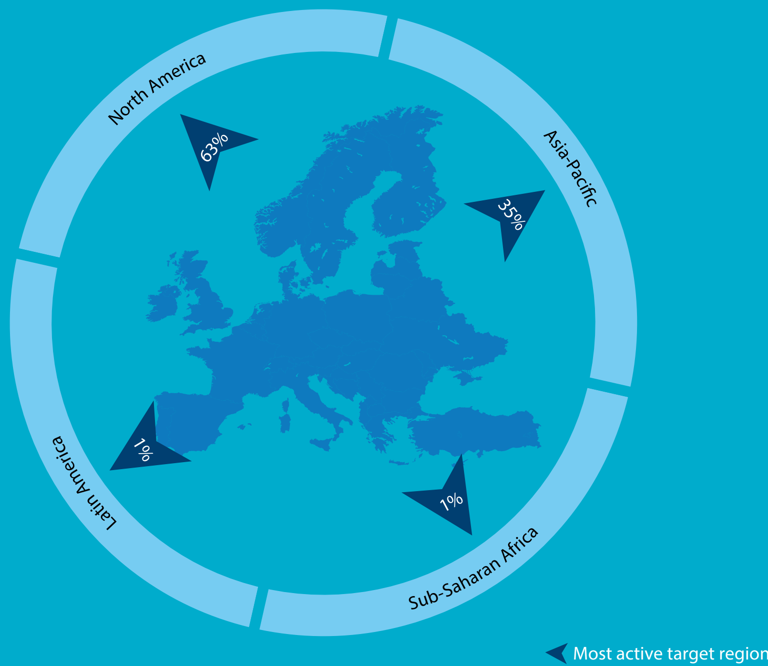
When businesses have pursued M&A, domestic and regional consolidation has trumped forays abroad. Pre-pandemic outbound dealmaking was also already being curtailed somewhat by tightening M&A control procedures globally. In the US, for example, the Committee on Foreign Investment in the United States regime received a broader remit in 2018 when the sectors and criteria for deals it could review were widened.

The presence of additional hurdles when investing abroad has caused dealmakers to pivot towards domestic and regional transactions. In H1, intra-European

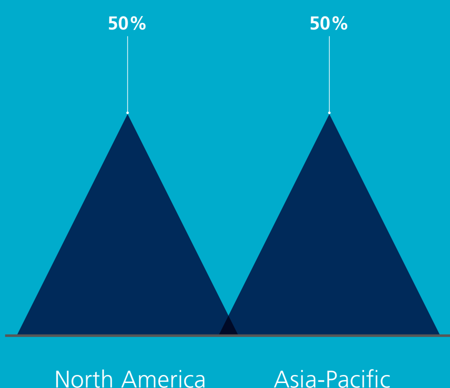
The US is probably underreported as an investment destination for European corporates. Particularly, the TMT, life sciences and healthcare sectors offer good opportunities for investment. US trade restrictions require regional diversified production sites to satisfy the US market. Established European bidders may be favoured over those from regions less liked by the US government.

Dr Heike Wagner, Partner, CMS Germany

Which will be the most active non-European target region for European acquirers over the next 12 months? (Please select only one each)



Which region do you believe will be the most active inbound acquirer into Europe over the next 12 months?



deal value stood at USD 63bn, 75.4% of overall European dealmaking. The tie-up between listed payment services provider Worldline and rival Ingenico in France and the Virgin Media/ O2 deal are examples of mega-mergers involving regional players.

Eventually, however, European investors will have to turn their attention outbound again in search of growth and deal targets that do not trigger domestic antitrust thresholds. This was a feature of European dealmaking in 2019, when various regional deals were blocked because of competition concerns.

North America appears the most attractive overseas market. 63% of survey respondents predict it will be the top non-European target region for European acquirers over the next 12 months, with Asia-Pacific a distant second (35%). A negligible share chose Africa and Latin America.

Respondents favoured North America even though inbound activity into the region was down by 64.3% in H1 2020 and Asia-Pacific activity was actually marginally up, showing an increase of 2.3% year-on-year. The upcoming US presidential election in November doesn't seem to have deterred respondents from opting for North America either.

The responses reflect the fact that North America is expected to suffer a smaller GDP

In light of the pandemic, European investors will look outbound in search of growth and deals that do not trigger domestic antitrust thresholds. North America looks to be one of the most attractive markets; it is politically more aligned with Europe and is expected to suffer a smaller GDP contraction and see a quicker recovery.

Daniela Murer, Partner, CMS Italy

contraction than Europe and a swifter recovery, according to Deutsche Bank economic forecasts. North America is also more closely aligned politically with Europe, which will be a factor in light of rising geopolitical tension between China and Western powers.

In the other direction, equal proportions of respondents identify North America and Asia-Pacific (50% each) as the most active inbound acquirers into Europe over the next 12 months.

Even though inbound M&A into Europe almost halved in H1 2020, Asian and North American buyers have been prominent in the region's M&A this year. US-headquartered Blackstone Group, the world's largest alternative asset manager, acquired UK-based student housing provider iQ Student Accomodation for EUR 5.5bn, and Japan's Mitsui & Co and Singapore's Temasek backed French veterinary group Ceva Santé Animale in a EUR 5bn funding round.

European markets, however, have also instituted merger control rules, which will add another layer of complexity to deals atop COVID-19 challenges. Germany, the UK and Italy have all broadened the scope of deals that can be blocked on national security grounds.

Sector watch

Changing consumer behaviour points investors towards bullish TMT and PMB sectors

Remote working accelerates uptake of digital services, while health crisis turns all eyes to pharmaceuticals space

TMT and PMB are the sectors that have experienced the least amount of disruption to M&A activity through the pandemic.

TMT businesses have traded strongly through lockdown periods as workers, consumers, teachers and pupils became more reliant on broadband and digital services to work, learn and shop. The PMB space has been similarly robust, highlighting governments' commitment to funding healthcare systems as well as COVID-19 treatments and potential vaccines.

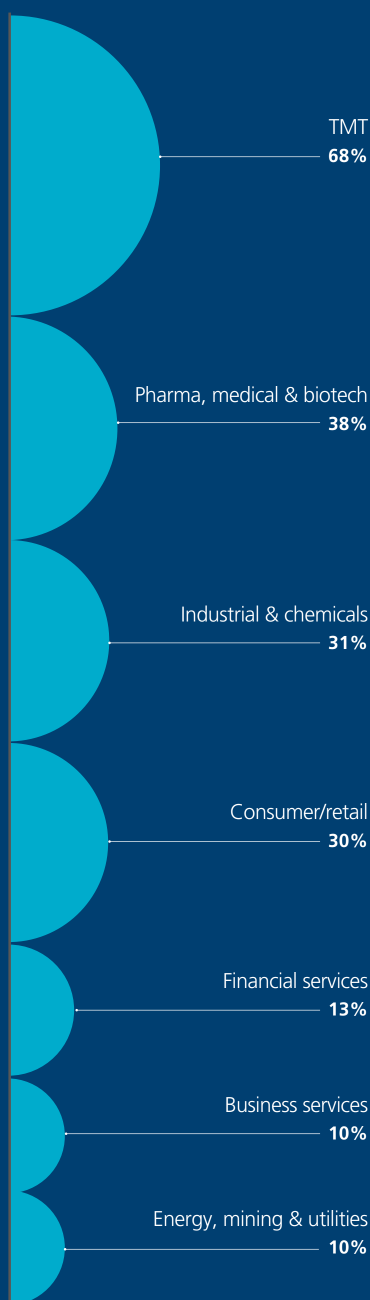
Survey participants pointed to TMT (68%) and PMB (38%) as the two sectors where they expect to see the most M&A activity in Europe over the next 12 months.

Spotlight on: TMT
TMT was the largest sector in Europe by volume and third largest by value in H1 2020, logging 637 transactions worth EUR 51.7bn, down 17.7% and (just) 2%, respectively, year-on-year.

The pandemic has accelerated the already growing appetite for digital services, including cloud, mobility and security solutions. Strategic and other industry players are using M&A to expand their offering in new directions and acquire new technologies. Dealmaking decisions not only address current business needs, but also create resilience for the future.

Eva Talmacsi, Partner, CMS UK

Which sectors do you believe will witness the most M&A activity in Europe over the next 12 months? (Select up to two)



Pressure is the common theme driving M&A in the telecoms sector. There is pressure on consumer pricing, hyperscalers and alternative technologies. Increased use of technology and the need for infrastructure investment is driving the search for scale economies.

Chris Watson, Partner, CMS UK, Head of the CMS TMC Group

The UK recorded the largest number of TMT deals (125) as well as the highest aggregate value (EUR 18bn). Germany placed second for both (85 deals worth EUR 7.9bn), while France was third by volume (77 deals worth EUR 2.7bn) and Spain third by value (EUR 5.5bn from 26 deals).

The largest TMT deal of H1 2020 was the EUR 11.5bn merger of the UK operations of Liberty Global (Virgin Media) and Telefónica (O2), creating one of the largest fixed-mobile providers in the country. The merged company is estimated to be worth GBP 31.4bn.

This deal, announced in early May, illustrates TMT companies' ability to continue trading through lockdowns and maintain earnings. This has given interested parties the confidence to proceed with transactions underpinned by long-term strategic drivers. The increase in demand for broadband when economies were shuttered, and the fact that scale is imperative in this market, also helped see this deal over the line.

The fact that broadband connectivity has been in such demand has seen other telecoms deals proceed. The second largest deal in the sector in H1 was the EUR 4.7bn take-private offer for Spanish telecoms operator MasMovil by a private equity consortium. Private equity was also involved in Germany's largest TMT deal, as EQT and OMERS Infrastructure joined forces to acquire fibre optics provider Deutsche Glasfaser.

Spotlight on: PMB
The PMB sector was the fifth largest by volume and value in H1 2020. 208 deals worth EUR 15.4bn were announced, year-on-year declines of 29.7% and 87%, respectively, although 2019 figures were inflated by AbbVie's EUR 75.8bn acquisition of Allergan and the EUR 23.7bn Novartis/Alcon deal.

The pharmaceuticals sub-sector accounted for the lion's share of deal value (EUR 7.5bn from 39 deals), while the medical sub-sector accounted for the majority of deal volume (136 deals worth EUR 3.5bn).

The largest PMB deal saw France's Ceva Santé Animale raise a EUR 5bn funding round from Japan's Mitsui & Co and Singapore's Temasek. The next largest PMB transaction in H1 saw Netherlands-based Royal DSM acquire Austrian animal nutrition specialist Erber Group for EUR 980m.

Healthcare assets have also proven very attractive to private equity buyers, who have been drawn by the sector's growth potential coupled with protection against downside risk.

In January, French private equity firms Ardian, UI Gestion SA and Groupe HLD acquired a majority stake in Lyon-headquartered homecare treatment company Elivie for EUR 950m. Global investor Warburg Pincus, meanwhile, led a EUR 550m secondary buyout of biotech group Polyplus from healthcare specialist Archimed and CBPE Capital off-loaded SpaMedica to Ober Scharrer, a platform business backed by Nordic Capital.

Regarding activity levels in individual European nations, Germany recorded the greatest volume of PMB deals announced in H1, with 44 transactions worth EUR 2bn in aggregate. France saw the highest total for PMB deal value, recording 23 deals worth EUR 6.9bn. Deals targeting French companies accounted for three of the seven largest PMB transactions in H1 2020.

Despite COVID-19 disruption, healthcare stocks are up more than 8% over the last 12 months on MSCI indices. Dealmakers, therefore, have some visibility on current earnings in the sector and can pursue deals with greater confidence than in less steadfast industries.

PMB deals are thriving at levels roughly comparable to pre-pandemic times. Most are fuelled by market and innovation potential of the acquisition targets – with their prospects being even more critical to deal decision-making in the current climate. There is a lot of activity with start-up and scale-up companies.

Ellen Gielen, Partner, CMS Netherlands

In context: Global M&A

While wary of the risk of a COVID-19 resurgence, Europe's outlook is already much improved from the early phases of the pandemic

Globally, 6,943 M&A deals worth EUR 766.3bn were announced in H1 2020. European M&A accounted for 2,800 of those deals (40%), worth EUR 262.9bn in aggregate (34%). During the same period last year, 10,154 deals worth EUR 1.8 trillion were announced globally, of which European M&A contributed 39.8% of the volume (4,046 deals) and 20.6% of the aggregate value (EUR 371bn).

The continent faces stiff challenges ahead, but it is positioned to at least maintain its share of the global M&A market for the rest of 2020 and into 2021.

Although a second wave of coronavirus infections seems to be spreading, European countries are better prepared to react and limit the need for very wide-ranging lockdown measures.

The economic outlook for the region is also brighter than expected earlier in the year. Deutsche Bank has revised its GDP forecasts and expects the European economy to contract by 8.6% in 2020, versus an earlier prediction forecasting a 12% decline. This was the largest upward regional revision to the bank's global forecasts and should offer dealmakers some encouragement.

Europe, however, will not be able to escape the impact of deteriorating international relations between China and the West. Tensions between China and the US, and to a lesser extent Europe, have been escalating. The spread of coronavirus, trade disputes, protests in Hong Kong, and allegations of cyber attacks and industrial espionage have all been points of contention.

Against this backdrop, the EU issued a white paper outlining ways to tackle 'distortions' to competitive dynamics caused by overseas companies that benefit unfairly from government subsidies. The UK government, meanwhile, banned mobile network operators from purchasing technology from Chinese telecoms giant Huawei, and several European countries have introduced tougher rules for foreign investors who want to acquire prized European assets at low prices amid the COVID-19 slump.

In Italy, for example, the coalition government introduced 'golden power' rules allowing it to block inbound deals involving companies deemed to be of strategic interest. The new rules cover numerous sectors, including banking, insurance, healthcare and food.

These protectionist leanings, however, are not unique to Europe. The US and Australia, too, introduced similar merger controls before the onset of the pandemic.

Inbound activity has been an important source of M&A investment for Europe in 2020, with foreign investors involved in either the buy or sell side in six of the ten largest deals announced so far this year.

That being said, for the foreseeable future, Europe may not be able to rely on cross-border activity to lift M&A volumes, albeit that most M&A markets globally are likely to share that experience.

Chapter two

Deal dynamics

The fall in European deal activity this year has meant that, in instances where deals have gone ahead, buyers and sellers have only transacted when there are clear strategic rationales or vendors have to sell to raise capital

Top findings

65%
of survey respondents are not considering M&A at this time

12%
are currently considering acquisitions

74%
of private equity respondents cite distressed/turnaround opportunities as one of the two greatest motivations for acquisitions

83%
of corporate respondents identify the acquisition of new technologies as one of their two principal deal drivers

Almost two-thirds (65%) of respondents are not considering M&A, up from 45% in last year's survey. For 72% of those people, the outbreak of COVID-19, unsurprisingly, is the main reason for this hiatus.

For those who remain open to M&A in Europe, the acquisition of new technologies and corporate venture capital investment is the main driver of activity (cited by 83% of corporates respondents). Worldline's EUR 9.2bn acquisition of Ingenico, for example, consolidates its position in the competitive and fragmented payments processing space. Combining the companies' technology platforms creates a player with the scale to lock in a large portion of the value chain.

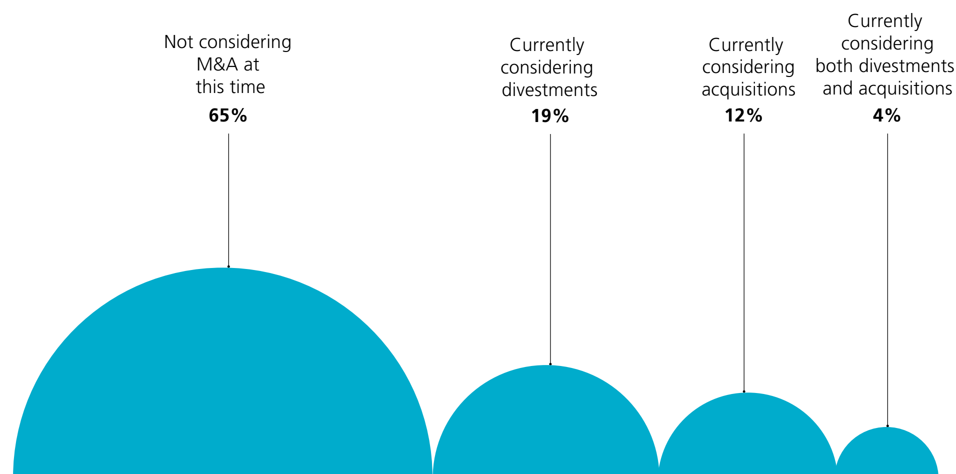
Distressed and turnaround opportunities emerged as a strong deal driver, being identified by 74% of private equity survey respondents. Only 14% of corporates, however, are interested in taking on troubled companies.

Fundraising for distressed and special situations deal strategies climbed in Q2 2020. Companies in the retail, real estate, leisure and travel sectors have been heavily impacted by lockdowns and will be candidates for restructuring. High-profile businesses that have already fallen into insolvency include German department store Galeria Karstadt Kaufhof, French media company Technicolor and UK airline Flybe.

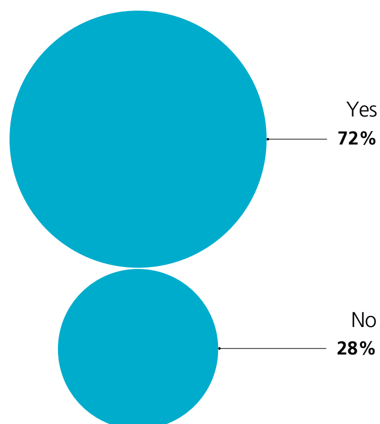
Restructuring deals in these troubled sectors, such as the debt-for-equity swap involving low-cost airline Norwegian Air and its aircraft lease holders, are starting to filter through and are likely to continue rising as businesses exhaust cash reserves. Private equity will see opportunities to fund similar business rescues.

Falls in valuations that favour buyers could likewise drive activity. The Argos Index shows that valuations had already started to drop in Q2 2020, with the multiples paid for European businesses valued between EUR 15m and EUR 500m down almost

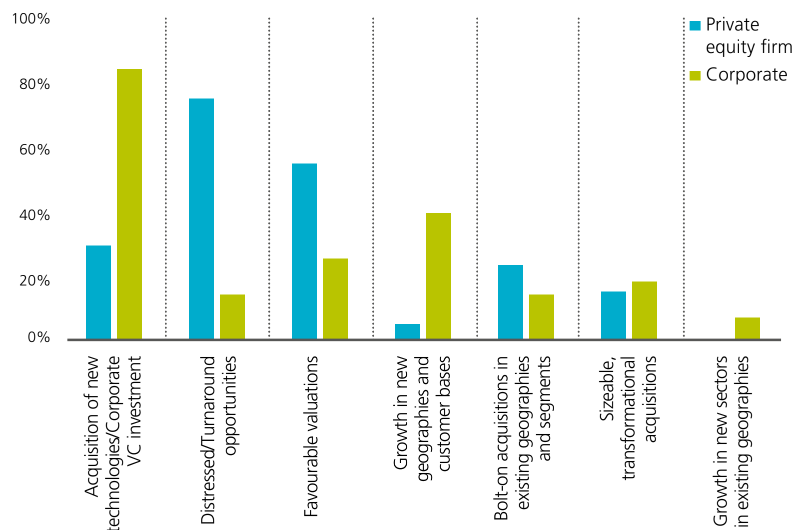
Where does M&A currently fit into your corporate strategy? (Please select only one)



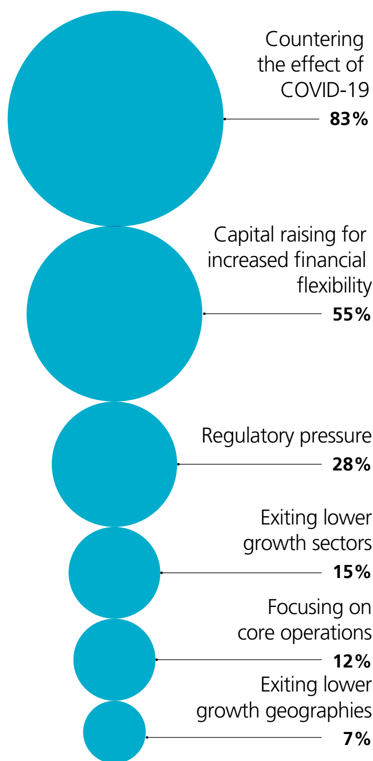
If you answered "Not considering M&A at this time", is this due to the COVID-19 outbreak?



If you are considering acquisitions in Europe, what is the motivation for this? (Please select the two most important)



If you are considering divestments, what is the motivation for this? (Select up to two)



a full turn at just above 9x Ebitda versus more than 10x Ebitda at the end of 2019. Such favourable valuations were identified as a key deal driver for 54% of private equity respondents, versus just 25% of corporate respondents.

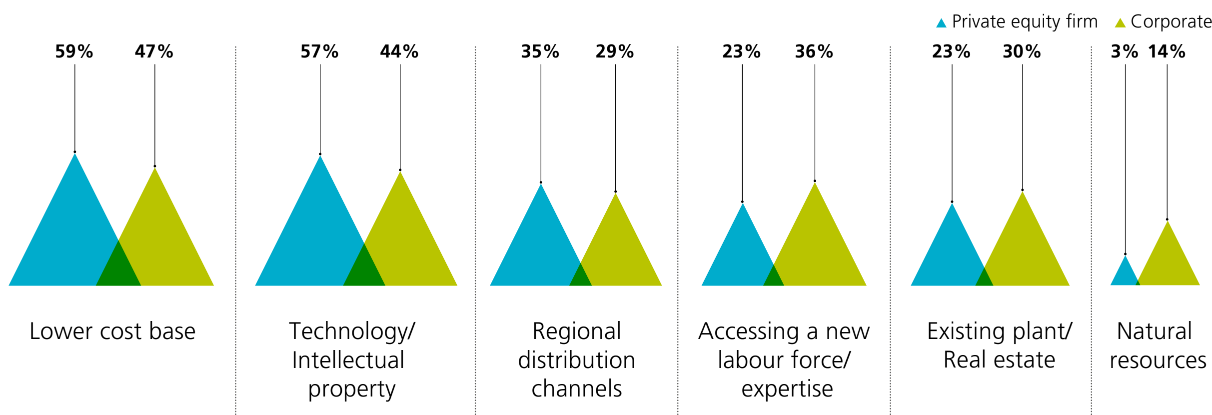
Corporates and private equity firms are more closely aligned on turning to M&A to lower costs bases. 47% of corporate respondents and 59% of private equity respondents cite this as one of the two most important objectives informing their next deal.

Divestment is also emerging as a key post-coronavirus theme. Among those considering divestments, 83% say they want to counter the effect of COVID-19, 55% are looking to raise capital for increased financial flexibility, and 28% cite regulatory pressure.

ThyssenKrupp's disposal of its elevator business to private equity firms Advent International and Cinven, for example, will be used to fund pension obligations and reduce debt. Energy company BP, meanwhile, is rolling out a USD 15bn programme of divestments to finance debt repayments. It recently sold its petrochemicals arm to INEOS for EUR 4.44bn.

Other notable carve-outs include Canadian engineering group Bombardier passing on its German transportation business to France's Alstom in a EUR 7.6bn deal, and KKR's EUR 2.3bn purchase of a 60% stake in Coty's professional and retail hair and beauty business. Like BP, Coty has committed to a long-term divestment strategy. The programme will help Coty to focus on its core beauty business and lock in cash to strengthen its balance sheet.

Considering the COVID-19 crisis, what will be the most important objective for your next European M&A target? (Please select the top two)



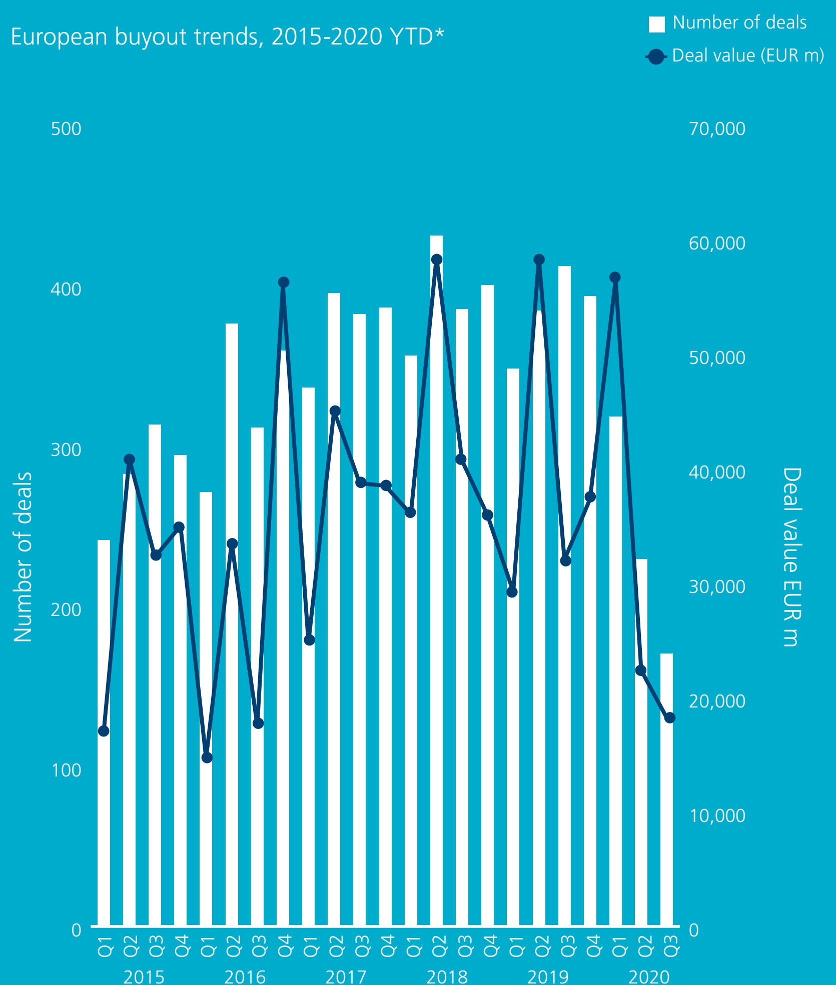
In context: Private equity

Although private equity firms are sitting on record sums of dry powder (USD 1.45 trillion, according to Preqin), buyout activity and exit activity has dropped sharply this year

European buyout volume saw a year-on-year decrease of 25.3% in volume, falling to 547 deals in H1 2020. Compared to the same period in 2019, aggregate value decreased 10% to EUR 78.9bn. Exit volume plunged by 31.9% and value by 27.3% in H1 2020, dropping to 325 deals worth EUR 51.6bn. Q2 saw the lowest volume of exits on record for a quarter since 2013.

Most private equity activity was concentrated in Germany, the UK and France, which accounted for 29%, 23% and 17% of deal value, respectively.

Social distancing and travel restrictions have made it difficult for private equity firms to transact with confidence, as relationships with management teams are a primary driver of value creation. Uncertainty around future earnings has given firms further reason for pause. So, too, has the slowdown in debt markets, which has made it more difficult to find leverage for buyouts.



Data correct as of 8 September 2020

Top buyout deals, 2020 YTD*

Announced date	Target company	Target sector	Target country	Bidder company	Bidder country	Deal value EUR (bn)
27/02/2020	ThyssenKrupp Elevator AG	Industrials & chemicals	Germany	Cinven Partners LLP; Advent International Corporation; RAG-Stiftung	USA	17.2
26/02/2020	iQ Student Accommodation Limited	Leisure	United Kingdom	Blackstone Group L.P.	USA	5.5
04/02/2020	Ceva Sante Animale S.A.	Pharma, medical & biotech	France	Mitsui & Co., Ltd.; Temasek Holdings Pte. Ltd.; Sofiproteol SA; EMZ Partners; Sagard Private Equity Partners; Public Sector Pension Investment Board; Klocke Gruppe; ContiGroup Companies, Inc; Hopu Investment Management Co., Ltd.; Tethys Investment Management LLC; Merieux Equity Partners S.A.S.	Singapore	5.0
01/06/2020	Masmovil Ibercom SA (90.8% Stake)	TMT	Spain	Lorca telecom BidCo	USA	4.7
18/03/2020	Viridor Waste Management Limited	Industrials & chemicals	United Kingdom	Kohlberg Kravis Roberts & Co. L.P.; Hermes Infrastructure	USA	4.6
09/01/2020	Veeam Software AG	TMT	Switzerland	Insight Partners	USA	4.5
17/07/2020	Elsan SAS	Pharma, medical & biotech	France	Kohlberg Kravis Roberts & Co. L.P.; Ardian	USA	3.3
14/07/2020	Industrial & Financial Systems AB	TMT	Sweden	EQT Partners AB; TA Associates Management, LP.	USA	3.0
10/02/2020	Deutsche Glasfaser Holding GmbH	TMT	Germany	EQT Partners AB; OMERS Infrastructure Management Inc.	Sweden	2.8
01/06/2020	Coty Inc. (professional and retail hair beauty business) (60% Stake)	Consumer	United Kingdom	Kohlberg Kravis Roberts & Co. L.P.	USA	2.3

**Data correct as of 8 September 2020*

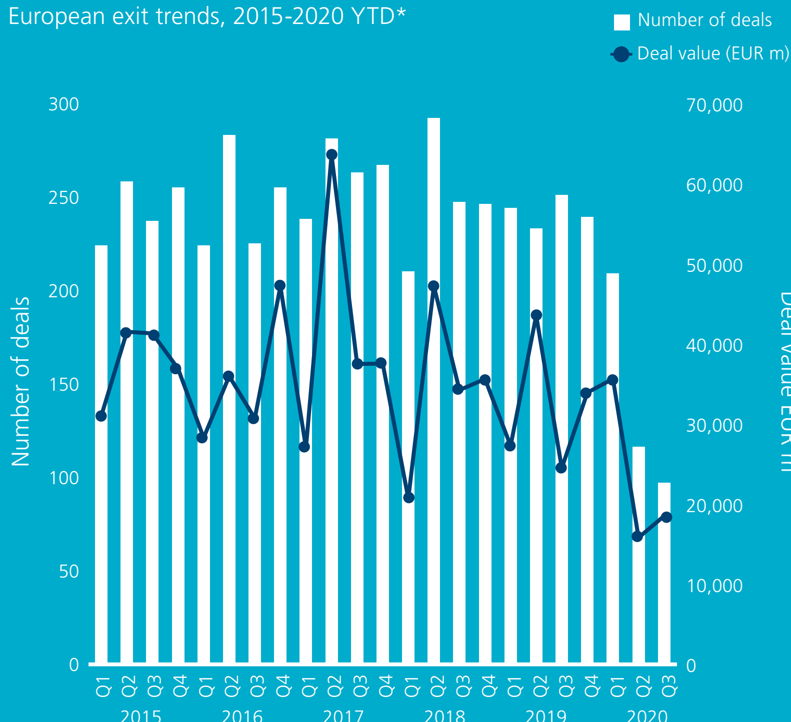
“European fund managers are having to look for opportunities in a congested market. For many that means being more innovative and looking beyond their typical hunting ground. Whether that is taking strategic stakes in stressed businesses, taking undervalued listed companies private or executing complex carve-outs, there are opportunities for those willing to be bold.

Narinder Jugpal, Partner, CMS UK

Recessions do not affect all sectors in the same way. As funds are available, PE investors will compete for new investments in industries that will not suffer a downturn, including TMT, pharma and life sciences. Accordingly, prices for such targets could even exceed pre-crisis levels.

Ralf Kurney, Partner, CMS Germany, , Co-Head of the CMS Private Equity Group

European exit trends, 2015-2020 YTD*



Data correct as of 8 September 2020

Exits have also slowed, with firms reluctant to bring prized assets to market at a time when valuations could be whittled down because of COVID-19 concerns. The fact that corporates and private equity firms are focused on protecting existing lines of business and portfolios has also seen the universe of potential buyers for companies shrink. Rather than selling when buyer numbers are limited, and then trying to buy a replacement for the portfolio of similar quality, private equity firms are riding their winners for longer.

The outlook for activity in H2 2020 and into 2021, however, is brighter. Meeting management teams and advisers has become easier as lockdowns have eased, and a correction in asset prices could throw up opportunities to buy good companies at attractive valuations.

Industrials interest

Industrials & chemicals accounted for just under one-third (32%) of total European buyout deal value in H1 2020, with EUR 25.6bn worth of transactions. This was almost double the 17% market share the sector enjoyed in H1 2019.

Figures for industrials buyouts have been inflated by a handful of megadeals, including the EUR 17.2bn carve-out of ThyssenKrupp Elevators and KKR's EUR 4.6bn swoop for Viridor Waste Management, but the sector is likely to keep generating deal opportunities for buyout firms.

The industrials sector has suffered a fall in demand as well as supply chain disruption during the pandemic. Corporates in the space have prioritised their core businesses and many are looking at possibly selling off non-core assets to shore up balance sheets. Consolidation could also follow.

Private equity firms will be eager to participate in any reshaping of the industry and are well-positioned to acquire and consolidate non-core assets. Attractive valuations could spur further interest in the space from buyout investors.

Chapter three

Regional environment: The future of European M&A

Across Europe, governments and central banks have taken extraordinary steps to support companies through the steepest and most sudden economic decline since the Great Depression of the 1930s

Top findings

50%
of survey respondents say their appetite for European M&A would increase the most if the EU does much more together across all policy areas to address the effects of the COVID-19 crisis

69%
disagree with the introduction of a mechanism for the screening of foreign direct investment into the EU

50%
of those surveyed cite antitrust as one of the two most challenging forms of regulation when transacting in Europe

The European Central Bank has provided EUR 1.35 trillion to relieve government debt and laid on a further EUR 120bn for quantitative easing and EUR 20bn for debt purchases. The European Commission temporarily waived EU fiscal rules, allowed more flexibility on state aid rules and made a EUR 100bn financial facility available to member states to cover spikes in public spending resulting from worker support schemes.

In July, the EU agreed a further EUR 750bn programme to support businesses as they emerge from lockdowns. This will consist of EUR 390bn in grants and EUR 360bn worth of loans.

Individual governments have undertaken similar steps to shield businesses and workers from the coronavirus fallout. Programmes such as the UK's furlough scheme, Germany's Kuzarbeit, France's Chômage Partial and Ireland's temporary wage subsidy have extended more than EUR 100bn in wage support to employees put in stasis by lockdowns. Credit rating agency Fitch Ratings estimates that more than 40m workers have received such support in the four largest euro area economies plus the UK.

European states have moved to relax insolvency rules to help companies survive lockdown and related travel restrictions. The UK, Italy, Spain, France and Germany have all amended regulations to prevent businesses from going into forced insolvencies or continue trading even when they can't service debts.

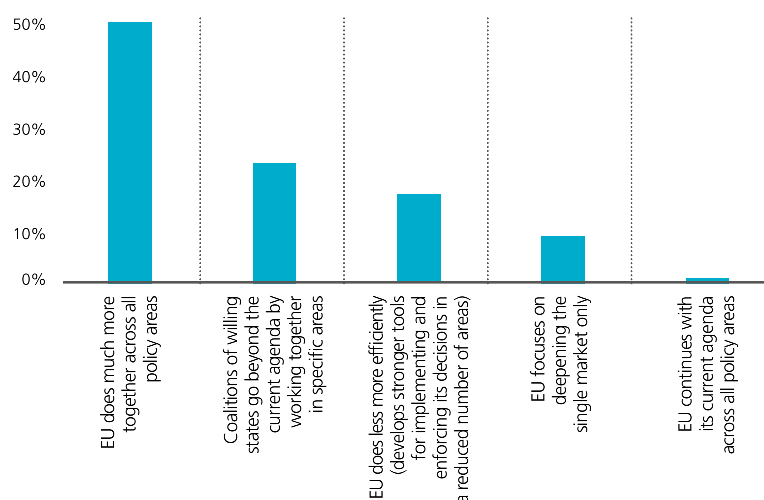
The M&A community has applauded authorities' coordinated response, with a consensus that stimulus measures have helped stabilise economies and provided some downside protection against risk.

Survey respondents were clear about the importance of such a policy response. Half of the participants say their appetite for European M&A would increase the most if the EU does much more together across all policy areas (the survey was taken before the EUR 750bn pandemic recovery fund was announced).

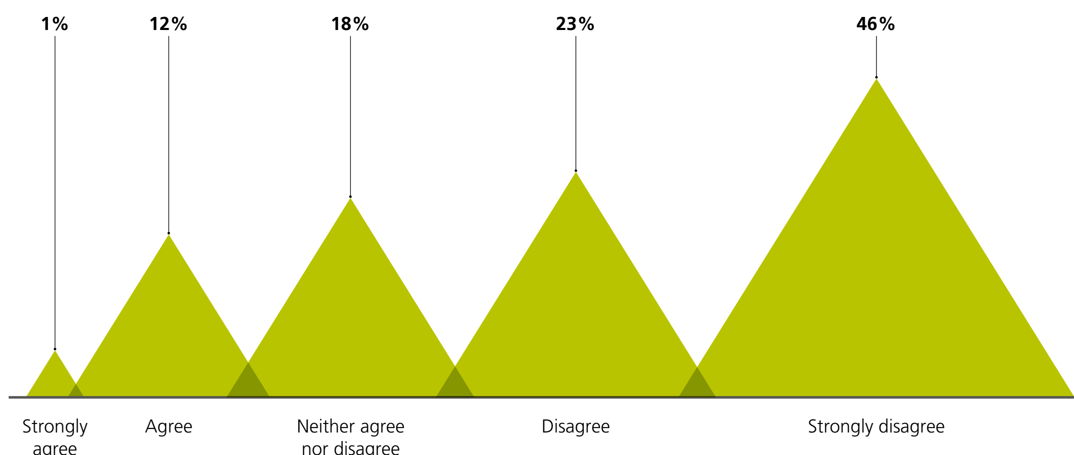
Foreign investment concerns
Survey respondents, however, express concern about steps taken by the EU and member states to screen foreign direct investment (FDI) into the continent.

The European Commission introduced guidelines in March outlining how member states should screen FDI so as to protect companies and critical assets during the pandemic. Healthcare, medical research, biotechnology and infrastructure were highlighted as industries that might need to be shielded from opportunistic overseas investment.

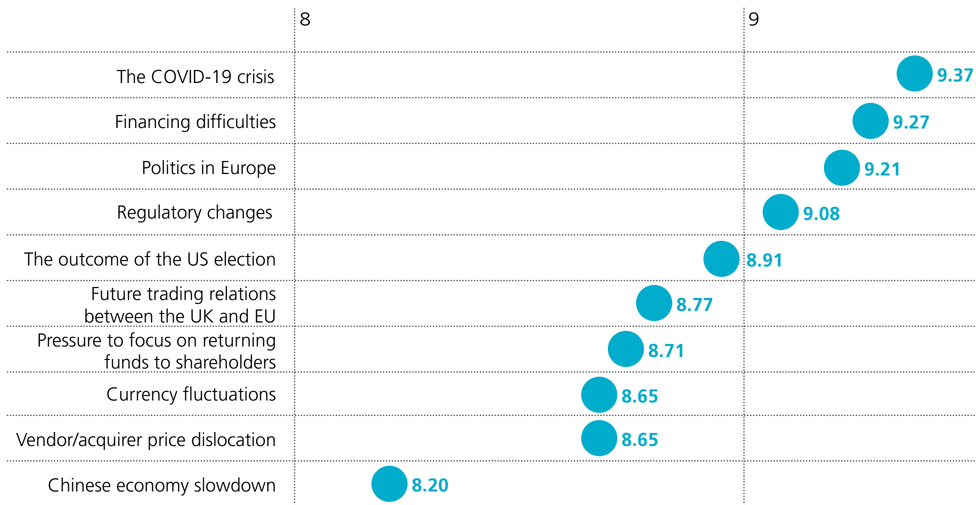
Looking at the future direction of the EU, which of the following scenarios would most increase your appetite for M&A in Europe over the next three years? (Please select one)



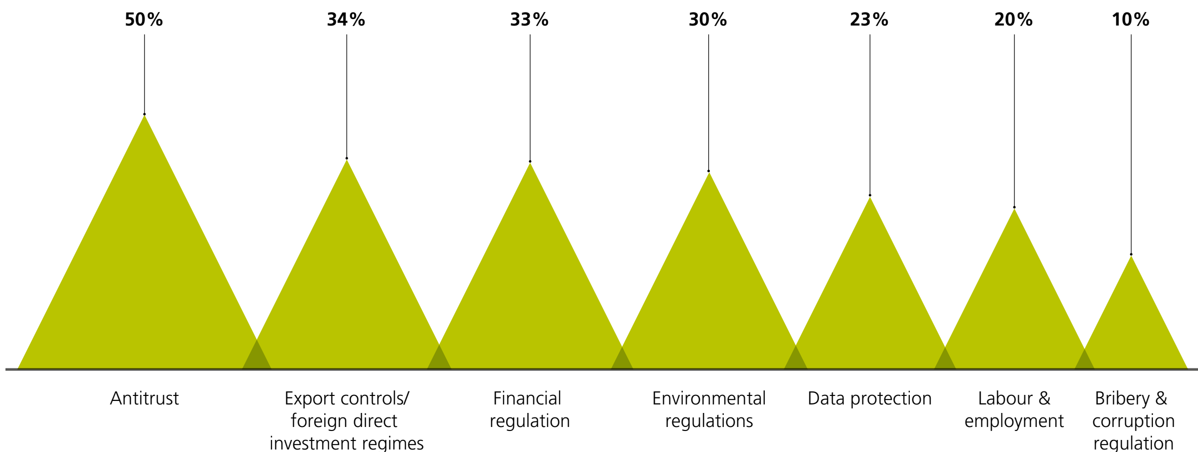
To what extent do you agree with the introduction of a mechanism for European screening of foreign direct investments into the EU?



What do you believe will be the principal obstacles to M&A activity in Europe over the next 12 months? (Rate the following on a scale of 1-10, where 10 = most significant)



Which form of regulation do you find most challenging when doing a deal in Europe? (Please select the top two)



There were already FDI screening mechanisms in place in 14 member states pre-pandemic, focusing mainly on national security. The EU had also introduced foreign investment screening regulations in 2019 to help coordinate measures across member states.

The guidelines encouraged countries with FDI screening measures in place to "make full use of tools available to them under EU and national law to prevent capital flows from non-EU countries that could undermine Europe's security or public order". The Commission also called on member states without screening regimes to consider all options to address cases where acquisitions by overseas investors could increase security risk.

However, 69% of respondents disagree with the introduction of a mechanism for the screening of FDI into the EU, including 46% who strongly disagree. COVID-19 has already laid low inbound investment into Europe, and the survey findings indicate that dealmakers and advisers are worried about the impact of screening measures on overseas investor appetite.

This dovetailed with another area that concerned dealmakers, namely antitrust. Half of those surveyed cite antitrust as the form of regulation that was most challenging when transacting in Europe.

The survey findings on antitrust follow a year when a number of high-profile deals were delayed or called off, with antitrust among the main reasons for transactions failing to cross the line. UK supermarket chains Asda and Sainsbury's, for example, abandoned a GBP 7.3bn mega-merger because of antitrust risk, and the European Commission blocked a merger between French train maker Alstom and the rail business of Germany's Siemens.

During the pandemic, competition authorities have agreed to take a pragmatic approach to antitrust and allowed coordination between competing businesses where this has been done to deal with the COVID-19 crisis and maintain supply chains. These allowances, however, are only temporary. As the impact of COVID-19 subsides, antitrust will remain a risk area dealmakers will have to assess and negotiate over the long term.

Access to finance

According to survey respondents, the second most significant obstacle to M&A activity in Europe over the next 12 months will be financing difficulties, which received a mean score of 9.27 out of 10, where 10 is the most significant. Invariably, leading the pack was the COVID-19 crisis, which scored 9.37.

Leveraged finance markets began to exhibit signs of recovery towards the end of Q2 and various government support measures have provided liquidity. IPO markets, however, are becalmed and securing lending for M&A has been challenging.

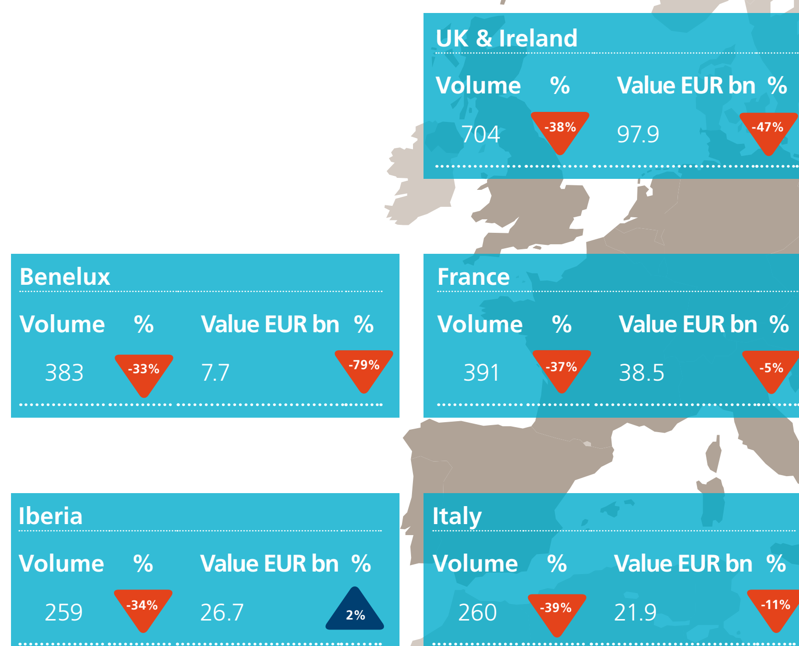
The survey findings suggest that respondents are waiting to see how the financing landscape looks when government support measures unwind and the full extent of COVID-19's impact on economies and liquidity becomes clearer.

Regional round-up

Compared to H1 2019, M&A activity in Europe fell by almost one-third in both volume and value terms in the first half of 2020.

Although certainly far from immune to the impact of the pandemic, the UK & Ireland remains the region's lead market, accounting for 33.7% of total deal value and 20.4% of total deal volume.

Germany and France were the next most important markets, contributing 19.1% and 12.4%, respectively, of Europe's aggregate deal value. Both markets were buttressed by the presence of some of H1's largest pre-lockdown transactions.



Nordics

Volume	%	Value EUR bn	%
536	-36%	17.5	-65%

Russia & Ukraine

Volume	%	Value EUR bn	%
74	-43%	9.2	-37%

Germany

Volume	%	Value EUR bn	%
477	-29%	52.2	31%

CEE

Volume	%	Value EUR bn	%
208	-34%	8.5	-32%

Austria & Switzerland

Volume	%	Value EUR bn	%
142	-31%	26.4	-52%

SEE

Volume	%	Value EUR bn	%
67	-37%	4.8	-26%

This infographic compares the period Jan-Aug 2019 with Jan-Aug 2020

Chapter four

Financing conditions

The sharp falls in equities and M&A activity in H1 2020 have filtered down to debt and financing markets

COVID-19 will have an impact on financing in 2020, but availability and terms are likely to vary significantly between sectors. Future uncertainties will make banks less keen to underwrite and we are likely to see more club deals with a greater reliance on local liquidity or alternative lenders.

Paul Stallebrass, Partner, CMS Czech Republic

Top findings

60%
of survey respondents expect financing conditions to be much harder in Europe in 2020 compared to last year

71%
identify underlying economic weakness as one of the two greatest impediments to financing acquisitions over the next 12 months

77%
expect the volume of distressed M&A activity to increase significantly over the next 12 months

55%
anticipate a decrease in the number of new IPOs over the next 12 months, including 12% who expect the fall to be significant

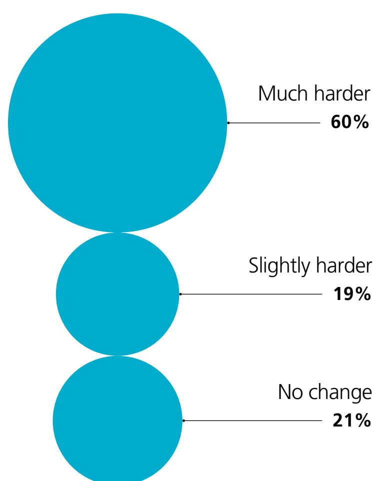
According to Debtwire, Europe's leveraged finance markets ground to a near halt in March, April and May. High-yield bond issuance managed to come in at EUR 41.1bn for H1 2020, an 8% year-on-year increase, but most of this activity came in Q2 when corporates rushed to shore up balance sheets. The loan market over the same period also climbed year-on-year, up 27% to EUR 75.53bn, but again this was primarily due to strong demand from corporates for general business use. Meanwhile, loans issued for M&A were down 39% over the period.

The European IPO market has had an even tougher time. According to PwC, European IPO proceeds more than halved from EUR 12.2bn in H1 2019 to EUR 5.4bn in H1 2020, with IPO volumes down from 53 to 28.

Expectations regarding possible IPO activity are way down, with 55% of survey participants anticipating a decrease in new listings, including 12% that expect the fall to be significant. So far, European investors have focused more on supporting the rights issues of companies in their portfolio rather than funding new stock market hopefuls in debut flotations. Further offer proceeds climbed from EUR 45bn in H1 2019 to EUR 65bn in H1 2020.

Given the conditions, securing financing for deals is unsurprisingly a major concern for dealmakers.

How do you expect financing market conditions to be in 2020 compared to 2019?

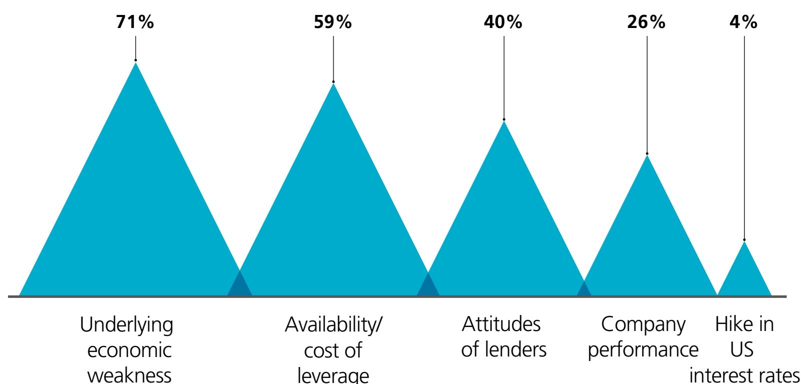


Almost four-fifths of survey respondents (79%) believe financing conditions are tougher this year than they were in 2019. Close to three-quarters (71%) say the weakness of underlying European economies will be among the two main challenges to financing acquisitions during the next 12 months, with 59% citing the availability and cost of leverage as one of the two main headwinds facing financing.

Banks and institutional lenders remain cautious, especially as downgrades and defaults start to rise and resources are shifted away from funding new deals to guiding existing portfolios through the downturn. Fitch Ratings forecasts that annual European high-yield and leveraged loan defaults will rise by between 4% and 5% this year and are likely to continue increasing in 2021. Fitch also downgraded more than 90 leveraged finance credits between early March and June.

As defaults and downgrades rise, the survey shows that the primary drivers of restructurings in Europe over the next 12 months are expected to be debt or liquidity issues and macroeconomic conditions, cited by 40% and 32% of respondents, respectively.

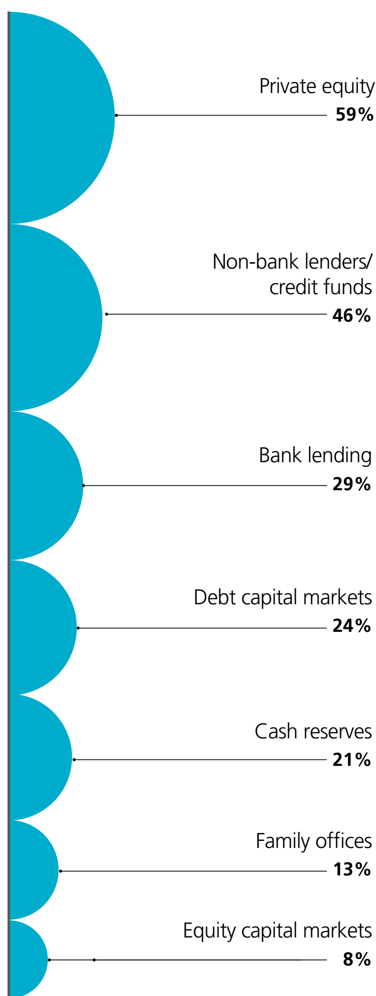
What do you view as the greatest challenge to financing acquisitions over the next 12 months? (Please select the top two)



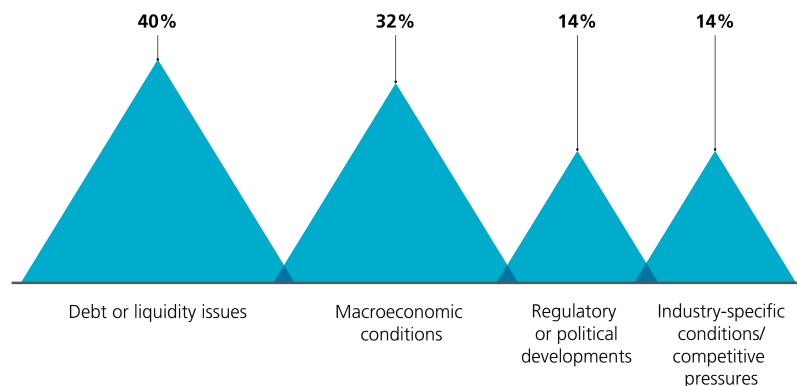
We are anticipating an even more risk-averse, though sector-based, financing environment in an economic downturn.

Dr Joachim Kaetzler, Partner, CMS Germany, Head of CMS Banking & Finance Group

What sources of financing do you think will be most available over the next 12 months? (Please select the top two)



Which of the following will be the primary driver of restructurings in Europe over the next 12 months?



Private capital to the rescue

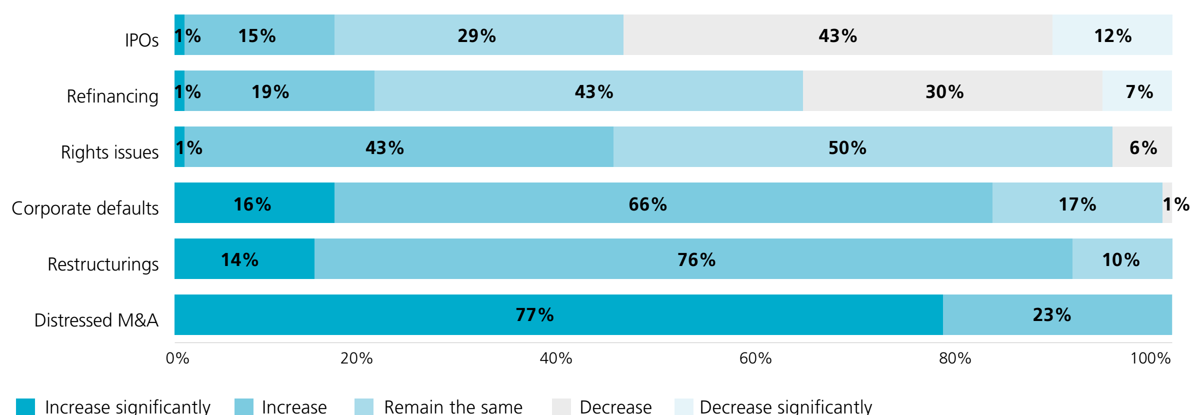
With banks and leveraged finance markets vulnerable to opening and closing unexpectedly, survey respondents see private equity funds, non-bank lenders and credit funds as the key providers of capital during this period of uncertainty. Close to 60% say private equity will be among the top-two sources of deal funding, with 46% looking to private debt funds.

Both these sources of finance entered the COVID-19 crisis cash rich. Globally, private equity and venture capital funds have dry powder cash piles of almost USD 1.5 trillion, according to Preqin, while private debt dry powder totals around USD 261bn.

Direct lenders appear to have stepped up to take on credits that likely would otherwise have opted for leveraged loans or bonds. For example, Ardonagh Group, the independent UK insurance broker, secured a GBP 1.87bn unitranche funding facility to fund a refinancing and support expansion plans. Direct lender Ares Management was the lead arranger for the facility, which also received support from CDPQ and KKR. The unitranche for Ardonagh, which is backed by private equity firms Madison Dearborn and HPS Investment

> The COVID-19 pandemic will have a profound effect on debt markets. Whilst we may see banks stepping back to concentrate on shoring up their balance sheets, we expect that debt funds and other direct lenders will be in a position to continue their support of sponsors and corporates when deal volumes return.
>
> *Patrick Donegan, Partner, CMS UK*

For each of the following transaction types, please rate your expectations for activity over the next 12 months.



> Many banks are still prepared to finance transactions and look at deals. As long as COVID-19 remains an issue, it will be key for borrowers to give comfort to lenders that there is enough liquidity to overcome any further lockdown measures or other restrictions that may have an adverse short-term effect on the business.

Günther Hanslik, Partner, CMS Austria

Partners, is believed to be the largest ever facility of its kind.

Distressed debt surge

Two areas of private debt fundraising that have been gaining momentum are distressed debt and special situations. According to Preqin, five special situations funds and nine distressed debt funds secured USD 12bn and USD 9.7bn respectively in Q2 alone, accounting for the bulk of private debt fundraising in that period.

Our survey reflects a similar trend. All respondents say there will be an increase in distressed M&A in the next year. Nine in ten predict an increase in restructuring activity, and 82% predict an increase in corporate defaults.

Any source of financing, however, is likely to be more expensive and subject to tighter covenants and terms. This is completely different to the pre-pandemic dynamics in financing markets, when terms and pricing were skewed in favour of borrowers as investors competed for a limited pool of transactions.

But financing markets are not totally shut and there is still appetite for yield in what remains a low interest rate environment.

High-quality credits in the right sectors, and those with credible sponsors, are continuing to receive funding. Cinven and Advent's buyout of ThyssenKrupp Elevator is proceeding with a multibillion leveraged finance issue. There besides, various blue-chip companies, such as cruise ship operator Carnival, have been able to tap bond markets.

The market, however, is showing signs of bifurcation, with investors crowding around a select pool of high-quality businesses. Companies and borrowers that don't meet the quality threshold are likely to find it increasingly difficult to secure finance in the coming months.

Conclusion

The findings exhibited in our 2020 CMS European M&A Outlook reflect the deep impact that COVID-19 has had on M&A activity. Stock market volatility, contracting GDP and sudden falls in company earnings have transformed M&A market dynamics

The vast majority of dealmakers are ready to sit on their hands and see out the rest of the year before re-engaging with M&A. Managing existing portfolios and protecting value are now at the top of the agenda for corporates and private equity firms, with investments in new deals on pause.

In this period of uncertainty, however, survey participants do believe that opportunities for distressed and special situations investors will emerge. Bold dealmakers will uncover chances to pick off good assets at attractive prices when vendors are willing to, or must, sell.

With dealmakers on the defensive, here are three takeaways to bear in mind for the rest of 2020 and into 2021:

Prepare for the recovery
A rebound in deal activity may still be someway off, but dealmakers that prepare now will be the best-placed to benefit from the recovery. Lockdowns have given private equity firms and corporate M&A teams a rare chance to step off the auction process treadmill and invest more time in building relationships with vendors and engage in direct origination. One silver lining to the crisis is that there has been time to invest in building up deal pipelines.

Divestment drivers
COVID-19 has forced corporates across the board to assess their portfolios, focus their efforts on core business and strengthen balance sheets. Coty, BP, Nestlé, Siemens and ThyssenKrupp are just some of the well-known corporate names to commence divestment programmes with these aims in mind, and once such plans are announced to stock markets it is difficult for companies to put the process into reverse. Buyers with the skills to execute carve-outs, and with a vision for a future for these assets, will benefit from steady deal flow opportunities in the coming months.

Going digital
Technology has been an essential tool for businesses, employees and consumers through lockdown periods. Companies have seen how effective homeworking and digital engagement with customers can be. Tech-enabled companies, meanwhile, have shown their ability to continue trading well through downturns. There is no going back and companies that are not up to speed digitally will be eager to find M&A targets that can move them up the curve. Investment in broadband connectivity, telecoms and essential digital infrastructure will prove a rich vein of deal flow in the months and years to come.

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Our latest CMS Corporate/M&A headline deals

Advent International
Advised Advent and its portfolio company Zentiva on the acquisition of Alvogen's CEE business.

agta record
Advised the shareholders of agta record on the sale of their majority stake in agta record to the Swedish group Assa Abloy valuing agta record at more than EUR 940m.

Alpla Holdings
Advised Alpla Holdings on the 100% buyout of their JV partner, Zamil Group, from Zamil ALPLA, a platform comprising five factories across the UAE and KSA.

Apollo Global Management
Advised Apollo Global Management on its acquisition of a substantial portion of SPX FLOW's former Power and Energy Isolated Segment with an enterprise value of USD 475m.

Banca Popolare di Vicenza
Advised Banca Popolare di Vicenza in the public bidding procedure under control of the Bank of Italy for the disposal of its subsidiary Immobiliare Stampa, owning an extensive portfolio of more than 200 real estate assets in six Italian regions and a platform for the provision of real estate services.

Biogroup
Advised Biogroup, the second-largest medical biology group in France and the first independent group with more than 600 medical biology sites throughout France, in connection with its merger with the medical biology group Laborizon, which comprises more than 100 medical biology sites and nearly 10 technical platforms located mainly in the west of France.

Blackstone
Advised Blackstone on the acquisition of a stake in US investment fund FRS Capital.

Colgate-Palmolive
Advised Colgate-Palmolive on its EUR 1.5bn acquisition of Laboratoires Filorga Cosmétiques.

CymbiQ Group
Advised CymbiQ Group, a portfolio company of Germany private equity investor capiton, on the acquisition of Aspectra.

Dürr
Advised the Turkish subsidiary of Dürr on the acquisition of a specific business line operated by its Turkish distributor.

Ei Group
Advised Ei Group on its GBP 3bn acquisition by Stonegate Pub Company Limited.

Essent
Advised Essent, part of Innogy, on the acquisition of renewable energy supply company Vandebron.

Everbridge
Advised Everbridge, NASDAQ-listed global software company, on the acquisition of Techwan, a Swiss software company.

Galliford Try
Advised Galliford Try on its GBP 1.1bn sale of its Linden Homes and Partnerships & Regeneration businesses to Bovis Homes.

Immatics Biotechnologies
Advised Immatics on the business combination with Arya Sciences Acquisition Corporation and listing on the NASDAQ Capital Market.

Krones
Advised Krones, a German packaging and bottling machine manufacturer, on the acquisition of Shanghai Xiantong Equipment Installation, a Chinese manufacturer of power equipment.

Lone Star
Advised Lone Star on the acquisition of BASF's Construction Chemicals business for EUR 3.17bn.

Macquarie's Green Investment Group
Advised Macquarie's Green Investment Group on the acquisition of the entire share capital of a project company holding 48MW onshore wind farm in Zajączkowo, Poland.

Nordex
Advised Nordex on the sale of its European wind and photovoltaic development pipeline to RWE, comprising approx. 2.6 GW of wind capacity, including one of the largest pipelines in France of approx. 1.8 GW, in addition to a 0.1 GW solar photovoltaic pipeline.

Quadient Inc
Advised Quadient on its acquisition of YayPay Inc in Ukraine.

Repsol
Advised international oil company, Repsol, on the divestment of its USD 100m Kurdamir oil and gas block in Kurdistan to WesternZagros.

Satisfaction Group
Advised on the acquisition of Sony Pictures Television France and Starling.

Shopback
Advised Shopback on the acquisition of interests in multiple Mongolian coal assets from an ASX-listed vendor.

Singapore-based resources company
Advised leading APAC e-commerce rewards and incentives group on its Series D fundraisings and the acquisition of Ebates Korea (from Ebates – now known as Rakuten Rewards).

SMA Solar Technology AG
Advised SMA Solar Technology AG, a leading global specialist in photovoltaic system technology, on the sale of 100% of its shares in its two China subsidiaries.

Sun Dreams
Advised Sun Dreams on the merger with Marina del Sol, creating the largest gaming and hospitality group in the region with an enterprise value above USD 1.2bn.

Telefónica Deutschland
Advised on the sale of its passive infrastructure comprising around 10,000 rooftop sites and up to 80 tower sites to Telxius Telecom for a purchase price of EUR 1.5bn.

Thermo Fisher Scientific
Advised the Massachusetts-based provider of laboratory products and services on the acquisition of a leading developer of mass spectrometry software.

Vivacom
Advised the sellers on the sale of Vivacom for EUR 1.2bn to United Group backed by its major shareholder, BC Partners.

x+bricks and SCP
Advised on the acquisition of the real group from Metro AG. The consortium is acquiring the entire operative business with an annual turnover of approx. EUR 7bn and the entire real estate portfolio of the supermarket chain comprising 80 owned properties and 219 leased properties.

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#1 by Bloomberg in Europe, Germany and UK
#1 by Mergermarket in CEE, DACH and Germany
#1 by Thomson Reuters in Benelux and Germany

Sources: Bloomberg, Mergermarket and Thomson Reuters, by deal count, 2019

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