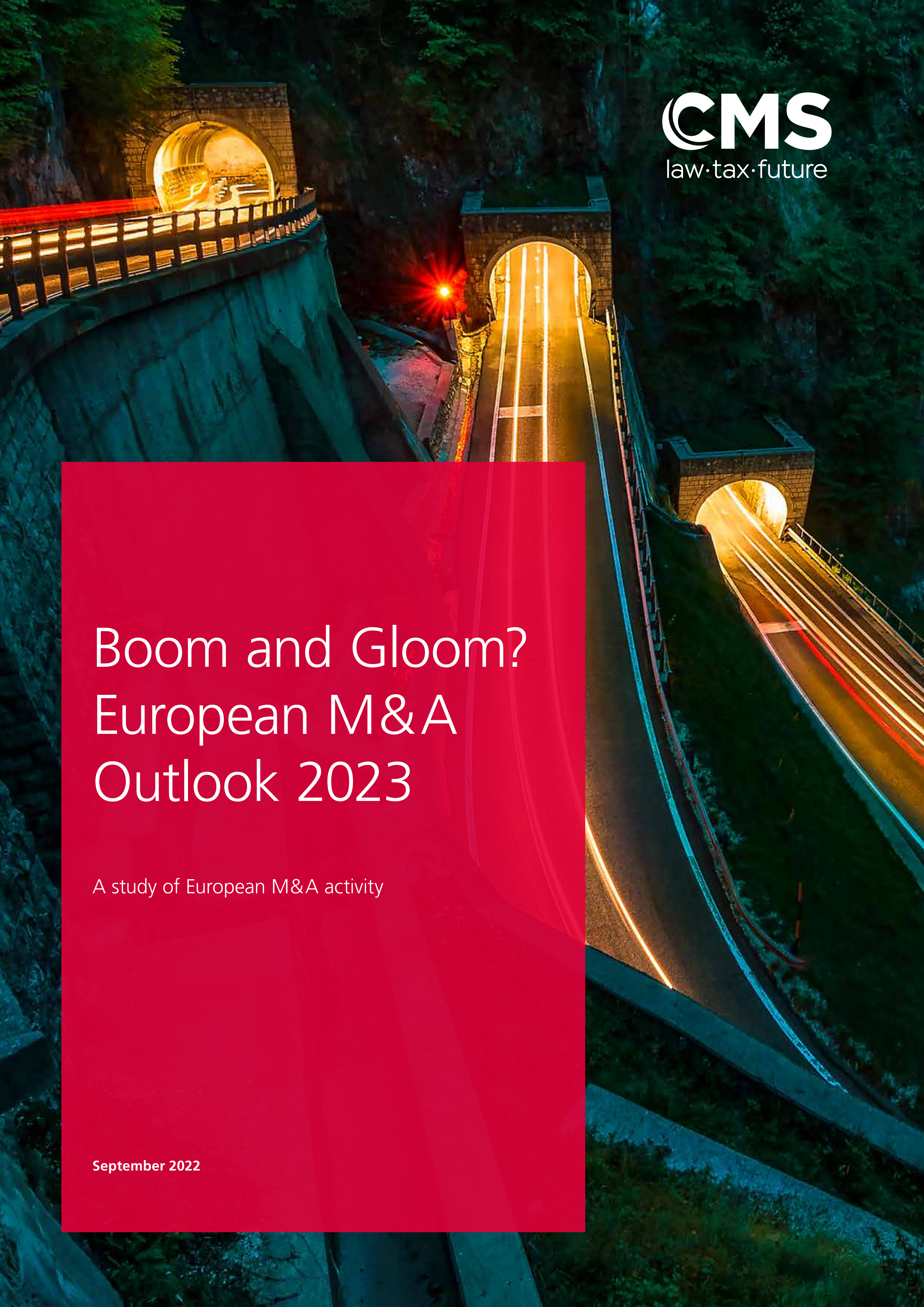

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Boom and Gloom? European M&A Outlook 2023

A study of European M&A activity

September 2022

Contents

Methodology

In the second quarter of 2022, Mergermarket surveyed senior executives from 240 corporates and 90 PE firms based in Europe, in the Americas and Asia-Pacific regions about their expectations for the European M&A market in the year ahead. Among the 330 executives interviewed, 70% are headquartered in Europe, while the remaining 30% are equally split between the Americas and the Asia-Pacific regions. 70% of all respondents have been involved in an M&A transaction over the past two years and 88% plan to undertake an M&A transaction in the coming year. All responses are anonymous, and results are presented in aggregate.

Foreword

Louise Wallace, Head of CMS Corporate/M&A

Malte Bruhns, Co-Head of CMS Corporate/M&A

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

After an unusually buoyant 2021, the European M&A market has normalised thus far in 2022. Activity levels are trending down, though they remain above pre-pandemic levels. A year ago, economic growth was booming, spurred by rebounding consumer demand and the return to business activity made possible by an easing of the COVID-19 pandemic.

However, inflation proved to be more deeply entrenched than the European Central Bank (ECB), the Bank of England, and other policymakers had initially anticipated. Moving into 2022 this raised the prospect of a hawkish turn in monetary policy to rein in prices. Then Russia invaded Ukraine, fuelling already elevated energy price pressures. Succumbing to inflation and the drag it is creating on demand, growth is expected to halve this year, and the eurozone's GDP forecast to expand by 2.6% in 2022 from 5.2% in 2021.

The deal market has held up impressively well in this environment so far and respondents are bullish on their own activity over the coming 12 months. Overstretched valuations in segments of the stock market last year came back down in the first half of the year and while the cost of financing is now increasing as credit conditions tighten, buyers are well positioned to capitalise on deals they have high conviction on.

Key findings from our research include:

M&A expectations run high
Almost all respondents are currently considering M&A, with only 12% saying they are not. This stands in contrast to the findings in our last two surveys – in 2021, 33% of those polled were not considering M&A and in 2020 this figure was as high as 65%.

Cost of financing
Despite the optimism for expected dealmaking, investors are realistic about borrowing conditions as the ECB and Bank of England begin to hike rates and reduce their balance sheets. As much as 87% of all respondents expect financing to be tighter in 2022 compared with 2021 – this includes 45% who expect it to be much harder.

ESG rises up the agenda
Europe continues to lead the world in setting out a path to a net-zero carbon future and this is having a clear impact on the ins and outs of M&A. Some 90% of respondents expect ESG scrutiny in their dealmaking to increase over the next three years, compared to 72% in 2021's survey. Compared to last year's survey, the proportion of respondents expecting ESG scrutiny to significantly increase nearly doubled to 48% from 26%.

A tale of two markets

Professor Scott Moeller, Founder and Director, M&A Research Centre, Bayes Business School (formerly Cass), introduces this year's M&A Outlook by examining how the European M&A market finds itself at an inflection point

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

How quickly things change in the M&A markets! It's similar to what Charles Dickens said in his opening line in *A Tale of Two Cities*: 'It was the best of times, it was the worst of times…'

M&A dealmakers are almost by definition an optimistic group, yet as we looked at the first half of 2021 a year ago, just over half of this extensive survey of experienced senior M&A practitioners expected the market to increase in the following 12 months. And even more cautiously, only 66% said that they were considering an acquisition in the next three years in Europe.

Then, as we all know, the market exploded with deal activity in the second half of the year, bringing the full year to record levels, not just here in Europe but globally. Companies and financial sponsors were flush with cash that was hoarded during the pandemic, there were growing pressures to restructure businesses because of digitalisation and the transition to net zero and there was a general optimism, at least in some parts of the world, that we had emerged from the pandemic.

But, as Charles Dickens noted further in that opening sentence to his novel, '… it was the age of wisdom, it was the age of foolishness, it was the epoch of belief, it was the epoch of incredulity,…' And thus it was with the M&A markets as reality hit hard in the first half of 2022 with geopolitical tensions rising globally and even a war on the European continent. Rising commodity prices, especially in energy; supply chain problems caused, in part, by a hard-line reaction to COVID-19 outbreaks in China and its impact on the rest of the world; and rising inflation and therefore interest rates all contributed to a gloomier mood for dealmaking. The number of deals in Europe dropped 8% year-on-year and overall aggregate deal value was essentially flat (at an increase of only 1%). Stock markets declined into recession territory and the IPO markets dried up. Increased market volatility made predictions difficult.

Yet, our ever-optimistic dealmakers – who have the ability to make their predictions come true as they control the levers (and purses) of the acquisition juggernaut – are not restrained in their outlook for the year ahead. Indeed, they feel more strongly than 12 months ago that activity will increase: one of the main headlines of this report is that 73% of these experts expect the level of European activity to rise over the next 12 months – 20 percentage points higher than the expectation last year, as noted above.

Given that these are the people who plan the deals that may be months or even years in the making, they have a unique insight into the likely deal activity for the next six to 12 months. Ignore their predictions, and you ignore the group who are working to make the future happen. And the icing on the cake? Almost half of that 73% expecting increased deal activity responded to the survey that they thought it would increase significantly!

And not one of the 330 respondents say the M&A market would decrease significantly. This is the prediction of the group of dealmakers where 88% of them say that their own firms would be doing a deal. Yes, they can make their predictions come true. Indeed, 70% of those respondents did a deal in the past two years.

It's probably healthy that the markets need to 'climb a wall of worry', because there is always something that can go, or even is going, wrong and not just the continuation of the list of market negatives noted above. Certain countries and regions, various sectors and industries will be stronger as others are weaker. The overall market activity is an average, yet M&A is conducted deal-by-deal.

It's important to remember that one company's carve-out or divestment is another company's (or financial sponsor's) acquisition. An excellent example of this is the energy industry, which was seen in last year's poll as the sector that would see the highest growth post-COVID-19. Large multinational companies are moving rapidly towards a carbon neutral world because they sense that this is where the future demand will be, they feel it is their responsibility to society and their shareholders, and in order to comply with changing regulations. Thus, they are shedding carbon-intensive businesses and buying, for example, electric vehicle parts manufacturers or wind farms. But do the M&A experts see these sectors as the most active for the next 12 months? No, because other events have taken front seat and will be driving the activity over the next year.

This year, it's the perennial favourite, technology, media and telecommunications (TMT) which continues to drive the expected future activity because of the digitalisation of businesses. Just over two-thirds of survey respondents (68%) rank this as the highest or second-highest growth area in the next 12 months. It's not just the CEO of Goldman Sachs who can state, as he did back in 2017, that 'We are a technology firm'. Today, just about every company in any industry needs to be saying something similar. Many firms realise that to stay competitive requires a technology-savvy organisation and that organically growing their technological expertise may not only be too slow but impossible. Thus they choose the faster route, which is to acquire the companies that have that knowledge.

The world is ever-changing. No one predicted a pandemic two years ago that would continue in some countries with city-wide lockdowns even now. Few predicted a war in Europe in 2022. Change will happen, and that will be the driver for the need for companies to restructure. The experts in this year's survey can provide some excellent insights into where this will occur. The dealmakers themselves are already planning their next several deals. For some, it will be the best of times in the next 12 months, for others, not. It will be a complex 'tale of two markets' (with apologies to Charles Dickens).

The rise of ESG in M&A transactions

The importance of ESG factors in M&A has grown exponentially in recent years. Investors are facing increasing pressures to uphold a higher standard – across all industries and geographic regions

Alexander Rakosi, CMS Austria

Environmental, social and corporate governance (ESG) considerations have shot to prominence in the M&A landscape across Europe as market participants aim to capitalise on more attractive value creation opportunities and/or are forced to incorporate ESG aspects into their strategic approach to remain competitive.

Whereas in previous years ESG constituted somewhat of a minor and vaguely defined element in an M&A process, it has now become a more tangible concept in both the corporate and private equity space, and is considered key to companies' growth prospects. ESG is no longer just about the investment case and the core pricing itself, but target companies are subject to demands by their suppliers or contractual counterparties (such as government/government-like organisations) to adhere to certain ESG requirements. Divestments may now also be driven by concerns that a certain business line might be incompatible with long-term ESG and sustainability goals.

Our survey suggests that these changes are only a start. The vast majority (90%) of respondents say they expect scrutiny of ESG issues in deals to rise in the next three years.

A cross-sector phenomenon

The importance of ESG considerations has increased across all sectors. We see that for industrial companies, displaying evidence of being ahead of the sustainability curve can be a core differentiator, not only in attracting lucrative supplier relationships or catering to increased customer demands, but also in appealing to acquirers who themselves are aiming to improve their ESG scorecards. Owners of real estate assets meanwhile are faced with growing pressure to offer solutions for energy-efficient management and ESG commitments of their own.

In a nutshell, those targets which can credibly prove they are at the forefront of ESG developments are able to generate significant market interest and achieve higher valuations from acquirers who are seeking to boost their own ESG credentials.

And then, of course, there is M&A activity in industries more explicitly linked to ESG goals. Take the recycling sector, which aims to close the loop in circular economy considerations for other industries such as packaging. In our view this explains the high level of M&A activity in the recycling sector. Market participants are cognisant of the fact that there will be high demand in the market for recycled material. Despite virgin material currently being cheaper to produce than gathering recycled material, they expect this price gap to narrow or disappear entirely, and, perhaps more importantly, they expect that legal and regulatory rules will provide for minimum requirements of recycled components to be used in manufacturing. As a result, market participants are intent on gobbling up recycling capacities now to be fit for the future and to make their model more commercially sustainable, catalysing M&A activity in this sector.

Globalisation of standards

This mantra of `keeping up with the times´ has an impact even in jurisdictions where there currently is no specific ESG legislation in effect, such as in certain Central and Eastern European countries.

In such situations, whichever standards will eventually influence the definition of the gold standard in specific industries will have a huge impact on how deals are valued and completed. In several instances, sophisticated market participants such as private equity funds and/or international corporates are bringing along a new set of rules and requirements in the context of their inbound investments, identifying ESG standards as a baseline and important driver in the value creation equation.

Impact on legal work
From a legal practice perspective, ESG ramifications can be felt in several ways. In capital markets, ESG matters add to risk factors in prospectuses. Other pending initiatives such as the EU Green Bond Standard may result in further impact, providing additional clarity and guidance on standards. Additional standards will also serve external reviewers who assess ESG and sustainability measures.

In the context of M&A due diligence, an increasing focus is being placed on ESG in the material agreements review, on target companies' ESG policies and initiatives, and on the assessment of compliance models. In this respect close alignment, between the various legal disciplines as well as with non-legal experts (such as financial or technical advisers) will be needed. Additionally, we would expect ESG considerations to become more relevant in the negotiation of transactional documentation (e.g. sale purchase agreements, asset purchase agreements), in particular with respect to the representations and warranties and covenants relating to pertinent standards, similar to the way anti-money laundering processes are handled.

In summary, we expect M&A activity will place an increasing importance on ESG. ESG-driven deal activity will continue to enter new geographic regions, affecting new and old industries alike, further cementing it as an element not to be ignored by both commercial and legal decision makers in the M&A industry.

Dealmakers seek protection as M&A disputes rise

Market volatility caused by the COVID-19 pandemic and war in Ukraine has led to a rise in M&A claims – a trend we expect will continue to grow over the coming year

Louise Boswell, CMS UK

Jean-Fabrice Brun, CMS France

Shravan Ratakondla, CMS UK

Cécile Gimonet, CMS France

M&A disputes are on the rise. In the last couple of years, we have seen a notable increase in M&A claims all across Europe and we predict this growth will continue given the significant challenges faced by businesses throughout the region.

In particular, disagreements over adjustments to the purchase price have risen, as buyers seek to realise more value post-acquisition. We saw clues to what is driving this in the CMS European M&A Study 2022 which showed a significant increase in the use of earn-out structures in European M&A deals. With the flexibility that such structures offer comes the risk of disputes arising if things do not turn out quite as expected. Deferred consideration mechanisms, completion accounts and warranties are all commonly used by disgruntled buyers to seek to reduce the consideration payable – perhaps one reason why we have seen an inexorable rise in the number of M&A deals being insured by warranty and indemnity (W&I) policies.

Growth of arbitration

One particularly interesting development is the increase we have seen in recourse to arbitration as a dispute resolution mechanism. This is particularly true for larger transactions, with our 2022 M&A Study revealing that parties to higher value transactions often negotiate arbitration clauses into the relevant documents.

Parties agree to arbitrate to avoid court claims in jurisdictions where proceedings are time consuming and the outcome unpredictable, as well as to maintain confidentiality. Large international (and listed) companies prefer their proceedings to stay out of the public eye where possible. Another factor is the need for an award that is enforceable in multiple jurisdictions, notwithstanding concerns about the ease of doing so in practice.

Arbitration also offers parties the freedom to choose the rules governing their arbitration proceedings, which could be national or international (e.g. UNCITRAL or ICC Rules). In 2021, the use of national rules to govern arbitration (68%) increased in popularity over the use of international rules. This might be caused by the result of the pandemic and the stronger focus on national interests.

Force majeure/hardship and MAC clauses

Force majeure clauses (or equivalent) have also been under the spotlight and, when it comes to the treatment of such clauses by courts, England and France offer good examples.

This year saw the first major cases in the English High Court on the validity of invoking force majeure clauses where performance of a party's obligations was hindered by the COVID-19 pandemic. We have also been advising on the application of force majeure and material adverse change (MAC) clauses in relation to Brexit and sanctions imposed following Russia's invasion of Ukraine.

The Court has upheld the validity of a party's declaration of force majeure due to US sanctions imposed on the counterparty's parent company. The general principles remain that (i) the force majeure event in question should be explicitly referred to in the relevant clause, and (ii) the occurrence of the event must have prevented the party from fulfilling its obligations (and not just delay or inconvenience it – an increase in cost is insufficient).

In France, case law has recognised that that the COVID-19 pandemic could be considered as a force majeure event, even though the High Court (Cour de cassation) considers that force majeure cannot in principle exempt debtors of money obligations from their performance. Although a force majeure event may cause a purchaser's project to lose financial viability, it is unlikely to actually prevent the purchaser from fulfilling its payment obligation. There are therefore certain risks borne by the parties, which parties may seek to address via hardship and MAC clauses.

Given these issues, parties are rightly placing increased focus on the wording and negotiation of force majeure and MAC clauses when entering into contracts, including expressly considering the possibility of a pandemic and its effects on contractual obligations, as such an event should no longer be considered unforeseeable after the COVID-19 crisis.

ESG-related claims will increase

Although still in its nascent stages in the context of litigation, ESG issues will without doubt have a huge impact on M&A in the near future. Nine in ten respondents to this year's M&A Outlook survey expect ESG scrutiny to increase over the next three years, while 92% expect M&A due diligence to include more scrutiny of ESG factors.

Consequently, we predict an increase in misrepresentation or breach of warranty claims, as well as claims grounded in MAC clauses in the ESG context. Such claims may also relate to parties' compliance with the Corporate Sustainability Reporting Directive. The UK Supreme Court has held in two decisions that there is a 'good arguable case' that parent companies owe a duty of care in connection to statements published by them on their non-UK subsidiaries' ESG credentials. Other areas that may impact M&A parties include greenwashing claims and shareholder activism in relation to ESG credentials.

Spotlight on the Nordics

Johan Svedberg, Partner at CMS Norway, reacts to the findings of the study and shares his thoughts on the outlook for the Nordic region

Johan Svedberg, CMS Norway

Briefly, how have the Nordics performed so far this year?
Overall, performance so far this year is somewhat weaker than in 2021. The market is continuing to feel the ripples from the war in Ukraine and prior to that it was the Omicron variant of the coronavirus which was affecting the region at the start of 2022.

There were 962 deals in the Nordics region in the first half of 2022, worth EUR 56.3bn. This was a significant 11% drop in volume compared to the prior year, although values increased 7% (if propped up in no small part by Philip Morris's EUR 16.5bn offer for tobacco producer Swedish Match). For comparison, overall European M&A also saw an 8% decline in volume and a 1% uptick in value.

Nevertheless, from an historic perspective, 2022 is still a strong year. We have seen an encouraging bounceback of mergers and acquisitions across the Nordics, which has contrasted with weakness in the capital markets where we have seen fewer IPOs as a result of high interest rates, inflation and more expensive capital.

There are still many deals in the pipeline too, both across capital markets and private M&A. We may see a significant rise in deal activity towards the end of the year, or potentially the beginning of 2023, depending on how circumstances affecting the current market situation continue to play out.

What have been the main drivers of M&A activity in the Nordics region so far in 2022?
Private equity is still very much at the forefront of activity in the region, with PE being strongly represented among the 20 largest acquisitions in the Nordics during H1. Many of the major Nordic PE players have been active in raising money and we have seen large deals involving them (i.e. Axcel in Denmark, EQT in Sweden and HitecVision in Norway).

From a sector perspective, the consumer sector has seen the greatest value of deals but this is driven largely by the huge Swedish Match transaction. TMT as well as industrials and chemicals were the next best performers though with EUR 10.1 billion and EUR 9.5bn worth of deals respectively. The tech sector was also the most active in terms of deal volume, with a total of 235 registered deals in the Nordic countries and well ahead of manufacturing & industrials as runner-up with 151 deals.

The energy sector has also been lively. The trend towards renewables deals is cooling off a little, while oil and oil services deals are recovering amidst the current geopolitical climate. In Norway in particular we also see fish farming as a winning sector, with strong performance so far this year from a deal value perspective.

We are expecting to release this year's European M&A Outlook in a very different macroeconomic environment than last year's report. What is the macroeconomic outlook for the Nordics region?

The Nordics, and Norway in particular, are in a strong position. In contrast to many other countries, we have not yet experienced as high inflation as in many other countries. This gives us some cause for optimism but things could change, of course, and we are monitoring the situation. However, higher interest rates, the increase in inflation, as well as increased commodity prices in the rest of the world will most certainly continue to affect investment activity in the second half of 2022 negatively.

Despite the fact that Norway has not experienced high inflation, the threat of inflation affects our due diligence exercises and the way we are analysing the businesses of companies. For example, are cash flows locked in or is there potential to re-negotiate contracts? Short-term contracts may suddenly be more attractive than before, as it gives more flexibility for a company, an important thing in an uncertain market with a potentially high inflation.

Overall, though, our view is that as long as there are good assets available, there will be buyers that are willing to pay for them.

What sectors/countries do you expect will remain active in terms of deal activity in the face of an economic downturn in the coming 12 months?

We are seeing increased interest for companies with a substantial cash flow, and with a high growth potential. Investors are steering away from early phase companies and we have seen a significant drop in the share price of listed early-phase green companies so far in 2022.

Based on what we are seeing on performance so far this year, our view is that the ESG, technology, energy as well as infrastructure sectors look the most attractive going forward, as well as the so-called `blue economy´ – that is, the sustainable use of ocean resources.

The oil and oil service industries have defied the expectations of some. Far from being `dead´, they have seen a resurgence in 2022 so far in light of the geopolitical climate. There will still be high interest for green ESG investments however, particularly with the EU taxonomy being implemented in Norway during the second half of 2022, and the ESG reporting requirements that will follow. Consumers are focusing on green behaviour and sustainable lifestyles, and this will ultimately affect which targets are the most interesting for investors.

The M&A environment and expectations for the year ahead

Despite facing a far more difficult deal environment, in the first half of 2022, M&A practitioners were able to achieve activity levels on par with 2021

Top findings

73%
expect European M&A activity to increase over the next 12 months

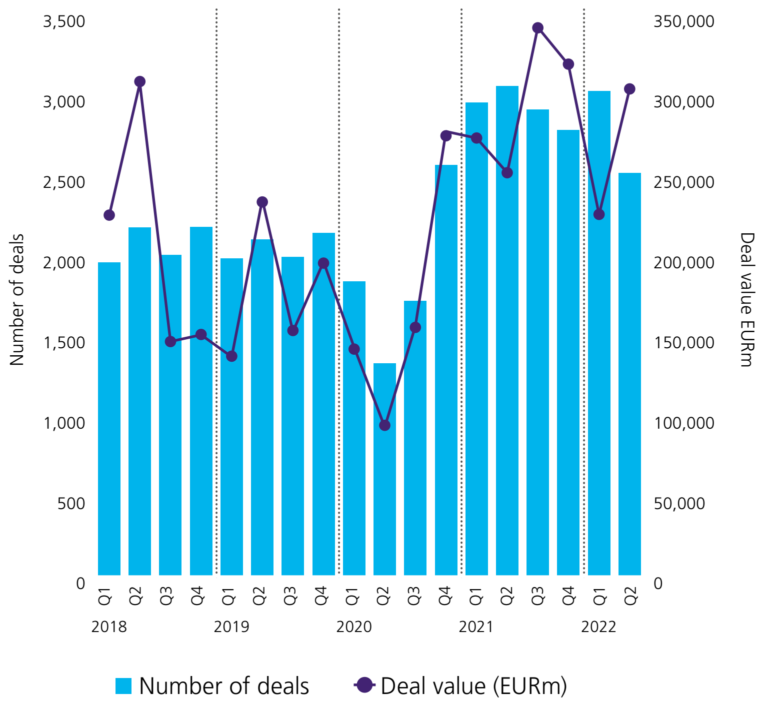
16%
believe that vendor/acquirer valuation gaps will be the top obstacle to M&A

26%
say that distress-driven M&A will be the greatest sell-side driver of deal activity

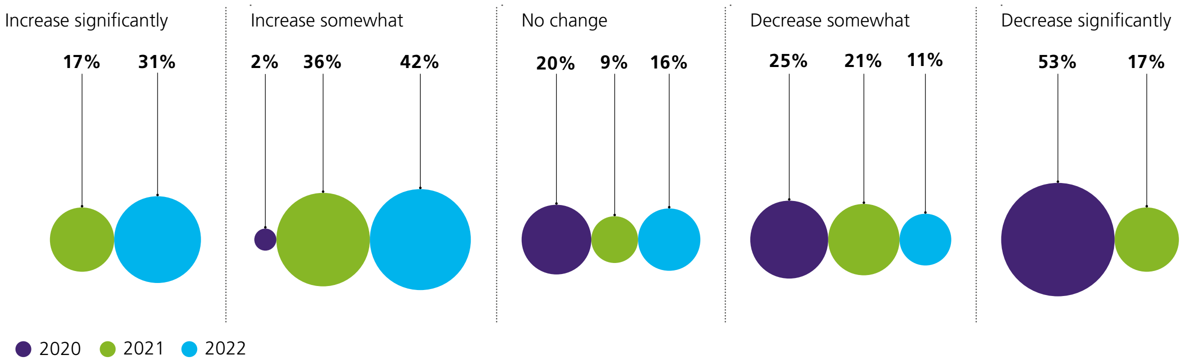
21%
think that undervalued targets will be the biggest buy-side driver of M&A

In the first six months of 2022, European M&A markets achieved the seemingly impossible. After a blockbuster year, total deal value in H1 came to EUR 529.2bn, a slight uptick of 1% compared with the same period last year. And while it's true that deal count over the same period came in 8% lower at 5,536 transactions, this is measured against the busiest period in Mergermarket history (since 2006) and remains comfortably above the corresponding period in any year prior to the pandemic. This is a remarkable feat considering the outbreak of war in Ukraine and the second-order effects of this conflict, which has weakened economic growth and exacerbated what was already decades-high inflation.

European M&A trends 2018-Q2 2022



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



The largest transaction in H1 was the EUR 42.7bn acquisition of Italian infrastructure firm Atlantia by Blackstone Group and Edizione, an investment vehicle associated with the Benetton family. The Italian government has 'golden powers' it can exercise to block or set conditions on takeovers in strategic sectors, such as airports, defence and energy. Atlantia's ADR unit, which manages Rome's Fiumicino airport, and digital road toll payment unit Telepass, which handles data on traffic, are highly strategic assets but the deal is expected to be cleared. The deal demonstrates the financial might of the PE industry's largest sponsors and the volumes of capital they are willing to put to work for the right deals.

After a pull-back in deal volume from a peak in Q2 last year, respondents in the second quarter are upbeat on the following 12 months. Nearly three-quarters (73%) of all respondents expect the level of European M&A activity over the next year to increase. This includes 31% who expect it to increase significantly. This is an even more optimistic result than last year's survey, which found that 53% expected deal activity to increase at that time, 17% of whom expected it to increase significantly. Not only that, no respondent says they expect activity to decrease significantly from here.

Private equity firms are more bullish than their corporate counterparts, which may reflect the dry powder at the industry's disposal. Preqin estimated that private capital funds had some USD 1.86trn as of June 2022 and with the reset in valuations that came in the first half of the year after stock markets crested in Q4, these savvy investors will be active in searching for ways to deploy its capital. Close to nine out of ten PE respondents (89%) expect European M&A activity to increase, with nearly half (46%) expecting it to rise significantly.

Market obstacles – valuation gaps and financing conditions

Vendor/acquirer valuation gaps and financing difficulties are seen as two of the biggest obstacles to M&A activity in Europe over the next 12 months: 16% of respondents rank valuation gaps and 15% rank financing, respectively, as their top concerns. Periods of volatility can complicate price expectations as sellers struggle to let go of previous all-time-high valuations and buyers wish to acquire repriced assets. It can take a period of equity markets signalling a bottom and showing upside and volatility subsiding before the bid/ask spread narrows.

European M&A top 20 deals, H1 2022

Announced date	Target company	Target sector	Target country	Bidder company	Bidder country	Deal value EUR(m)
14/04/2022	Atlantia S.p.A. (66.9% stake)	Transportation	Italy	Blackstone Group Inc; Edizione S.r.l.	USA	42,672
15/02/2022	Mileway BV (100% stake)	Real estate	Netherlands	Blackstone Group Inc	USA	21,000
31/05/2022	Firmenich S.A. (100% stake)	Industrials & chemicals	Switzerland	Royal DSM N.V.	Netherlands	19,309
11/05/2022	Swedish Match AB (100% stake)	Consumer	Sweden	Philip Morris International Inc.	Switzerland	16,523
27/03/2022	National Grid plc (UK gas transmission and metering business) (60% stake)	Energy, mining & utilities	United Kingdom	Macquarie Group Limited; British Columbia Investment Management Corporation; Macquarie Asset Management Holdings Pty Ltd	Australia	9,590
21/01/2022	SAZKA Entertainment AG (100% stake)	Leisure	Switzerland	CSR Acquisition Corp	USA	7,911
08/03/2022	Orange Espagne, S.A.U. (Spain business) (100% stake)	TMT	Spain	Masmovil Ibercom S.A. (Spain business)	Spain	7,800
25/01/2022	Element Materials Technology Group Limited	Business services	United Kingdom	Temasek Holdings Pte. Ltd.	Singapore	6,197
19/05/2022	HomeServe Plc (100% stake)	Financial services	United Kingdom	Brookfield Infrastructure Partners L.P.	United Kingdom	5,500
17/05/2022	ContourGlobal Plc (100% stake)	Energy, mining & utilities	United Kingdom	KKR & Co. Inc.; Cretaceous Bidco Ltd	USA	5,488
06/01/2022	LeasePlan Corporation N.V.	Financial services	Netherlands	ALD S.A.	France	4,900
29/06/2022	VTG AG (72.55% stake)	Financial services	Germany	Abu Dhabi Investment Authority; Global Infrastructure Partners, LLC	Germany	4,873
22/02/2022	Refresco Group N.V. (69% stake)	Consumer	Netherlands	KKR & Co. Inc.	USA	4,830
10/05/2022	FL Entertainment N.V. (100% stake)	TMT	France	Pegasus Entrepreneurial Acquisition Company Europe B.V.	Netherlands	4,754
22/04/2022	Banca d'Italia S.p.A. (60% stake)	Government	Italy	Undisclosed bidder	Italy	4,400
09/03/2022	Sartorius AG (20.04% stake)	Industrials & chemicals	Germany	Armira Beteiligungen GmbH & Co. KG; LifeScience Holding SCSp	Germany	4,328
14/05/2022	Vodafone Group Plc (9.8% stake)	TMT	United Kingdom	Emirates Telecommunications Group Company PJSC; Atlas 2022 Holdings Ltd	United Arab Emirates	4,229
07/04/2022	Euronav NV (100% stake)	Transportation	Belgium	Frontline Ltd	Norway	4,145
18/05/2022	Siemens Gamesa Renewable Energy, S.A. (32.93% stake)	Industrials & chemicals	Spain	Siemens Energy AG	Germany	4,048
30/05/2022	Student Roost (100% stake)	Real estate	United Kingdom	Greystar Real Estate Partners, LLC; GIC Real Estate Pte Ltd	USA	3,877

Clearly, financing conditions have deteriorated from the same time last year, as credit markets price in elevated risks and the ECB winds down its bond purchasing and lifts rates for the first time in over a decade. This makes fixed-rate debt financing less viable, although high-quality companies in strongly performing sectors can still access floating-rate loans. This tighter access to debt financing can have a knock-on depressive effect on deal pricing.

The repercussions of the war in Ukraine are also seen as a major concern. More than one in ten (11%) say this is their biggest worry and a further 16% say this is the second-biggest obstacle to the European M&A market over the coming year. Heightened geopolitical tensions in and of themselves can sap investor confidence, but they also have second-order effects. In Q2 the Ukraine conflict sent the price of oil to a decade high of above $120 a barrel. For now, however, these effects appear to be short-lived, with oil trending back to pre-invasion levels.

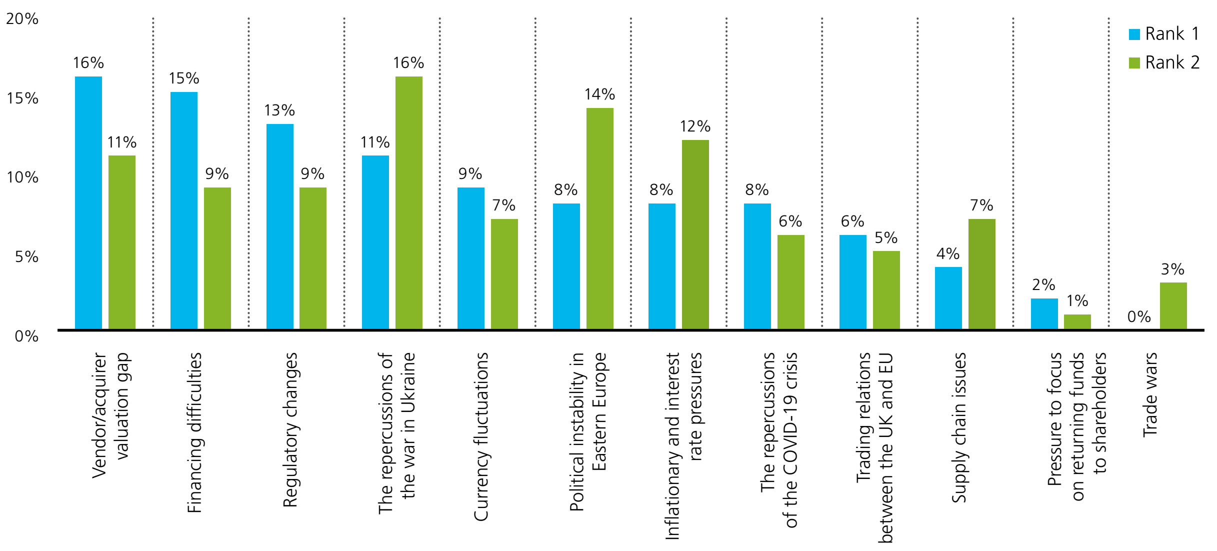
> Deal activity remains strong but slower than we have seen in recent months. This is in part driven by wider macro uncertainties but also caution as investors consider whether there will be more distressed opportunities in the coming months. For those requiring debt there are additional challenges as the mainstream banks are taking a more cautious approach to lending.
>
> *Victoria Henry, CMS UK*

Deal drivers – undervalued targets and distressed sales

The biggest M&A buy-side driver, meanwhile, is expected to be the availability of undervalued deal targets. A fifth (21%) of respondents cite this, making it the top pick, and it's not hard to see why. The Euro Stoxx 50 topped out in mid-November and over the first half of 2022 fell by 20% amid a broader sell-off in global equities. Investors took risk off the table amid worsening inflation, anticipation of a tightening monetary environment and uncertainty over Ukraine.

M&A experts are also confident that both cash-rich corporates and financial sponsors will be important buy-side drivers of deal activity over the coming months. Just behind valuation resets, 16% of respondents point to the healthy balance sheets

What do you believe will be the principal obstacles to M&A activity in Europe over the next 12 months? (Please select the two most important, 1 = most important, 2 = second most important)

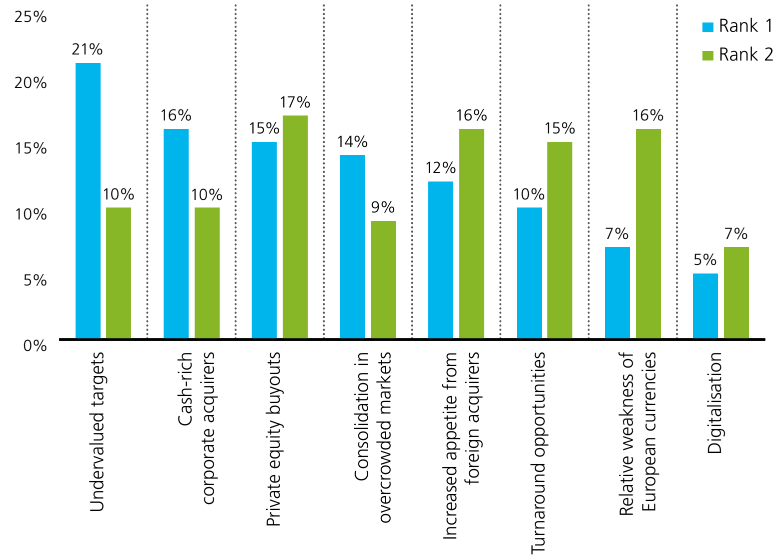


of strategics as being a primary driver fuelling deal demand. Meanwhile, 17% see PE buyouts as the second most significant factor buttressing the buy-side.

Strategics continue to hoard cash, a mentality adopted to weather the worst of the pandemic. Looking at the US, for example, the collective balance sheet cash holding of the S&P 500 at the end of Q1 was USD 8.3trn, a full 42% higher than Q4 2019, immediately before the onset of the COVID crisis. Add to that the USD 1.86trn in committed, uninvested capital on the sidelines in private capital funds and there is a wall of demand. PE is also likely to benefit from the suppressed appetite for IPOs as companies seek alternative routes to realising liquidity.

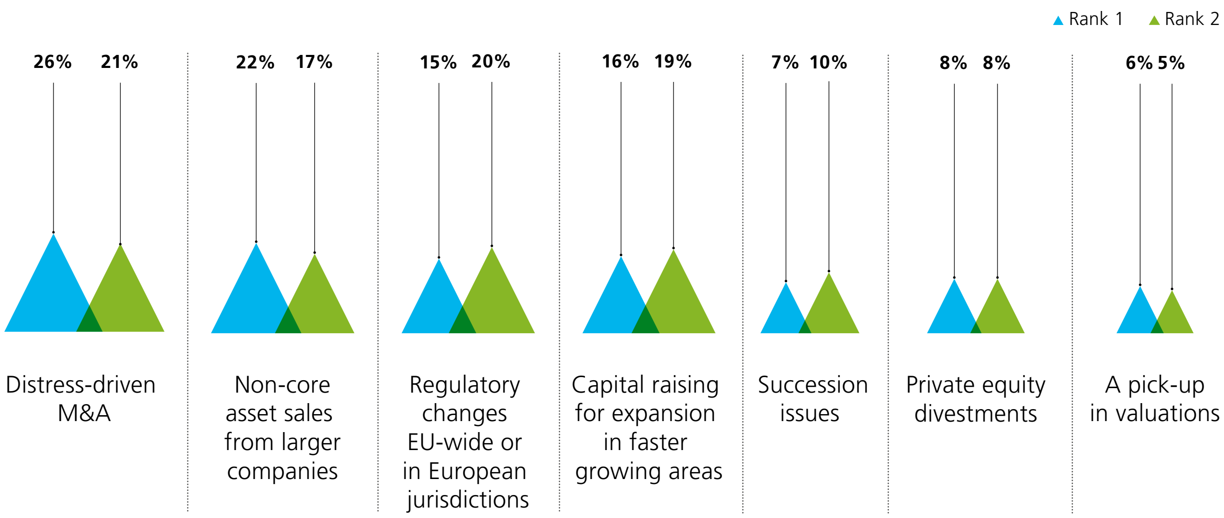
On the sell-side, the biggest driver of activity is expected to be distressed situations: 26% rank this as the top driver, while an additional 21% believe it is the second most important driver. Declarations of bankruptcy in Europe remain at depressed levels for the time being and have in fact decreased since the beginning of 2021,

What do you believe will be the greatest buy-side drivers of M&A activity in Europe over the next 12 months? (Please select the two most important, 1 = most important, 2 = second most important)



> We will see more distressed deals as we face simultaneous economic problems, including lingering losses due to the pandemic, continuing supply chain problems, high inflation and recession fears, but also multiple severe geopolitical crises and uncertainties – such as the war in Ukraine and rising tensions between China and Western democracies.
>
> *Oliver C. Wolfgramm, CMS Germany*

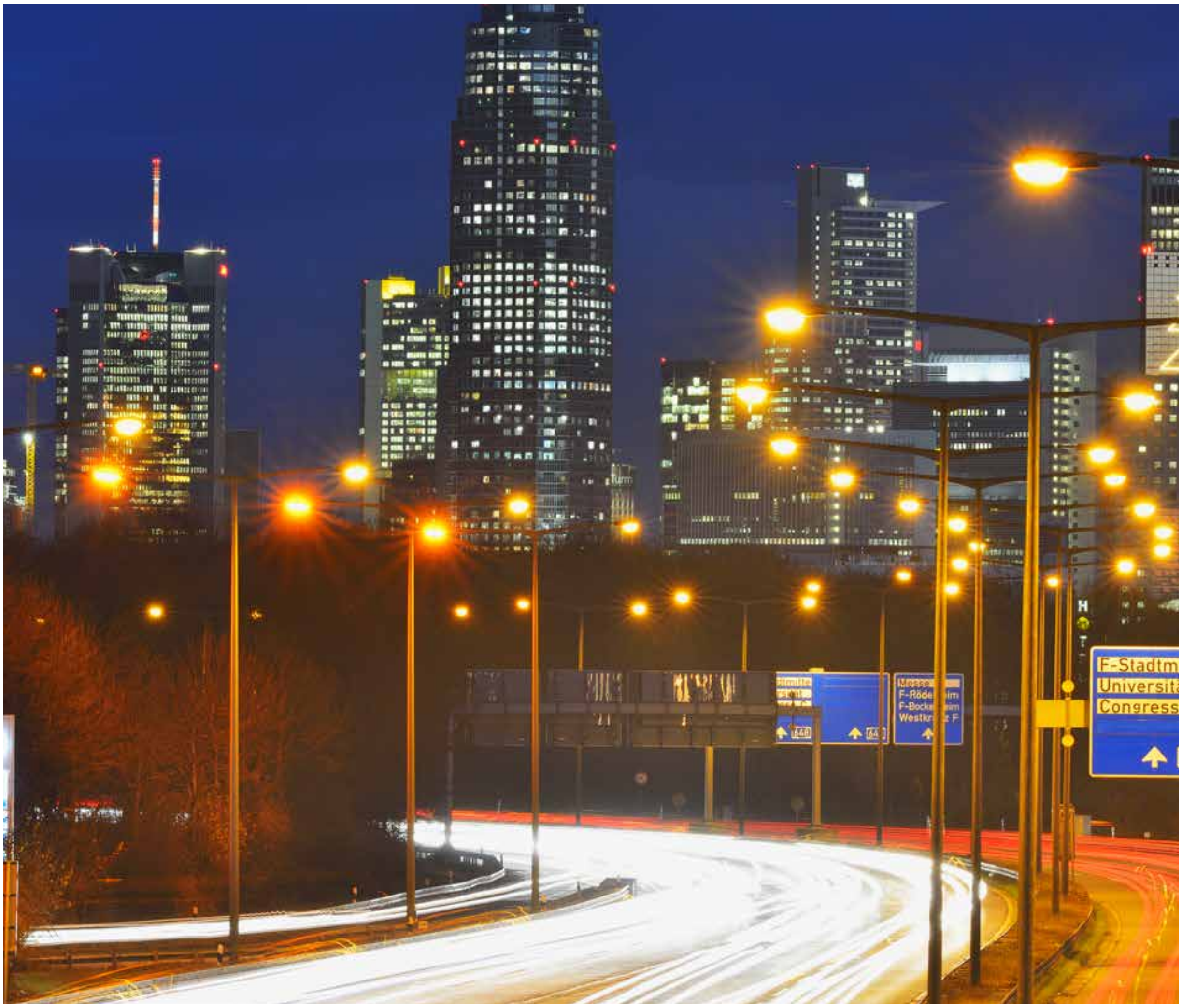
What do you believe will be the greatest sell-side drivers of M&A activity in Europe over the next 12 months? (Please select the two most important, 1 = most important, 2 = second most important)



according to Eurostat, the statistical office of the European Union.

This is a function of the mass of liquidity that has been made available to the economy under unprecedented stimulus measures. However, this support has been wound down and with the ECB now beginning to raise its base rate, insolvencies have the potential to tick up from here, creating deal opportunities for sponsors. Not too far behind, 22% see non-core asset disposals from larger companies as being a top sell-side driver of M&A, as corporates continue to reappraise their long-term strategies and realign their business models.

> We are currently experiencing fast changes which lead to challenges in many economic dimensions. The energy sector is currently under especially high pressure. As the outcome of these developments have an impact on almost all enterprises, I am sure that distressed transactions will play a major role.
>
> *Alexandra Schluck-Ahmed, CMS Germany*



Deal trends

M&A practitioners are facing a very different deal environment today than they were a year ago and PE firms are set to take advantage of the opportunities this presents

Top findings

60%
say financial buyers are better positioned to take advantage of buying opportunities

24%
believe that PE activity will be the most important trend in European M&A

22%
expect more spin-off/carve-out activity to be the top trend in the next 12 months

18%
think that greater competition is the biggest challenge for M&A in the next 12 months

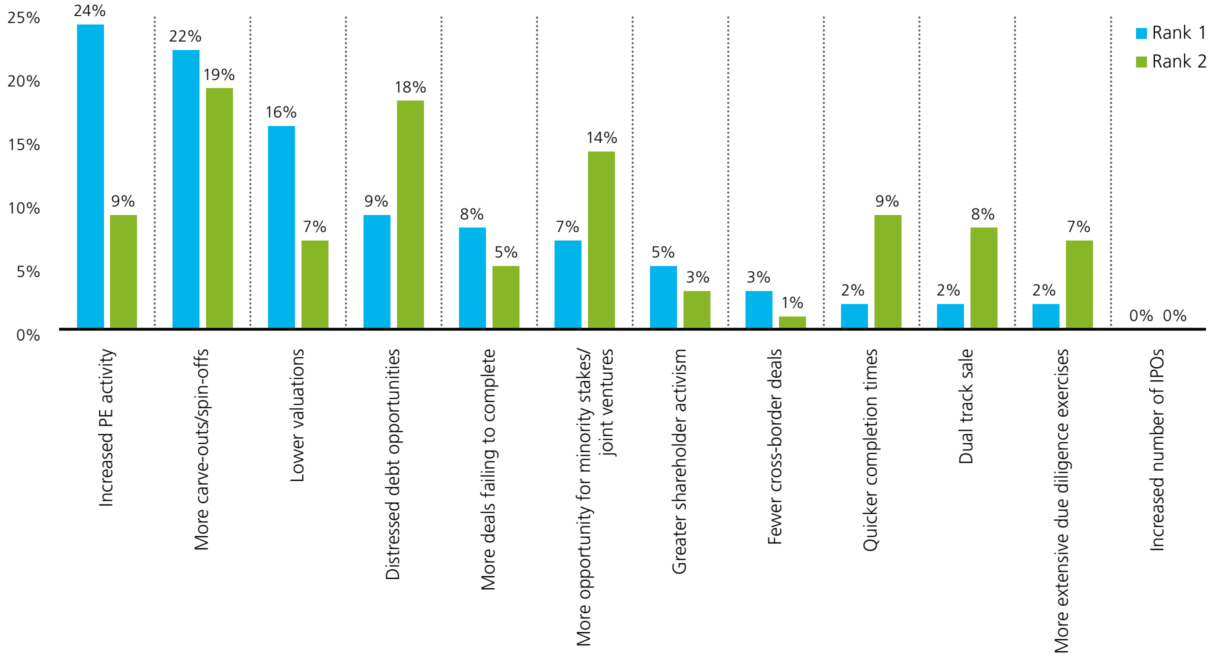
As mentioned, expectations are high that corporates will supply deal flow with asset disposals. Nearly a quarter (22%) of respondents see an increase in carve-outs and spin-offs as a defining trend of Europe's M&A market over the next 12 months. An additional 19% see it as the second most important trend. While it's true that corporates have lots of cash, they are also carrying heavy debt loads. In Europe, this is compounded by the inflationary effects stemming from natural gas supply disruptions from the Ukraine conflict amid weakening economic growth, putting additional pressure on profit margins and the ability of companies to service their liabilities. Fitch Ratings in June revised its bonds and loans of concern upwards to 4.3% from 3.7%, driven by weakness in the real estate and consumer discretionary sectors.

PE to drive activity

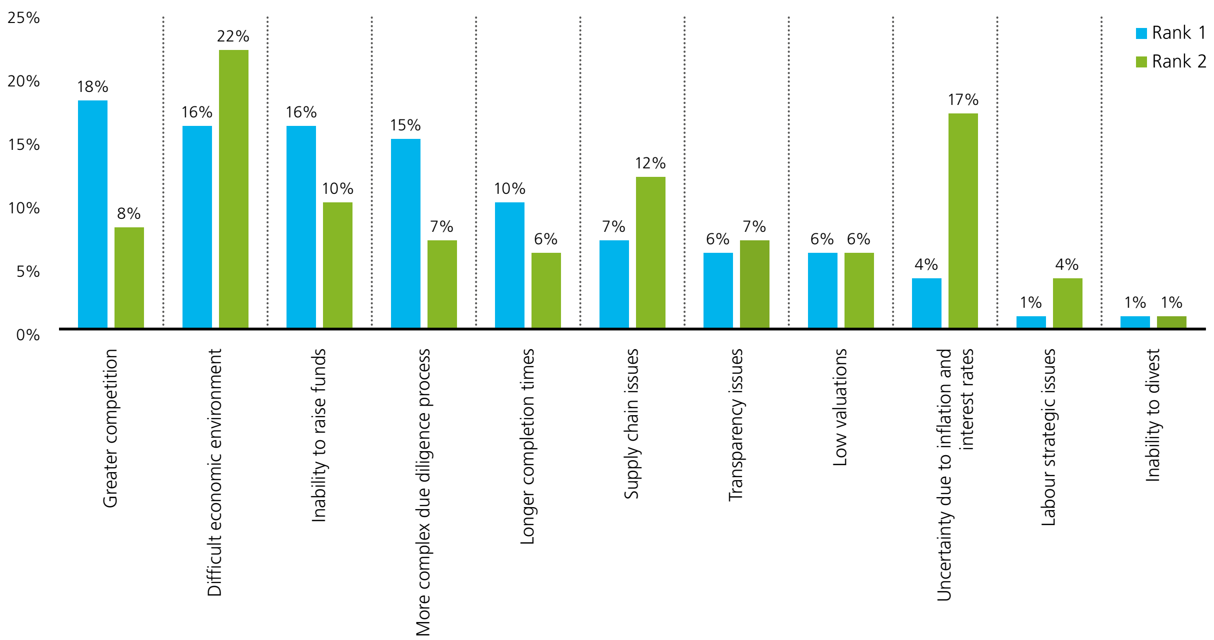
These headwinds have the potential to motivate more divestment activity from corporates as a means of raising capital. The natural buyers for corporate carve-outs are specialist PE funds with a track record of undertaking these complex transactions, which require delicately separating assets from their parents and accurately cleaving balance sheets while causing minimal disruption. And, as mentioned, the PE industry is stocked with capital commitments. Unsurprisingly, then, we find that 24% of respondents rank increased PE activity as the most important trend they expect to see in the next 12 months, slightly ahead of corporate disposals but with a smaller share of secondary votes at only 9%.

> The COVID scenario led many large corporations to implement a divestment strategy. This trend is significant and we will keep seeing opportunities popping up from companies selling non-core assets.
>
> *Ignacio Cerrato, CMS Spain*

What trends do you expect to see in European M&A in the next 12 months?
(Please select the two most important, 1 = most important, 2 = second most important)

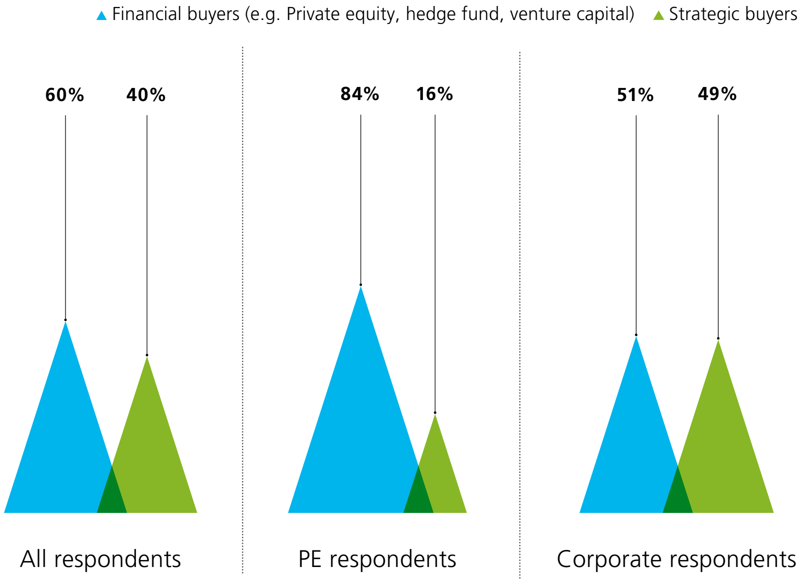


What challenges do you expect to see in European M&A in the next 12 months?
(Please select the two most important, 1 = most important, 2 = second most important)



Economic growth, or a lack thereof, is playing on the minds of M&A experts at this time. GDP across the EU is expected to expand by 2.7% in 2022 – this rate of expansion is expected to fall to 1.5% in 2023 and will be slightly lower in the eurozone. Russia's invasion of Ukraine has fed into rising food and energy costs and prompted a swifter than anticipated policy response from the ECB, dampening growth expectations. Overall, this more challenging economic environment is regarded as a top challenge in the coming 12 months, 16% of respondents viewing it as the most important roadblock and a further 22% seeing it as the number two obstacle. Greater competition for deals is also seen as a major challenge, with 18% flagging the issue. The asset devaluations over the first six months of 2022 combined with vast volumes of sidelined capital among PE funds mean that the deal environment is likely to be highly competitive, especially for high-quality businesses that have achieved growth in spite of more toilsome conditions that have manifested since the post-lockdown M&A boom in the second half of 2020 and through 2021.

Which of the following do you feel is better placed to take advantage of buying opportunities presented by the future political/economic climate?



The PE model is robust and flexible; underpinned by strong investments and an experienced cohort of professionals with a breadth of experience across multiple portfolios and sectors. As generally sector agnostic investors, PE is able to identify asset classes/sectors that have the best chance of withstanding the apparent coming economic storms.

Jason Zemmel, CMS UK

Corporate vs financial buyers

It is these financial sponsors that are expected to have the upper hand. Nearly two-thirds (60%) of all respondents say that financial buyers are better positioned to take advantage of today's uncertain political and economic climate. This mirrors last year's findings when a majority of M&A experts surveyed similarly saw sponsors as being better placed to take advantage of deal opportunities. However, this time last year 71% shared this view, which likely reflects today's tougher financing market. PE funds have the equity to transact but accessing credit to leverage the very largest of these buyouts will not be as forthcoming as it was 12 months ago – and where it is available it will come at a higher cost. Corporates are divided on PE's competitive advantage. There is an almost even split among these respondents over whether sponsors are better positioned. While it's true that PE funds have plenty of dry powder and the optionality of selecting from a wider pool of opportunities given their sector agnosticism, corporates can typically afford to bid a strategic premium over PE funds, owing to the cost synergy potential of mergers, a luxury that's not available to sponsors.

Most M&A players will have a clear view of the market again in the coming year and, accordingly, activity will pick up again. At the same time, we will most likely see a stronger selection on the sell-side settling in which should result in more suitors competing for targets.

Jacob Siebert, CMS Germany

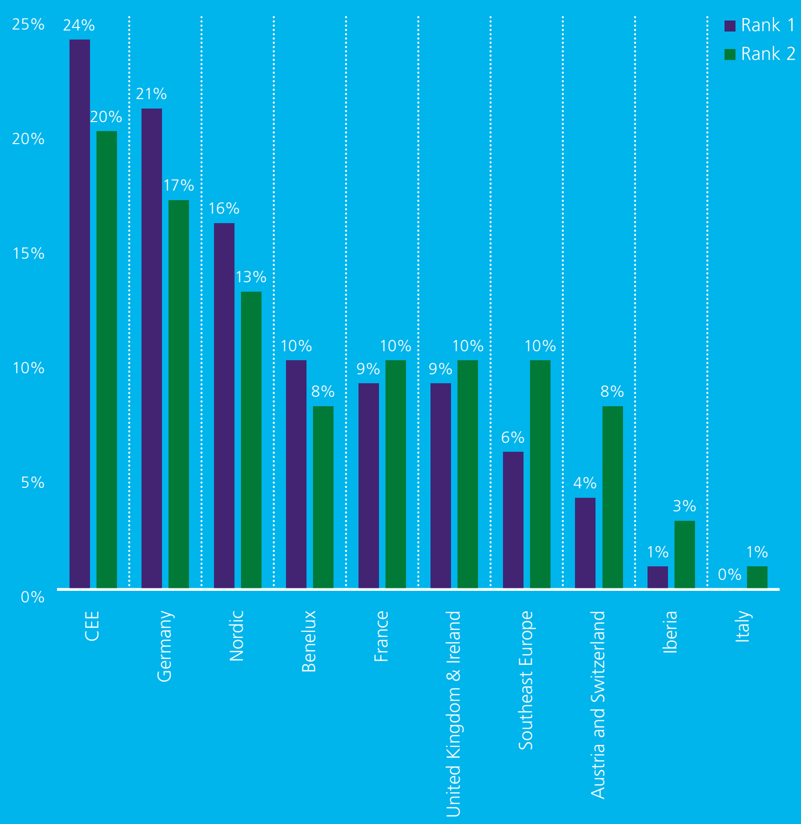
Focus on regions and sectors

The M&A market outlook in CEE is highly conflicted. The region stands out as being considered both the highest and lowest potential deal market in Europe in the months ahead. Nearly a quarter (24%) of respondents, the largest share, expect to see more deal growth in the CEE than anywhere else, while 19%, also the largest share, simultaneously see it being the weakest-performing M&A market in the region.

The likes of Estonia, Lithuania, Latvia and Poland have become hotbeds for foreign direct investments (FDI) in the past few years, but that has been threatened by recent events. Foreign investors are more likely to show a greater risk aversion to markets nearby to Ukraine given that the conflict has had an impact on neighbouring countries' economies. That's the bear case.

The bull case is that many CEE economies have been some of the fastest growing in Europe and the M&A market here is less mature, leaving further upside to capture. Deal value was down by 6% to

Which regions will see highest growth in the next 12 months? (Please select the two most affected, 1 = highest growth, 2 = second highest growth)



> Such different perceptions of economic prospects for the CEE region result mainly from uncertainties caused by the geopolitical situation. The Russian invasion in Ukraine is foremost an immense human tragedy, but it also adversely affects regional markets, which may experience a recession and prolonged periods of high inflation rates, as well as increased costs of capital. Many risk-averse investors are holding back their investment decisions or even withdrawing from CEE markets.
>
> *Rafal Zwierz, CMS Poland*

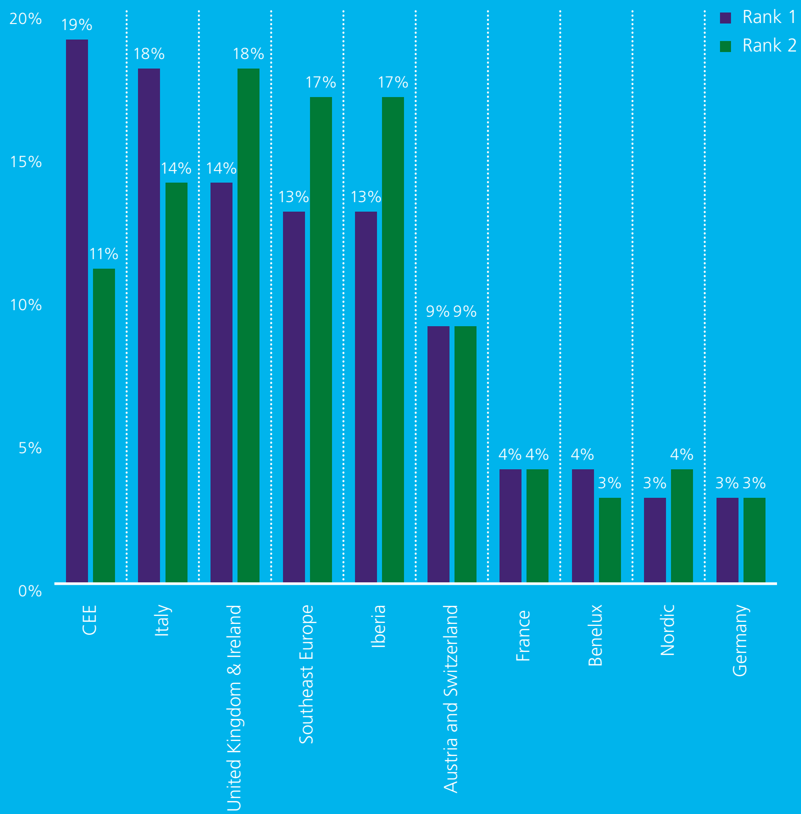
> The various crises, the war in Ukraine, the disruption of supply chains, and high inflation are weighing on Germany, especially given that it is an export-oriented economy. At the same time, Germany has enormous economic resources and opportunities, a robust labour market with very well-trained specialists, as well as legal and political stability.
>
> *Richard Mitterhuber, CMS Germany*

EUR 13.2bn in H1 2022, volume falling by 8% to 322. This contrasts with a year-on-year decline of 1% in aggregate value to EUR 529.2bn overall in Europe, albeit volume slipped by a comparable level of 8%, to 5,536 deals.

Germany is seen as another favourite for deal activity: 21% of respondents rank it at the top, while an additional 17% cite it as the area that will see the second-highest growth. Just over 4.5% of global M&A volume took place in Germany in H1, in line with previous periods, though there was some slight softening in the second quarter back to pre-pandemic levels. This is impressive considering the ongoing energy crisis, the country being one of the most dependent on Russian gas on the continent along with Italy. Real disposable incomes of households will suffer, and companies will have increasing difficulty in dealing with higher input costs from strained energy supplies, putting corporate profit margins under pressure.

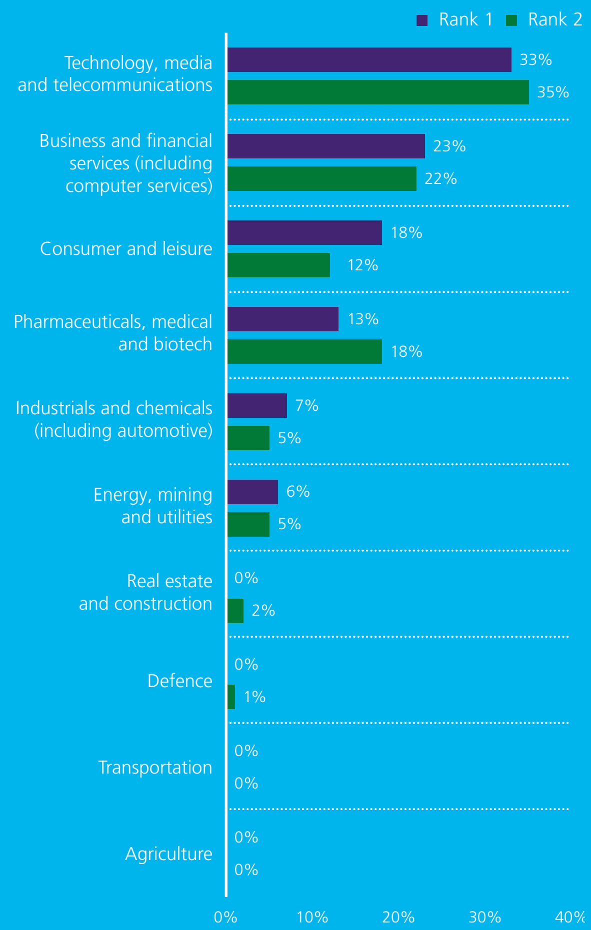
Italy is seen as the likeliest to be the weakest performer in the region – 18% of respondents believe it will see the slowest deal growth in Europe over the next 12 months. Italy's prospects have not only, like Germany, been upset by its energy travails; its fiscal crisis makes it one of the most vulnerable economies in the eurozone. The ECB has introduced an anti-fragmentation tool to suppress Italy's government

Which regions will see lowest growth in the next 12 months? (Please select the two most affected, 1 = lowest growth, 2 = second lowest growth)

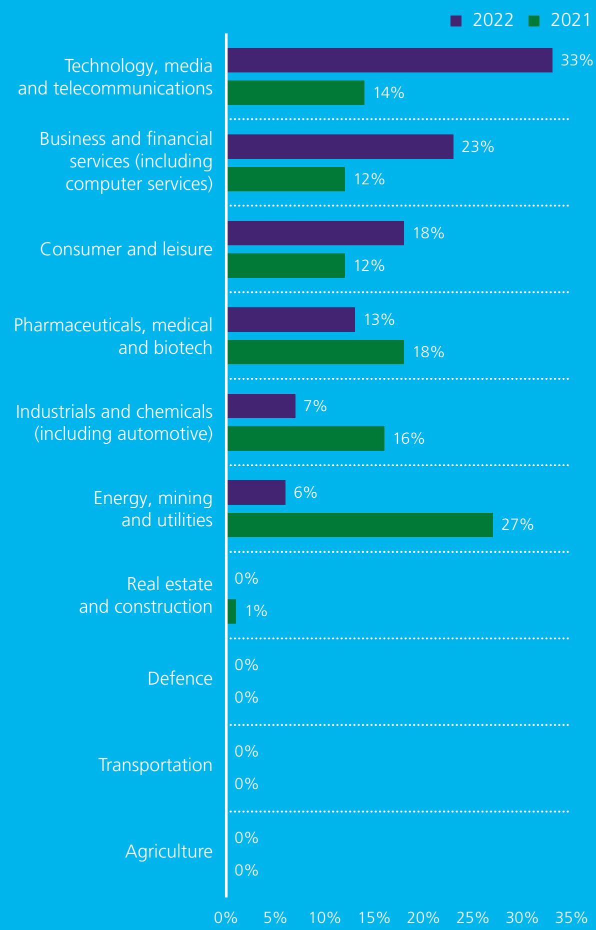


> The output growth in Italy in the second quarter of 2022 proved to be more resilient than expected. Output growth for 2023 is estimated to be lower due to gas supply disruption, inflation hitting households' purchasing power, rising funding costs, and the collapse of the Draghi government, whose reforms should at least leave Italy's economy in better shape to weather these challenges.
>
> *Daniela Murer, CMS Italy*

Which sectors will see highest growth in the next 12 months? (Please select the two most affected, 1 = highest growth, 2 = second highest growth)



Which sectors will see highest growth in the next 12 months? (Highest growth only)



bond yield spreads from widening, making the central bank the net buyer of the country's sovereign debt.

TMT reigns supreme

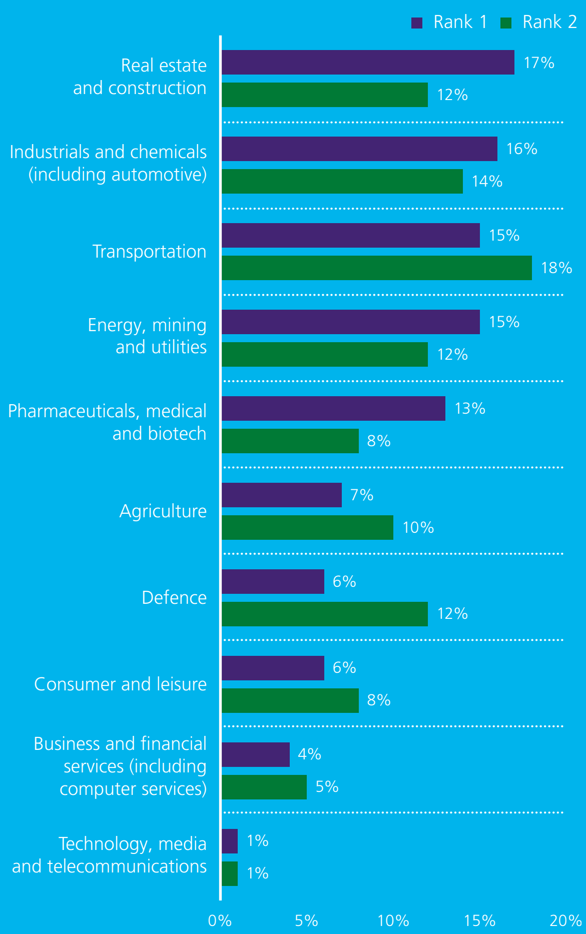
Acquirers are more upbeat on TMT than any other sector, which is justified given that it has consistently claimed the largest share of M&A value in Europe over the past decade, correlating with increasing rates of digitalisation and connectivity. A third (33%) of respondents expect it to see the highest growth over the next 12 months, a further 35% anticipating it to be the sector which delivers the second-highest growth. In Europe, the telecoms industry tends to make an outsized contribution to aggregate TMT value and this was the case in H1. Mobile network operator Orange sold its Spanish business to compatriot competitor Masmovil for EUR 7.8bn in March. Europe's telecom industry remains highly localised and ripe for consolidation, which should deliver yet more deals.

EMU and real estate under pressure

There has been a major deviation from last year, when 27% of respondents expected the energy, mining and utilities (EMU) sector to deliver the most growth over 2021–2022. That has since fallen to just 6%. From a profitability perspective, EMU companies have been thriving since the pandemic and lockdowns threw supply and demand out of equilibrium. Energy prices boomed and oil and gas producers and utilities have enjoyed windfall earnings, making capital available for transformative deals as Europe takes decisive action towards its net-zero goals. However, those ambitions have been thwarted by the Ukraine conflict making short-term capital allocation less certain. Germany, however, is now regressing to refiring up coal plants and lawmakers recently settled on defining investments into natural gas and nuclear energy as climate-friendly under the EU taxonomy, moving the goalposts for investors.

Real estate and construction is ranked as the sector which will see the lowest growth by 17% of respondents. This area of the economy does not perform well amid rising interest rates given that higher financing costs discourage buyers from taking loans to purchase properties, dragging on asset prices. However, there are always exceptions. The second-largest M&A deal of H1 in Europe saw Blackstone Group pass Dutch warehousing company Mileway from one fund to a longer-term vehicle in a EUR 21bn transaction. As supply chain frictions persist, high-quality logistics properties will be in high demand and canny investors will make selective bets in commercial real estate where they see opportunity.

Which sectors will see lowest growth in the next 12 months? (Please select the two most affected, 1 = lowest growth, 2 = second lowest growth)



M&A in a global context

Global M&A underperformed in the first half, deal value slumping by 20% to USD 2.3trn compared with Europe matching last year's showing. This was driven by a material weakness in transactions in emerging markets in Latin America, the Middle East and Africa. Acquirers have pulled back on FDI in recent months, becoming more risk averse as inflation in many cases erodes profit margins and the economic outlook deteriorates. Volume-wise, global dealmaking fell at a steeper rate than in Europe, down by 14% to 12,705 deals.

There was a notable softening in market activity in Q2, deal count slipping by 13% quarter-on-quarter. While far from a precipitous decline, this is something to watch since historically the second quarter of the year has outperformed the first quarter.

As was expected, global M&A was defined by the US market and its unrivalled technology sector. The largest deal announced in H1 was Microsoft's proposed acquisition of video game developer Activision Blizzard for USD 75.1bn. It remains to be seen whether the deal is successful. The Federal Trade Commission is reviewing the deal for potential labour and consumer data impacts and the stock market appears to be betting against the bid being approved, with Activision's share price languishing below the offer price.

> The data clearly shows optimism for M&A in H2. Inflation, rising interest rates and the Ukraine war combined to surprise and stifle M&A activity in H1, but dealmakers constantly re-adjust to their environment. As buyers and sellers adjust, the gap between buyside/sellside valuation expectations should close, and M&A activity should increase. Indeed, that triple combination may require some businesses to accelerate their M&A processes.
>
> *Tom Jameson, CMS UK*

In a similarly impressive bid, semiconductor manufacturer Broadcom offered USD 71.6bn for cloud software group VMware, which it hopes to integrate with its own enterprise software business. Global semiconductor M&A is trending up, with a total of 71 deals in the first quarter of 2022 – the highest of any quarter on Mergermarket record (since 2006).

With the passing of the CHIPS and Science Act of 2022 in the US, this trend could accelerate. The act prohibits funding recipients from expanding semiconductor manufacturing in China and countries defined by US law as posing a national security threat. A total of USD 52.7bn in federal subsidies have been allocated to support at-home chip manufacturing. While much of this is earmarked for semiconductor fabrication plants, the additional funding may free up capital for domestic M&A investment.

Regardless, the US tech space continues to dominate. One in every five dollars invested in global M&A in the first half of 2022 was in the country's TMT sector. This is despite the devaluation in tech assets that came from the major sell-off in long duration growth stocks over the period. Technology continues to be the fundamental driver of economic growth, increasing productivity against demographic headwinds. Indeed, the long-term impact of tech is deflationary as it enables the efficient scaling of goods and services production. At a time when inflation has run to levels not seen for decades, the industry could not be more relevant.

Deal dynamics and motivations

Despite a pull-back in M&A volumes and a far more challenging deal environment, the vast majority of survey respondents are eager to transact

Top findings

88%
are currently considering M&A

31%
find labour and employment rules to be the most challenging type of regulations

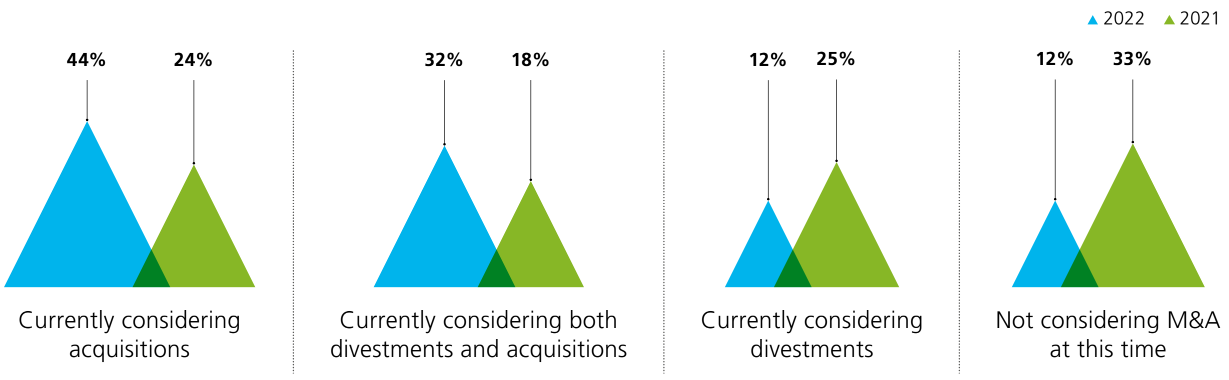
12%
are not considering M&A at this time – compared to 33% in last year's survey

20%
of those considering M&A are motivated by distressed/turnaround opportunities

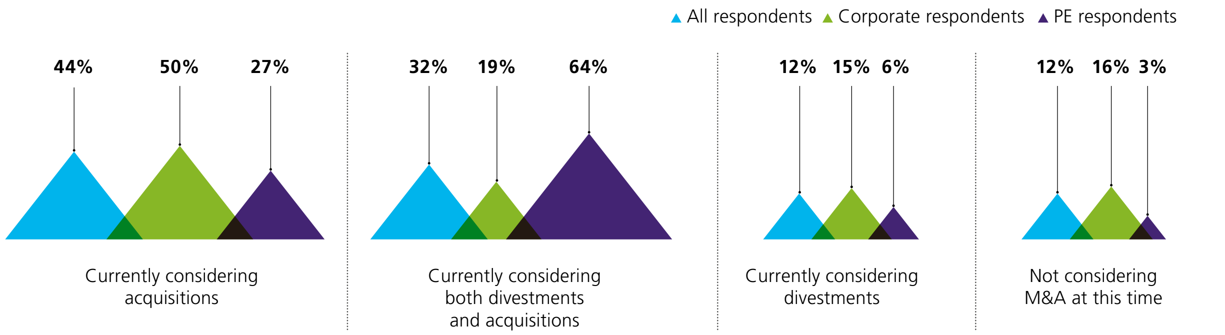
The vast majority of buyers are considering moving on deals right now, 88% of respondents signalling their intention to transact. Over the past two years confidence has built. Back in Q2 of 2020, at the onset of the pandemic, only a third of investors (35%) were contemplating M&A, a figure that doubled (67%) by the same time last year. The immediate impacts of the pandemic have since receded and although the domino effect of inflation stemming from lockdowns and unbridled monetary and fiscal stimulus is now dragging on the economy, dealmakers are more heavily front-footed.

> We are still seeing a very active market, but after a long period in which M&A was driven by a seller's market, we have now seen a few investors pulling out of transactions since they believe that current challenges will shift the sentiment to a buyer's market.
>
> *Stefan Brunnschweiler, CMS Switzerland*

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



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



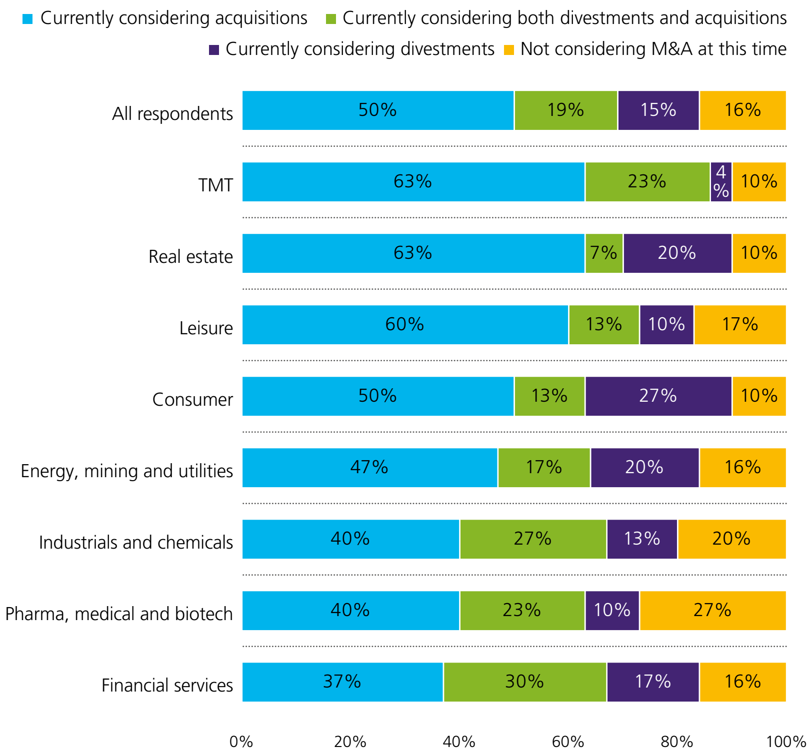
Tellingly, half of corporate respondents say they are considering acquisitions only, an indication that now is a buyer's market. Only 15% say they are solely considering divestments. Unless absolutely necessary, to raise cash or pay down debts, strategics will have less impulse to sell now than a year ago and may be waiting for greater market certainty before choosing to divest.

Deal incentives are very different for PE funds. Although sponsors may lean more heavily into new deals or exits depending on the macro and market climate, on average they are neither net buyers nor sellers; rather they constantly sow and harvest capital. True to these dynamics, 64% of PE firms surveyed say they are considering both purchases and exits, compared with only 19% of corporates who are in the same boat.

TMT and real estate are feeling acquisitive

The TMT sector is showing itself once again to be a hot prospect. Not only is this where respondents

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



see the greatest potential for deal growth in Europe, respondents from the sector are also prepared to be active. Nearly two-thirds (63%) say they are considering acquisitions, a further 23% having an eye on both acquisitions and divestments.

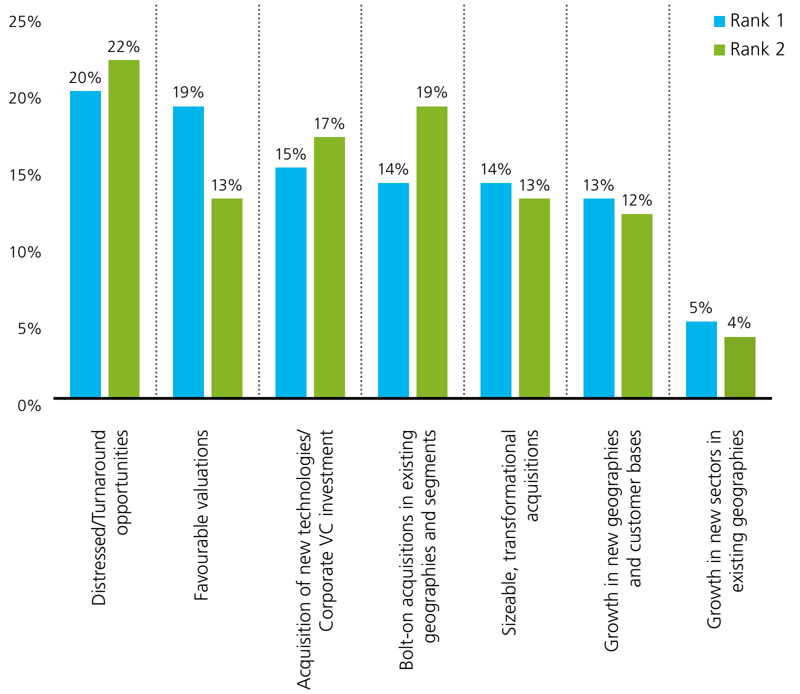
In a surprise finding, although real estate is seen by respondents as among the least likely to witness growth in the coming 12 months, 63% of respondents from the sector say they are expecting to make acquisitions. The sector is receiving considerable renewed interest from investors, especially when it comes to specialist firms like warehousing, data centres and healthcare assets. Blackstone's recapitalisation of Mileway – one of the largest transactions announced so far this year in Europe – is a case in point. Investors looking for steady returns are turning to established players in the industry as platforms for buy-and-build deals.

Sluggish growth in residential and office properties could lead to consolidation as well. The merger between two large German real estate investment trusts (REITs), Vonovia and Deutsche Wohnen, in 2021 could catalyse further activity among residential REITs.

Distress signals

Consistent with expectations of sell-side M&A drivers covered earlier in this report, 20% of respondents considering acquisitions see distressed/turnaround opportunities as the biggest motivation for their own dealmaking activity, while 22% see it as the second most important motivation. Again, this speaks to the shift in monetary and macro conditions, with businesses facing higher financing costs at the same time that growth is slowing. It is atypical for central banks to adopt more hawkish policy amid decelerating growth and is a function of inflation being

If you are considering acquisitions in Europe, what is the motivation for this? (Please select the two most important, 1 = most important, 2 = second most important)

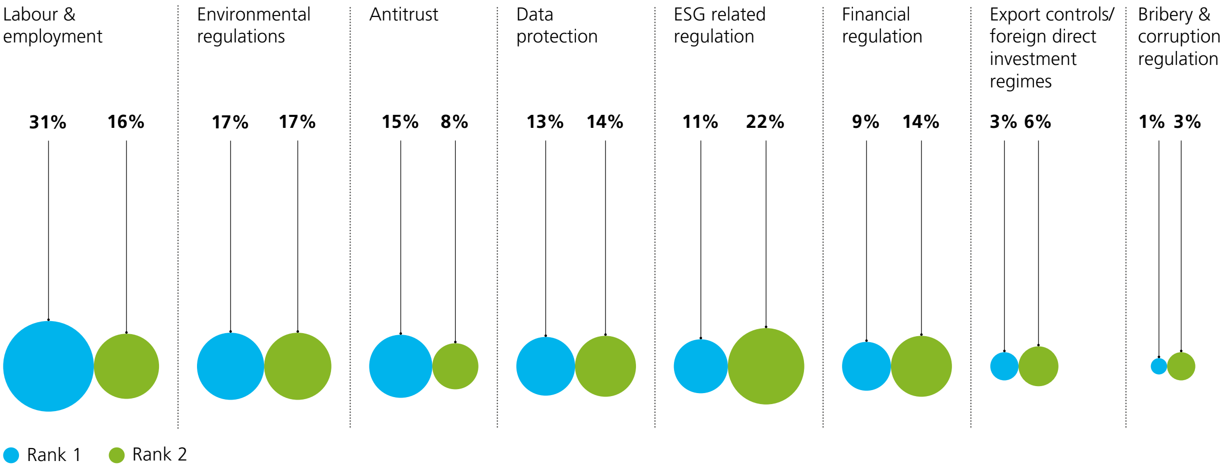


> Given the turbulent climate, an increased focus on preserving value and position will be inevitable. However, this is not necessarily to the exclusion of an offensive approach to M&A, as businesses will be looking to implement a range of strategies and many motivating factors that have gained some favour among respondents this year are on the offensive spectrum.
>
> *Valentina Santambrogio, CMS UK*

the principal policy priority at this time. This is a major change from last year's survey, when distressed opportunities was chosen by only 10% of respondents as the top motivating factor for their forthcoming deals.

This year's survey saw a slight uptick in the number of respondents who say that they are motivated by growth in new geographies and customer bases, up from 11% to 13%. Intra-European dealmaking benefits from the harmonised regulatory landscape and, within the eurozone, the shared currency. And acquisitions of businesses in other countries can help to strengthen fraught supply chains by bringing vendors under ownership. However, the responders we surveyed report having less appetite for cross-border M&A, instead taking an opportunistic view on distressed situations.

Which form of regulation do you find most challenging when doing a deal in Europe? (Please select the two most important, 1 = most important, 2 = second most important)



Rules and regulations

ESG rules and regulations are increasing in scope in Europe, which on a policymaking front is leading the world in realising its net-zero future ambitions. We find that 17% of respondents cite environmental regulations as being the most challenging type of regulation in Europe while 11% see the broader scope of ESG regulation as the most onerous.

But it is labour and employment regulation that respondents find most challenging – 31% of respondents rank it as the most important, while an additional 16% rank it second. In practice, ESG and labour risks are close bedfellows. The European Commission's proposed Directive on Corporate Sustainability Due Diligence, for instance, includes a focus on labour standards and potential human rights abuses that exist in supply chains. While the 'E' in ESG has attracted much of the attention and conversation around sustainability to date, there are signs that the social and human element is now coming into sharper focus.

> Most European countries started to rapidly change employment regulations as a result of a post-COVID-19 push from the market and employees to work remotely or in a hybrid model. Also, old-fashioned regulations are not able to keep up with the new reality. A few countries have used the situation to attempt to review and change labour codes. This has made the overall situation unknown and unpredictable.

Katarzyna Dulewicz, CMS Poland

> Changes in the type of M&A activity likely explains why antitrust is as pressing a concern compared to previous years. If recent or projected deals are mostly investments in new geographies or sectors, with limited overlaps between parties, antitrust is unlikely to be a challenge. The comparative rise of other regulation may also have contributed.

Jacqueline Vallat, CMS UK

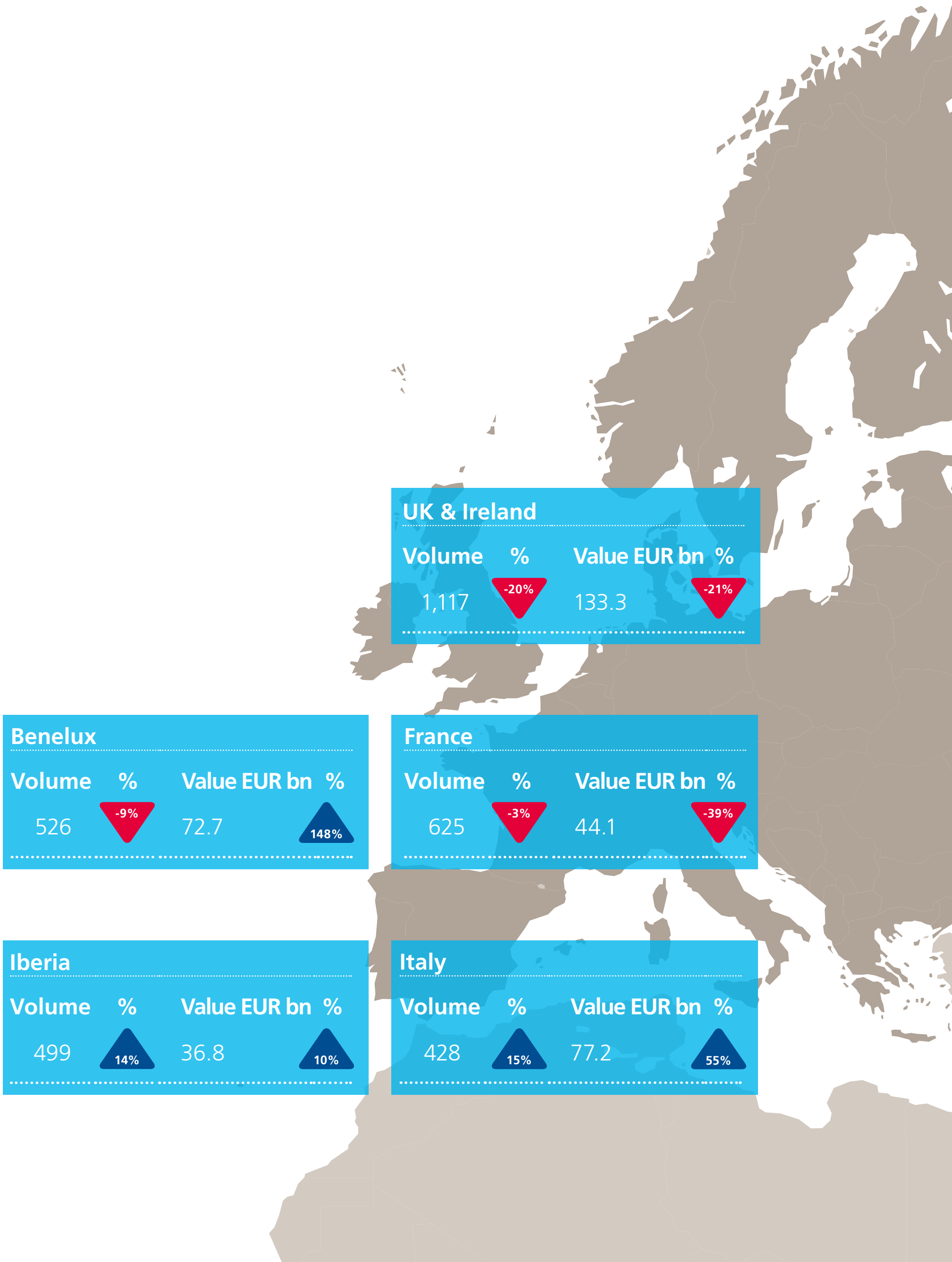
Regional round-up

M&A activity in Europe maintained a strong level of activity in the first half of 2022.

Total deal value ticked up by 1% compared to the same period the previous year, while the number of deals dropped by 8% year-on-year.

The UK & Ireland remains the region's lead market, accounting for 25.2% of total deal value and 20.2% of total deal volume.

Italy and Benelux were the next most important markets, contributing 14.6% and 13.7%, respectively, of Europe's aggregate deal value. The Nordics, meanwhile, accounted for an impressive 17.4% of total deal volume.



Nordics

Volume	%	Value EUR bn	%
962	-11%	56.3	7%

Russia & Ukraine

Volume	%	Value EUR bn	%
91	10%	4.3	-71%

Germany

Volume	%	Value EUR bn	%
640	-9%	41.6	-21%

CEE

Volume	%	Value EUR bn	%
322	-8%	13.2	-6%

Austria & Switzerland

Volume	%	Value EUR bn	%
203	-19%	39.1	62%

SEE

Volume	%	Value EUR bn	%
118	11%	10.4	9%

This infographic compares H1 2021 with H1 2022

Foreign direct investment environment

FDI rebounded in 2021 on the strength of the global economic recovery. According to the United Nations Conference on Trade and Development (UNCTAD), FDI reached USD 1.58trn last year, back to pre-pandemic levels.

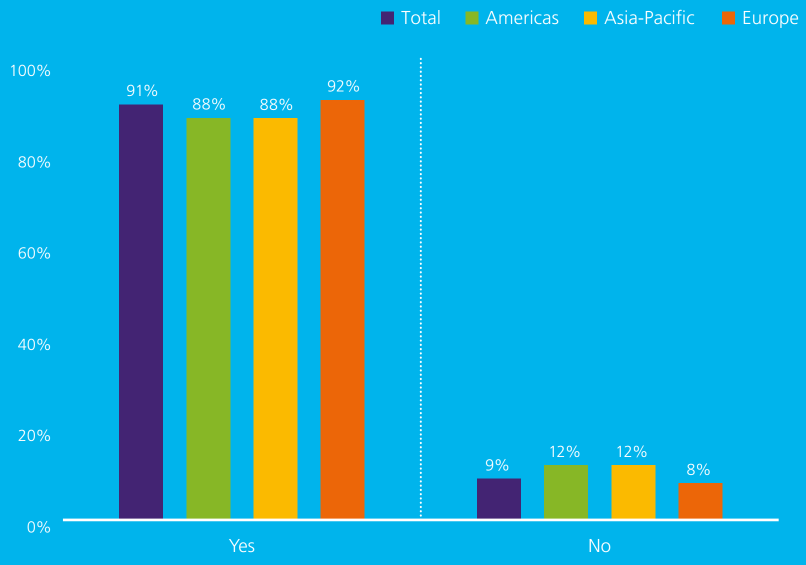
This recovery was fuelled by the unprecedented boom in M&A activity coupled with rapid growth in international project finance due to loose financing conditions, and major infrastructure stimulus packages. However, the body has cautioned that this activity is unlikely to be sustained through 2022.

Conditions have very much changed since last year, with geopolitical risks and their consequent impact on food and fuel prices likely to dampen appetite for cross-border investment, particularly in exposed countries. In Europe, this is likely to encompass nations in the eastern part of the continent which are in closer proximity to the conflict in Ukraine and which are showing the highest rates of inflation.

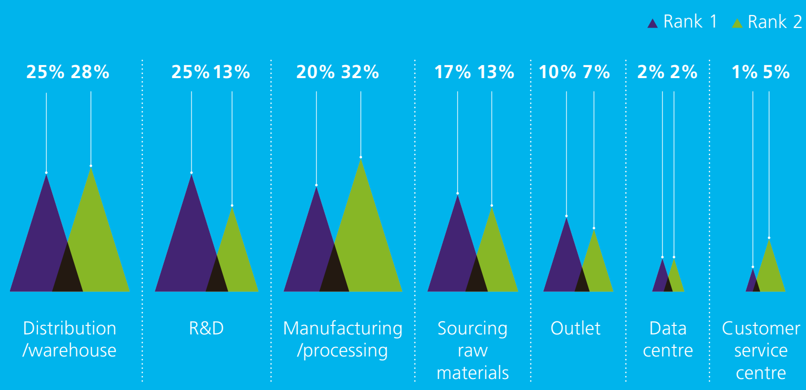
Even so, investors are committed to Europe as a whole: 88% of respondents based in the Americas and Asia-Pacific are planning to invest in Europe in the next three years. This is up substantially from the 58% and 48% of respondents based in the Americas and Asia-Pacific, respectively, who said the same in last year's poll.

There is strong motivation for this in light of the mass disruption to supply chains, both caused by pandemic lockdowns and more recently exacerbated by the Ukraine

In the next 3 years, are you planning to invest in Europe?



What type of facility is your organisation planning to build overseas? (Please select the two most important, 1 = most important, 2 = second most important)



war. This is reflected in investor sentiment, building overseas distribution and warehousing being the most widely cited type of facility that respondents are planning to build abroad, with 25% citing this as a first choice and 28% as a second choice, ahead of any other capex project. R&D facilities also ranked highly, tying first place with warehousing as a first choice, but only 13% reporting it as a second-choice investment.

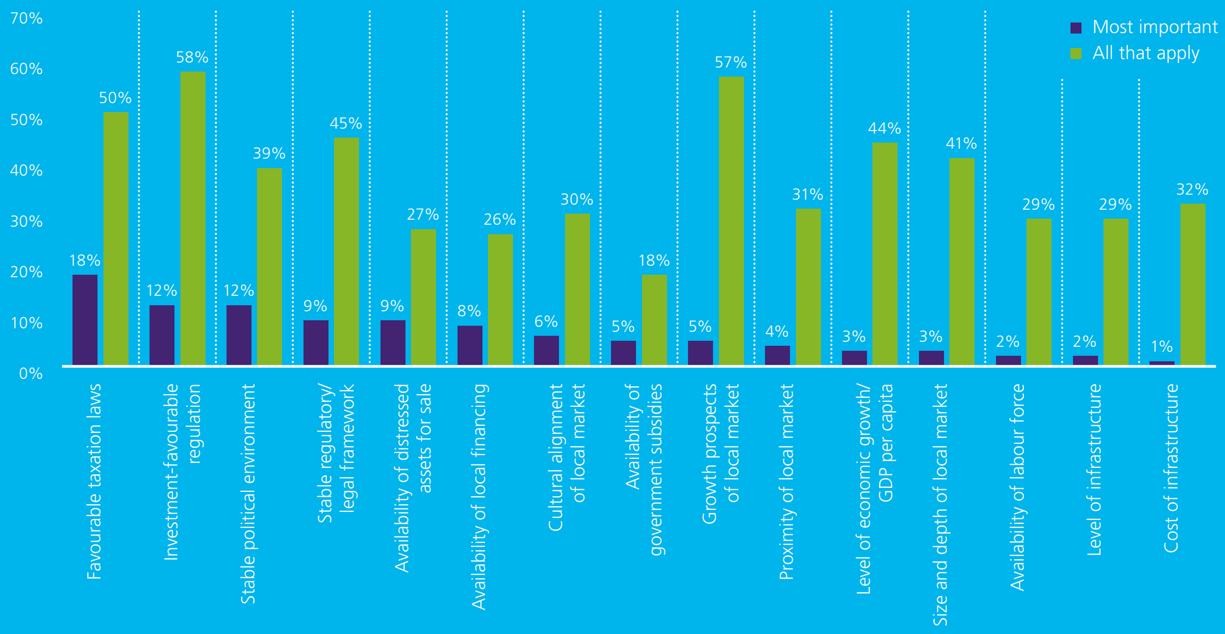
Tax matters

The most important factor when choosing investments outside of their home country is favourable taxation laws, receiving 18% of the vote, followed by a stable political environment and investment-

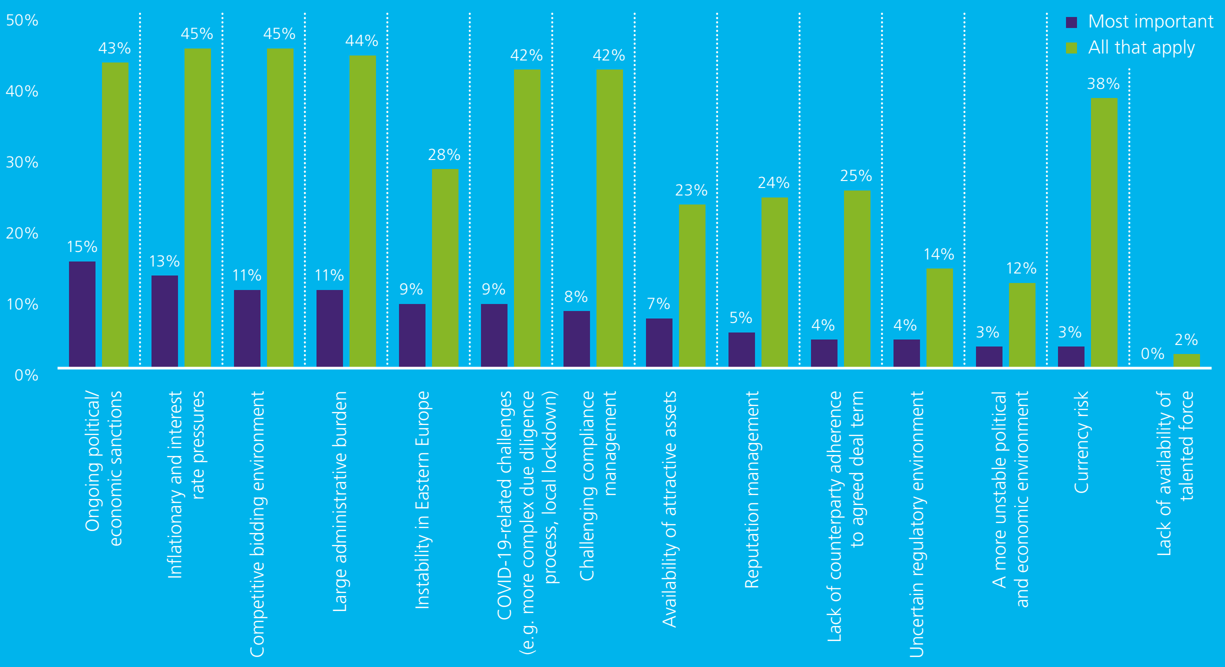
> Tax revenue as percentage of GDP has been increasing across the EU in recent years and as a response to the recession caused by the COVID pandemic, various jurisdictions have introduced tax reforms designed to maintain tax revenue levels while supporting investment and economic growth.
>
> *Sam Dames, CMS UK*

> After a decade of low interest rates and rising valuations, the new market conditions of higher inflation and interest rates have been disruptive for deal valuations. In the short term, the disruption is negative, with debt financings acquisitions becoming more expensive and inflation cutting into the real rate of return on investments.
>
> *Helen Rodwell, CMS Czech Republic*

What are the factors that will most impact your choice of investment(s) outside your home country?



What do you expect will be the biggest risks to investing in your country of choice?



favourable regulation, each with 12%. Tax implications are clearly important when investing overseas as they can have a huge bearing on the fundamental cost-benefit of the investment. All else being equal, a lower tax regime will attract more foreign business, especially those involved in lightly regulated services with no physical goods to freight.

This is a departure from last year, when only 5% saw favourable taxation as the top factor when choosing investments abroad. Instead, investors at the time cited the level of economic growth in the destination country as the priority deciding factor when choosing a destination country, which is now a priority for only 3% of respondents. Since then global GDP forecasts have been revised downwards amid rampant inflation, closing the gap between markets. For example, Europe and the US are broadly expected to grow at the same pace in 2022, making GDP performance less of a determinative factor.

Risk considerations

The current key-risk consideration for cross-border investment is ongoing political and economic sanctions, which have stemmed from the ongoing war in Ukraine: 15% of respondents flag this as their top risk. Unsurprisingly, this is followed closely by inflationary and interest rate pressures, cited by 13%. Russia is clearly off limits for investment, but acquirers have to think carefully about the 'predominance' of revenues their assets derive from the country, which is likely to be a bigger concern for Eastern European deals. Incidentally, it is also these countries that are experiencing some of the highest rates of inflation on the continent. In June, Poland, arguably one of the most compelling and investable countries in the CEE, saw prices increase by 15.5% year-on-year versus an EU average of 8.6%.

> We see nearly every international M&A transaction being affected by sanctions: negotiations about warranty catalogues regarding compliance with sanctions regimes, carving out of Russia-related business or time-consuming clearances with investment control authorities.

Błażej Zagórski, CMS Poland

ESG factors in European M&A

The importance of ESG in M&A has increased exponentially in the past few years – but scrutiny of ESG issues is only set to grow further

Top findings

90%
expect scrutiny of ESG issues to increase in the next three years

59%
say the EU's proposed directive on corporate sustainability due diligence will be positive for M&A

28%
think workplace diversity is the top ESG concern for their firm and their investor base

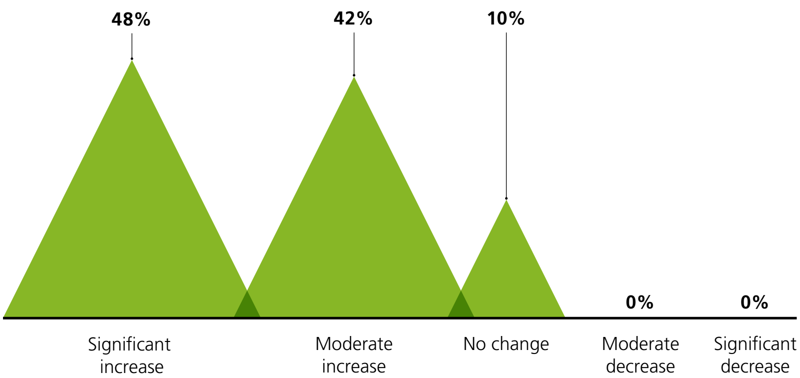
18%
see climate change/ greenhouse gas emissions as the most important priority

Europe is taking the lead on ESG, and while much progress has already been made relative to other territories, an overwhelming majority of investors expect scrutiny of these issues to continue increasing from here. As much as 90% of respondents anticipate ESG coming under closer focus in their dealmaking over the next three years, compared with 72% in last year's survey. Further driving this point home, the proportion of respondents expecting ESG scrutiny to significantly increase has nearly doubled to 48% from 26% 12 months ago. The trend could not be clearer.

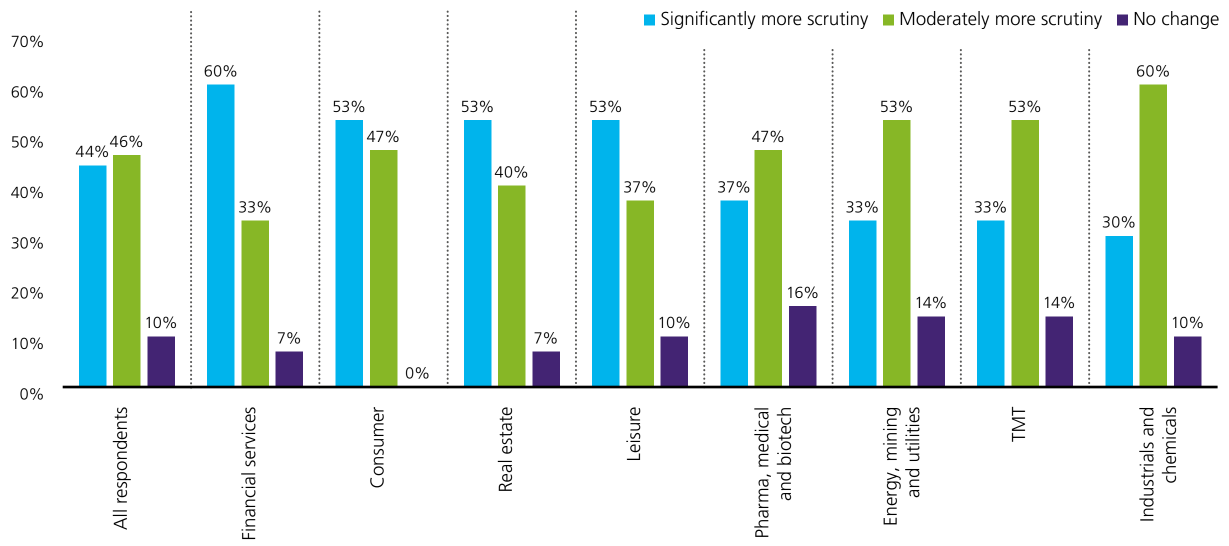
> One of the key drivers behind the massive adoption of ESG in M&A is that companies increasingly need to be sustainable in order to obtain or maintain social licence to operate. The regulatory wave coming from all over the world – but especially Europe – is huge as well and is bringing many trends to the forefront of corporate strategy making.

Döne Yalçın, CMS Turkey

How do you expect ESG scrutiny to change in deals over the next three years?



How do you expect due diligence to change in terms of ESG factors in transactions in the next three years?



And it is within financial services that deals are expected to be subjected to significantly more scrutiny during due diligence in the coming three years. As much as 60% of respondents in the sector forecast this trend, ahead of any other industry. At the other end of the spectrum, respondents in the industrials and chemicals sector were the least likely to expect significant change in this respect, with only 30% of respondents saying so.

A core part of these deal reviews will be due diligence. Financial services businesses are among the world's most heavily regulated organisations, especially since the global financial crisis as regulators sought to improve banks and other institutions' capital positions to prevent another credit collapse and bail-out scenario. Since then, the industry in Europe has had to contend with greater oversight, with an increasing focus on ESG. In January, a number of authorities including the ECB and the UK's Prudential Regulation Authority set out their supervisory priorities,

> Though regulatory pressure has brought ESG from a niche into the spotlight, the strategic value of an ESG assessment as a core aspect of the M&A due diligence process has often been underestimated. Given widespread low standards, ESG ratings aren't suitable to get a clear benchmark on ESG and replace ESG due diligence. Materiality is key, as ESG risks are manifold.
>
> *Petra Schaffner, CMS Germany*

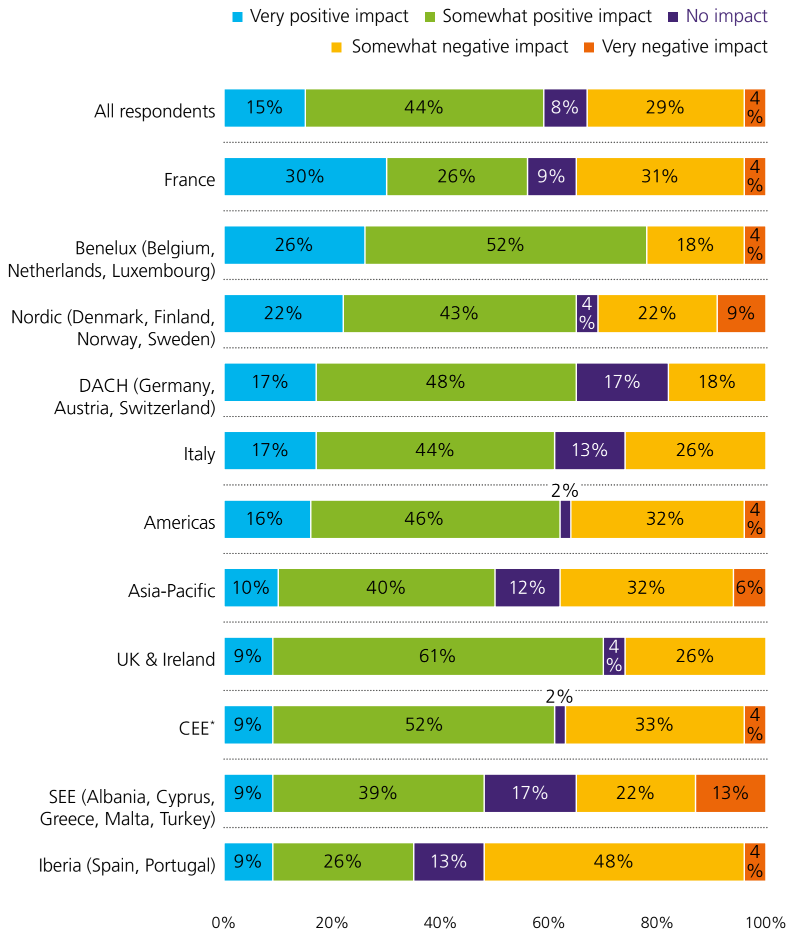
including expectations for firms to monitor and manage climate-related financial risks. A month later and the European Securities and Markets Authority (ESMA) published its three-year roadmap for sustainable finance.

Corporate sustainability due diligence

The European Commission (EC), meanwhile, is proposing a Directive on Corporate Sustainability Due Diligence that would compel companies across all industries to carry out due diligence across their supply chains to identify indirect adverse human rights and environmental impacts of their business. The proposal envisions obligating companies by law to take action to mitigate any undesirable impacts and embed sustainability and human rights considerations into their corporate governance and management systems. This would not only apply directly but also to their supplier networks. The directive is expected to apply to companies with a net turnover in the EU of EUR 40m or more.

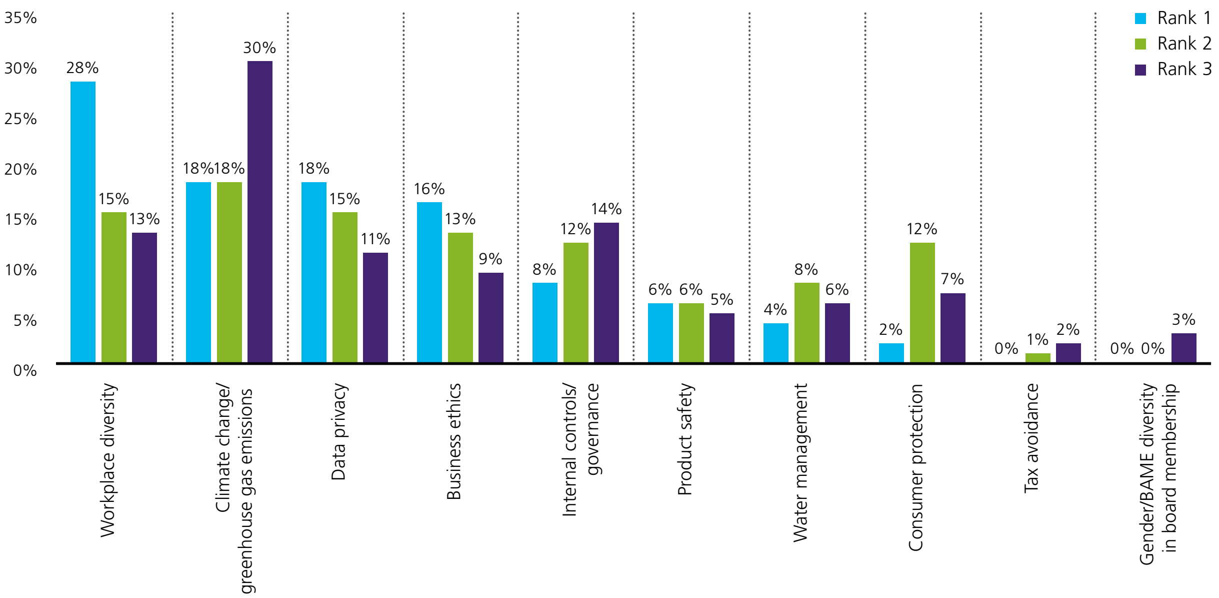
Respondents across Europe mostly believe that the EC's proposal would have a positive impact on M&A. More than half (59%) believe it would have a positive impact – this includes 15% who see the impact as being very positive. France is a frontrunner, with 30% of respondents from the country expecting a positive impact, higher than any other country. This coincides with France having passed its Corporate Duty of Vigilance Law back in 2017, which the EC's proposal closely mirrors. That means large French corporates are likely already compliant with the proposal and have the security of knowing that similarly sized companies they may choose to acquire have also done the work to identify and mitigate supply chain sustainability risks. Respondents in Iberia, meanwhile, take a far dimmer view: 52% of respondents in

To what extent do you think the recent Proposal for a Directive to tackle human rights and environmental impacts across the global value chain issued by the European Commission in February 2022 will impact M&A dealmaking?



> Companies are under a collective pressure to observe ESG requirements and buyers carrying out their due diligence want to be aware of the target company's compliance with those obligations in order to understand what lies ahead for the post-acquisition integration process. Given that ESG due diligence is at an early stage and absent of any general standards, one of the challenges consists in obtaining a gap analysis of the target's ESG situation.
>
> *Dietmar Zischg, CMS Italy*

Which ESG issues are most important to your firm and your current investor base? (Rank from 1 to 3, where 1 = most important)



the region expect a negative impact, the highest proportion, compared with 33% across geographies.

Not only do respondents expect greater regulation with regard to ESG when it comes to day-to-day activities, they are also expecting that due diligence of their M&A transactions will involve greater scrutiny of ESG factors as well. Nine out of ten respondents say they expect due diligence of ESG factors will receive more scrutiny – this includes 44% who believe it would receive significantly more scrutiny.

With the growing focus on ESG among corporate stakeholders, expectations for diverse workforces and an inclusive working culture have become common boardroom topics. Businesses need to ensure the `G´ in ESG includes diversity and inclusion measurement resulting in better business outcomes on the long term. Whereas five years ago it seemed like a distant prospect, these topics have now become a topic that no successful company can afford to ignore. Not only is there an exponential increase in legislative initiatives, but awareness among stakeholders is also pushing companies to put governance items such as a diverse workforce at the top of their agenda.

Virginie Fremat, CMS Belgium

Tightening financing conditions

After years of unusually benign conditions, financing is tightening up in Europe and around the world

Top findings

87%
of respondents believe that financing conditions will be more difficult

40%
think that private equity will be the most available source of financing in the next 12 months

18%
say that company performance will be the greatest challenge to financing

22%
rank geopolitical conficts as the second most important challenge to financing

Monetary conditions are tightening in Europe and across a number of fronts, as the ECB attempts to gain a handle on roaring inflation. In July the central bank began phasing out collateral easing measures introduced in April 2020 to cushion economies as the pandemic spread across the region. The measure opened banks' access to liquidity by allowing them to post weaker assets as collateral for borrowing from the ECB, mobilising an additional EUR 240bn. Also in July, the central bank raised interest rates for the first time since 2011, the base rate being moved up by 0.5 percentage points, above expectations of a 0.25 point hike. The ECB has been following in the footsteps of the US Federal Reserve and Bank of England, which had begun raising their rates earlier. Further increases are expected through the remainder of the year.

In a further tightening of conditions, the ECB has also decided to conclude its net Asset Purchase Programme (APP) used to backstop borrowing markets. Bond buying under the ECB's EUR 1.85trn Pandemic Emergency Purchase Programme (PEPP) ended in March. However, purchases under the older APP were being used as a bridge through the end of the PEPP.

Tougher financing and unequal access
All of this is making borrowing more costly and less readily accessible, a fact that respondents are keenly aware of. No less than 87% say they expect financing market conditions to be tougher in 2022 compared with 2021, including 45% who expect them to be much harder. Hammering home this reality, not a single respondent believes that financing conditions will be easier through 2022 than in 2021.

This access will not be uniform, of course. Corporates with solid balance sheets that are managing to achieve growth amid the economic slowdown and carry higher credit ratings should have relatively less trouble accessing financing. This is especially true for those whose strategies are well understood by the market, benefit from riding secular tailwinds such as the energy transition and have found previous support from debt markets or high demand for past follow-on equity issuance.

But laggards that were able to tap markets for capital with relative ease in 2021 are sure to struggle. Even otherwise solid performers that have seen their stock prices plummet in 2022 will not be incentivised to issue equity at beaten-down valuations.

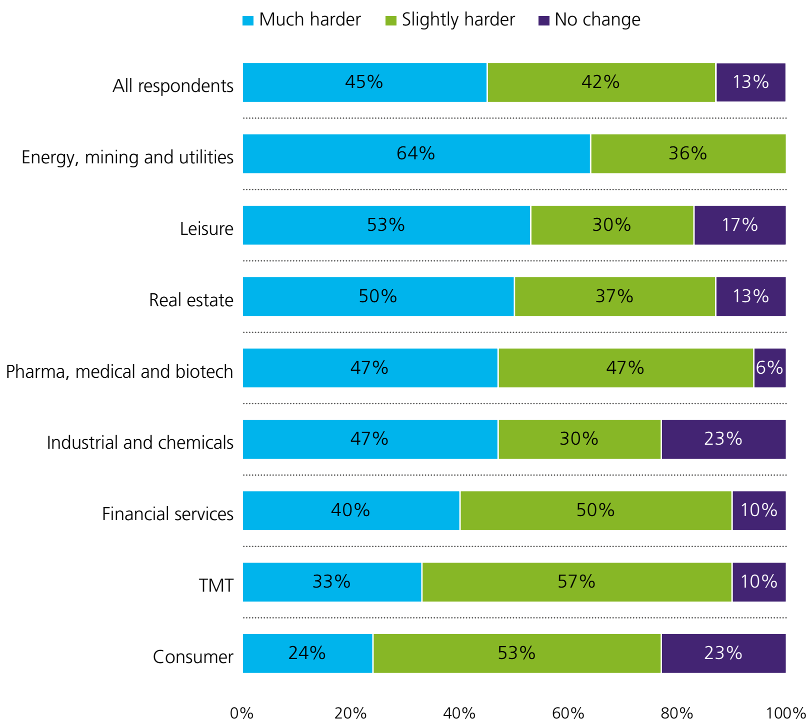
Company performance is seen as key in accessing deal financing. Nearly a fifth (18%) of respondents, the largest share, believe that revenue and profit underperformance will be the single greatest challenge to financing M&A over the next 12 months.

Geopolitical factors at play

Geopolitical conflict is also seen as likely to be important – it was chosen by 22% as the second-biggest challenge to financing acquisitions, in addition to 12% who consider it to be the top challenge.

The conflict in Ukraine is not only a humanitarian disaster, it has disrupted physical supply chains and sanctions have complicated the deal environment, as buyers are required to undertake more scrutinous due diligence. The dynamics are constantly changing and investors do not like uncertainty. Global geopolitical issues have since ratcheted up further, with tensions rising between the US and China

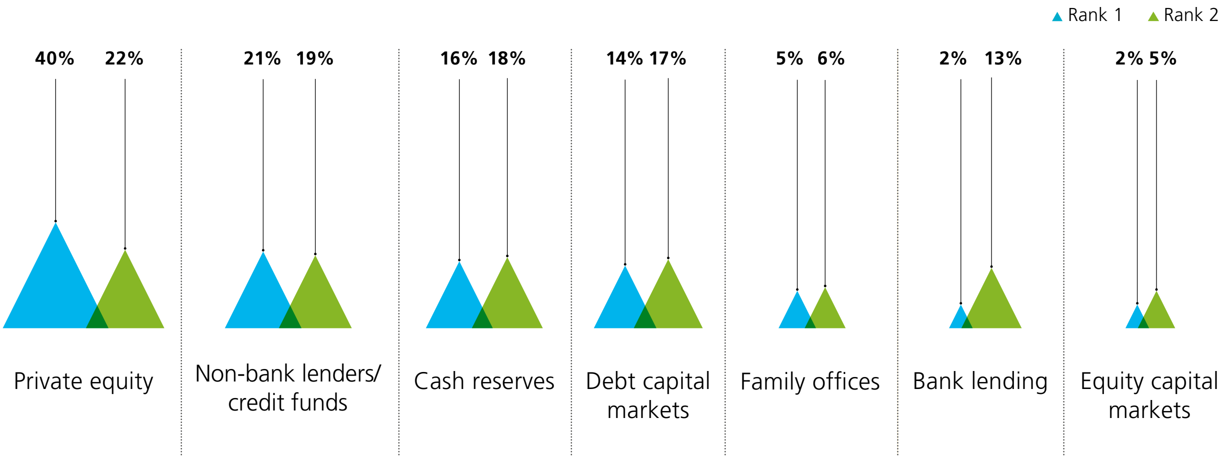
How do you expect financing market conditions to develop compared to 2021?



> Inflation and economic uncertainty have led to more difficult financing conditions, which in turn leads to greater risk scrutiny. With higher risk, lenders will set higher premiums. Together with increased interest rates, this pulls the credit markets towards lower leverage, and stronger lender protections in case of default. In the end, one would expect less debt to be taken on by buyers.

Rafal Zakrewski, CMS Poland

What sources of financing do you think will be most available over the next 12 months? (Please select the two most important, 1 = most important, 2 = second most important)



since House Speaker Nancy Pelosi's visit to Taiwan on 2 August.

In reality, a decoupling between the world's two largest economies and political superpowers was in motion before even the previous administration. The Made in China 2025 industrial strategy, devised to reduce the country's reliance on Western technologies, was introduced in 2015. These tensions have practical implications for cross-border M&A as countries place a greater emphasis on their national interests than ever before and tighten the net on FDI. And, naturally, any heightened geopolitical risk results in a further tightening of credit conditions, stunting investors' ability to access deal financing.

Private equity resilience

Amid this tighter access to financing, private equity is seen as a keystone. Two-fifths (40%) of respondents rank PE as the most available expected source of financing over the next 12 months, an additional 22% ranking it second. While it's true that financial sponsors typically have relatively high risk appetites and so remain

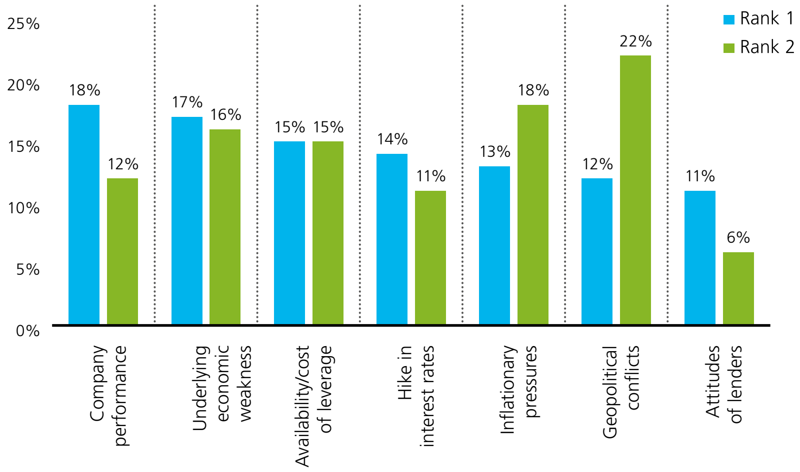
> For years, firms have been able to raise funds on capital markets and from banks, despite successive economic shocks. Borrowers will now have to adapt to the new normal brought about by the return of inflation, rising interest rates and a persistently uncertain economic outlook. We have already seen a tightening of the terms of financing agreements, and this is likely to continue as banks and investors become more selective.

Marc-Etienne Sébire, CMS France

steadfast investors throughout the business cycle, it is important to note that these funds are reliant on credit financing. Some of the very largest leveraged buyouts in Europe, including that of UK high street pharmacy chain Boots, have run into trouble as banks have found it challenging to sell down the debt packages used to back them amid heightened risk aversion. PE is far from immune to today's tightening financing conditions.

However, a number of dynamics have developed that put private equity in a stronger position than in the past. One is that it has become less reliant on debt. The average loan-to-value ratio on buyouts was 53% in 2020, according to the Investment Council, down from 68% in 2005 as sponsors have become more operationally focused when it comes to their value creation. There will be added incentive to double down on this amid a weakened economic environment. It is also the case that the private debt industry in Europe has flourished in recent years. Assets under management reached GBP 364bn at the end of 2021, the market having shown annual double-digit growth and managers raising successively larger funds. Ares Management is currently in the market collecting an EUR 11bn European private credit fund, the largest on record for the region. These direct lenders will play an even more central role in PE activity if banks and debt capital markets continue to exercise caution.

What do you view as the greatest challenge to financing acquisitions over the next 12 months? (Please select the two most important, 1 = most important, 2 = second most important)



Conclusion

The macro and geopolitical picture has deteriorated somewhat over the past six months and there is reason to tread carefully at this point. Investors will be keeping a keen eye on energy prices and broader inflation as demand shows signs of softening.

Nevertheless, the fact remains that corporates and PE are well equipped with capital for deals and optimism is running high, even in the face of darker clouds gathering on the horizon. The easing off of valuations in the first half will have increased appetite among buyers who were already actively seeking specific targets and TMT is expected to continue making an outsized contribution to activity.

Over the next 12 months, financing costs are likely to increase even further and debt markets will be more selective with the deals that they are willing to back, seeking quality of earnings and business models that are fit for the future.

As acquirers consider M&A over the coming months, some core trends should be borne in mind that will potentially shape activity.

Managing valuation gaps
Deal negotiations are expected to be challenged by valuation gaps and acquirers will need to be prepared for this eventuality. This will hinge upon the volatility of equity markets over the coming year as recession risks are higher today than they were a year ago. This may require creative deal structuring on the part of buyers. For example, smartly designed earn-out milestones may be sought to risk-manage deals over the coming year and deliver more equitable outcomes for both sides of the negotiating table.

Distressed and carve-out activity to rise
With debt servicing costs rising for the first time in years, stimulus measures expiring and growth decelerating, many are expecting a rise in distressed deals. Some sectors are under greater pressure than others and this will play to the advantage of PE firms with a breadth of industry expertise and a track record in turnaround situations. These sponsors also stand to benefit from the anticipated increase in corporate carve-outs as businesses with weaker balance sheets face renewed pressure to pay down their debts, raising cash through asset sales.

Spotting the inflation peak
Inflation continued to rise in Europe in July, whereas the US saw both the consumer price index and producer price index peak in the same month. It is only when inflation finally crests and begins to come down to the ECB's 2% target that the central bank will begin to consider loosening monetary conditions, supporting the economy and markets. Until then, investors should be mindful of the macro context and hone in on assets that benefit from powerful secular tailwinds that fuel their performance amid high input costs and weaker macro growth.

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We strive to develop long-term relationships with our clients, giving prompt, straightforward and commercial legal advice. We draw on renowned industry expertise in a number of sectors including Financial Institutions and Services, Energy and Climate Change, Technology, Media and Telecommunications (TMT), Life Sciences & Healthcare, Consumer Products, Construction and Development, Hotels, Leisure and Sport, Infrastructure and Project Finance.

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Our latest CMS Corporate/ M&A headline deals

National Grid
CMS has advised a consortium on its agreement to acquire a 60% stake in National Grid's UK gas transmission and metering business. The terms of the transaction imply an enterprise value for the business of approximately GBP 9.6bn.

United Robotics Group
CMS advised Germany-based United Robotics Group on a cross-border equity joint venture with Japanese technology giant SoftBank. United Robotics Group is acquiring France-based SoftBank Robotics, manufacturer of the world-renowned Pepper and NAO robots. In return, SoftBank will become a minority shareholder in the United Robotics Group.

Greiner AG
CMS advised world-leading Austrian plastics and foam specialist Greiner on the successful sale of its extrusion division in a complex cross-border transaction involving teams from Austria, Czech Republic, China, UK, France and Poland.

Rohlik Group
A cross-border CMS team from Czech Republic, Germany, Hungary, Romania, Spain, Italy and Austria advised a group of investors on a EUR 220m investment in one of Europe's leading online grocery businesses, Rohlik Group.

Warner Music Group
CMS advised Warner Music Group in relation to the USD 250m acquisition by its US subsidiary, Warner Chappell Music Inc., of the entire musical works and the publishing rights to David Bowie's music catalogue from the David Bowie estate.

Biogroup
CMS advised French life sciences leader Biogroup on the acquisitions of Laboratoires Réunis in Luxembourg and Cerba and Analiza in Spain, involving a cross-border team from France, Luxembourg, Spain, Portugal and Brazil.

Daimler Truck
CMS advised Daimler Truck on its joint venture with Traton and Volvo to create a high-performance European public charging network for long-haul electric trucks and coaches.

West Ham United
CMS advised a Czech investment group on the acquisition of a 27% stake in London premier league football club West Ham United through the purchase of shares from its existing shareholders and a subscription of new shares.

Eaton Corporation
CMS advised Eaton Corporation plc on the EMEA aspects of the divestiture of its USD 3bn Global Hydraulics Business to Danfoss across 22 jurisdictions.

WOW Tech Group
CMS advised WOW Tech Group on its >EUR 1bn business combination with Lovehoney Group, in a complex cross-border deal involving Germany, Luxembourg, Switzerland, Netherlands and the UK.

Neo Energy
CMS advised UK energy company Neo Energy Upstream on its acquisition of JX Nippon Exploration and Production U.K. Limited for USD 1.7bn.

Turn/River Capital
CMS advised Turn/River Capital on the USD 1.25bn sale of the Invicti Group to Summit Partners, which includes a rollover by Turn/River and a USD 625m investment by Summit Partners.

Blue Prism
CMS advised listed British tech firm Blue Prism, on its GBP 1.24bn takeover by US-based SS&C Technologies.

Ford Otosan
CMS advised Europe's largest commercial vehicle producer on its EUR 700m+ acquisition of Ford's shares in its vehicle and engine manufacturing plant in Romania. Ford Otosan is a joint venture between Ford and the largest industrial conglomerate in Turkey.

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