

Domestic Investors Drive Buoyant M&A in the Mittelstand

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Key Findings:

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- M&A transaction volumes in Germany and Austria have bounced back from their post financial crisis slump, growing by almost 14% to €28m from 2010–2012. Across the rest of western Europe, activity contracted by 30% over same period
- SME deals are driving growth in M&A activity. Of 290 such deals in Germany and Austria, 106 were cross-border and 184 were domestic
- S&P Capital IQ data shows that domestic firms are more efficient at capturing undervalued assets; cross-border acquirers seem more willing to pay a premium
- The export industry in Germany and Austria remains an attractive asset group driven by deal volume in the Capital Goods sector

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M&A transaction volumes rebound, driven by activity on SMEs targets

Total M&A transaction volumes in Germany and Austria have bounced back from their post financial crisis slump, growing by almost 14% to €28M from 2010 to 2012. This compares favourably to Western Europe as a whole, where activity contracted by 30% over the same period, but is short of growth seen in the Nordics [28%]¹. Although recent data shows that transaction volumes are still short of the 2008 high of €70M, they are in line with normal pre-crisis market activity. Moreover, the failure to return to 2008 levels is a trend that has also been seen in the corresponding data for the UK and France², and is consistent with the prevailing uncertainty around the EU economic outlook.

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M&A activity targeting small and medium sized enterprises [SMEs³] in Germany and Austria is the driving force behind the recent growth in transaction volumes. In the last four years the number of SME deals has increased year-on-year from 179 deals in 2009 to 290 deals in 2012 [Figure 1]. By contrast, the total transaction value for non-SMEs in 2012 [€19.5M] represents a four year low.

Figure 1. Number of M&A Deals Involving German and Austrian SMEs

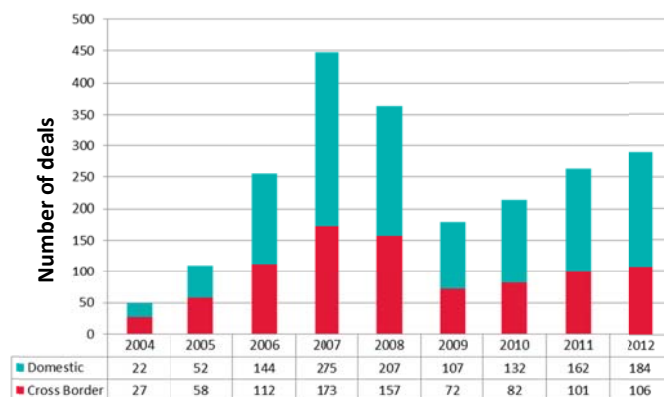


Chart Source Data: S&P Capital IQ platform, www.spcapitaliq.com

¹ 'M&A in the Nordic Region Boosted by the Fundamental Health of Private and Public Companies'

² 'U.K. M&A Activity Among Small- and Medium-Sized Enterprises Loses Momentum'

³ Where an acquired firm has total revenue less than €100M

Domestic companies more efficient at capturing undervalued assets

From a buyer's perspective, of the 290 deals involving German or Austrian SMEs that took place in 2012, 106 were cross-border⁴ deals and 184 were domestic. The stronger growth rate of domestic versus cross-border deals over the last four years [14.5% CAGR v 10.1% CAGR], perhaps indicates that closeness to domestic market dynamics gives local investors more confidence. S&P Capital IQ M&A transaction multiples data suggests domestic firms are more efficient at capturing undervalued assets, whilst cross-border acquirers are seemingly willing to pay a premium⁵.

As is the case in most European countries, United States-based companies are the most frequent cross-border acquirers of German and Austrian SMEs, averaging 15 deals a year since 2004. European companies follow, with those based in both France and the Netherlands averaging 11 deals per year, and the United Kingdom and Switzerland averaging 10 deals. More surprising, perhaps, are the 10 acquisitions averaged each year by Nordic firms. Away from mature Western markets, in 2012, 5% of cross-border deals involved buyers from Russia, India and China, the second highest share in the last 9 years. This reflects a recent trend of Emerging Market investors acquiring assets in order to deliver brand value and intellectual property to satisfy the demands of the growing middle class⁶.

The German 'Export Machine' – the Capital Goods sector remains an attractive asset group

Looking at the data, it is clear that based on the total number of SME deals completed over the period of study (2004-2012) the Capital Goods sector remains an attractive asset group. This is consistent with the overall economic profile of both Germany and Austria being net exporter nations on a global scale relative to other non-commodity based countries. This high activity sector carried 24%⁷ of overall deal volume in this period while also being the sector of choice for all investor types, including cross-border and domestic investors acquiring both strategic and non-strategic assets⁸.

Our analysis suggests that international investors across industries recognise the tactical value of the Capital Goods industry and, more broadly speaking, export-linked industries within this region. Furthermore, we see that cross-border deals display a bias towards investors acquiring assets that operate outside of their own primary industry⁹. This is characterised by the Capital Goods industry representing 24% [196 of 831 deals] of overall cross-border deal volume between 2006 and 2012, and at a significant premium of 19%¹⁰ over domestic investors based on average deal value. S&P Capital IQ's data indicates that investors seem willing to pay a premium for greater market presence within one of the key segments of the German 'Export Machine'.

⁴ For the purpose of this article "Cross border M&A" includes transactions where the target company was based in Germany or Austria, and the purchasing entity's domicile is any other country.

⁵ Based on 21% data coverage for domestic deals and 40% data coverage for cross-border deals

⁶ Research from Bank of America Merrill Lynch, Merrill Lynch, and U.S. Trust Finds Opportunities in U.S. Economy, Technologies, and Rising Emerging Market Middle Class, www.spcapitaliq.com

⁷ Total Cross-Border deal volume is 874 and Capital Goods deal volume is 206

⁸ A Strategic assets operates within the same primary industry as the Acquirer, a Non-Strategic assets operates within a different industry when compared to the Acquirer

⁹ Primary Industry is based on 2nd node GICs grouping

¹⁰ Strategic Asset average Cross-Border deal size – 23.96 vs. average domestic deal size – 19.43

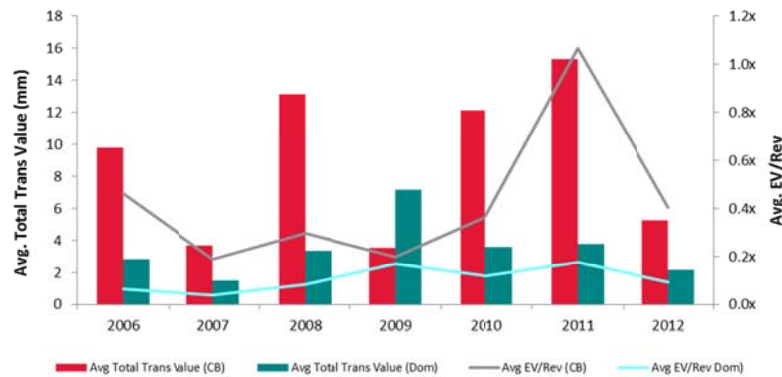
Figure 2. Strategic Deals – Capital Goods Industry

Chart Source Data: S&P Capital IQ platform, www.spcapitaliq.com

Observing overall deal volumes across industry segments highlights an interesting relationship between the Capital Goods industry and its supply chain. Over the study period the Capital Goods industry represented 22% of the overall deal volume, Software & Services 12%, Materials 10%, and Tech Hardware & Equipment 8%. This data suggests that deal volume in the Capital Goods sector could be in part driven by deal volumes in sectors within its supply chain.

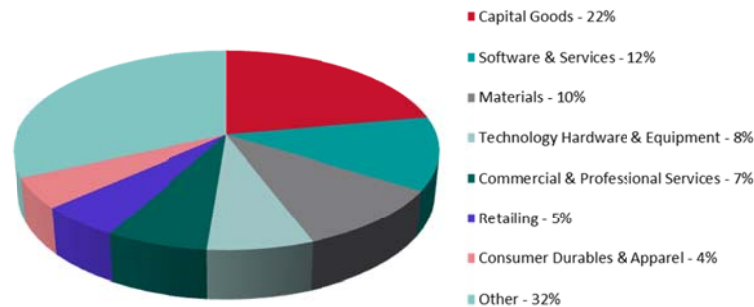
Figure 3. Aggregate Deal Volume by Sector

Chart Source Data: S&P Capital IQ platform, www.spcapitaliq.com

These interconnected industries and subsequent M&A spillover effects seem essential to the overall German and Austrian SME M&A market in that aggregate deal volume accounts for 52% of all deals completed between 2004 and 2012. This view is echoed in a research report published by Standard & Poor's Ratings Services on 20 February 2013 – "Serial acquirers in the sector [e.g., ITW, Ametek, and Roper] rely on a well-tested blueprint to integrate the many small to midsize companies they acquire every year [scale leveraging, low-cost sourcing, overhead structure simplification], providing scope for margin expansion after a few years." Global Capital Goods in 2013: Stable Credit Quality in Uneven Conditions.

Cause for Optimism

Taking stock of our overall analysis, there is a positive outlook for SME M&A activity within German and Austrian export-linked industries and, more specifically, the Capital Goods sector. In general, buoyant domestic M&A markets coupled with investors' appetite for this region appears to support growth in M&A activity. This is potentially encouraging for other EU countries with a similarly strong SME export sector.

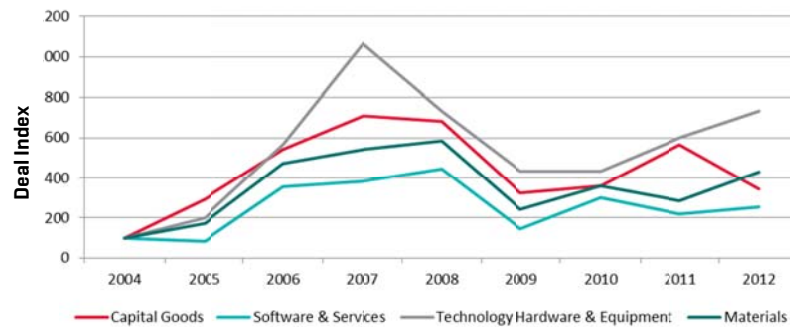
Figure 4. Indexed Deal Volume by Sector

Chart Source Data: S&P Capital IQ platform, www.spcapitaliq.com index constructed on the bases of deal volume by sector with year one set at 2004

Whilst in Germany and Austria the specific sectors of high activity remain relatively consistent in terms of deal volume and valuation growth, there are headwinds. Economic uncertainty across the wider EU casts a shadow on economic growth and business activity within the integrated market. This is reinforced by the expectation that France and other EU countries could experience a recession during 2013¹¹, linked in part to austerity measures and subsequent rebalancing of fiscal deficits countering economic growth. From outside the EU, the recent change in monetary policy in Japan and its impact on the global export market, and China's move from investment driven to consumer driven growth, poses an interesting challenge to the short term competitiveness of the German 'Export Machine'.

Behind the Analysis: Domestic Investors drive Buoyant M&A Activity in the Mittelstand

Using public and private company data on the S&P Capital IQ platform, S&P Capital IQ has analysed M&A trends in Germany and Austria between 2004 and 2012. The most salient trends around number of deals and volume of activity have been analysed and highlighted in this piece. This includes findings around M&A trends where the targets are SMEs versus public companies, the type of purchasing entity and observations on industries of higher interest within the studied period.

S&P Capital IQ platform

The S&P Capital IQ platform combines deep global company information and market research with powerful tools for fundamental analysis, idea generation, and workflow analysis. This interactive and dynamic web and Excel-based platform provides easy access to fixed income, fundamental, M&A and private company data.

¹¹ 'Entrenched In Recession, Europe Seeks A Balance Between Deleveraging & Growth'

S&P Capital IQ platform screening tool

The S&P Capital IQ platform screening tool allows users to screen easily and comprehensively for M&A transactions based on user's custom criteria. Transactions can be screened by geography, industry, date, deal status, etc. [see image]



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