Global dealmakers 2023:
Europe M&A market update

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Foreword

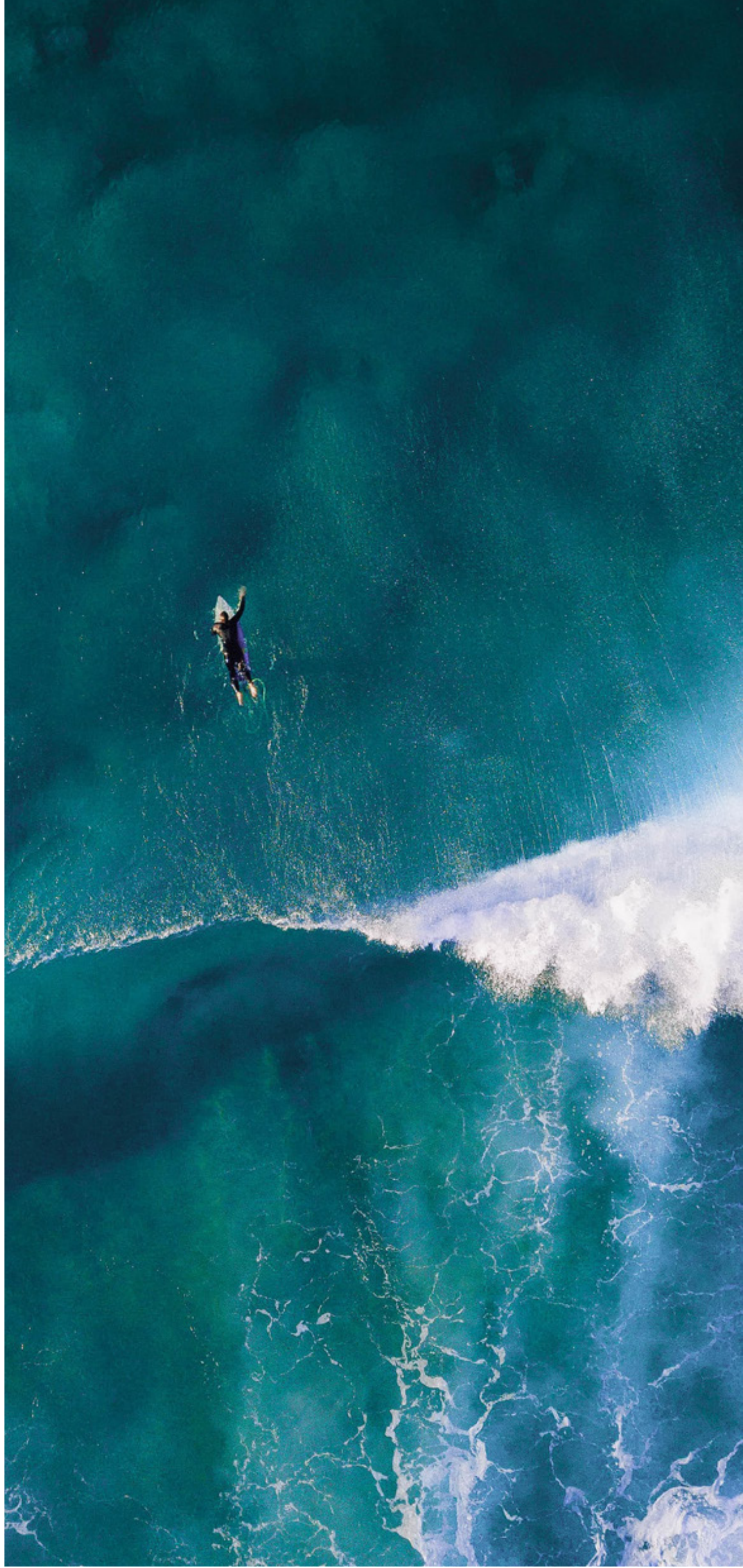
Global M&A markets have endured a difficult year, and European dealmaking has been no exception. Rising interest rates, high energy costs and geopolitical uncertainty have been just a few of the myriad challenges facing corporate and private equity dealmakers in recent months.

Given this period of market dislocation, European M&A activity has inevitably tailed off, with deal value and volume registering double-digit, year-on-year declines of 52% and 17%, respectively, in 1H23. Cautious, risk-averse corporates have battened down the hatches when it comes to big-ticket deals, while shuttered debt markets have put leveraged buyouts on hold. Gaps between buyer and seller valuation expectations, meanwhile, have made transacting difficult, the result of which has been prolonged deal processes and timelines.

Nonetheless, turbulent times often pave the way for transformative and strategic M&A by well-capitalized and well-informed market participants. Dealmakers in Europe have indeed proven nimble, shifting focus to smaller mid-market transactions that are easier to execute and less risky to finance. The long-term secular trends of digitalization and energy transition have also persisted, with M&A remaining a key lever for fulfilling these fundamental strategic objectives.

Uncertainty will be an ongoing theme for the rest of 2023 and into 2024, however, there are some positive indications that conditions and M&A momentum could be starting to improve. Inflation in key European markets has shown signs of cooling, giving some hope that interest rates may be peaking. This will provide dealmakers with much-needed clarity when pricing risk and structuring deals. Valuations are also correcting from 2021 market peaks, encouraging buyers to pursue deals for good assets at attractive prices.

These are still volatile times for European M&A, and while dealmaking may be muted compared to recent years, deal flow will nonetheless remain steady and strong. And for risk-tolerant acquirers, current conditions provide a rare chance to make bold, market-shaping deals that may not be available when competition for assets intensifies during the next cyclical upturn.



Looking ahead to the rest of 2023 and into 2024, we are poised to observe the interplay of diverse structural and strategic drivers in European M&A. Factors like divestitures, technology, ESG, and private equity will collectively shape the landscape. As inflation moderates and valuations stabilise, it relieves the strain on central banks to persistently raise interest rates and positions lenders and investors more favourably to formulate deals as rates eventually stabilise and create opportunities for growth and strategic repositioning.

Harsh Maheshwari
Head of Corporate Finance,
Baker Tilly International

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About this report: Data in this report comes from Dealogic and was compiled on 23 July 2023.
All figures are in USD unless otherwise stated.

Europe M&A: State of the market – and where to from here?

Macroeconomic and geopolitical challenges have taken a toll on the European M&A market – however, deal opportunities are still in abundance for the savvy dealmaker.

Dealmaking across Europe has not been easy over the first half of 2023 as the same headwinds that dampened M&A in 2022 – high inflation, rising interest rates and the Ukraine war – continue to weigh on market sentiments. As a result, deal value in 1H23 cascaded to a five-year low of US$280bn, a 52% decline from US$594bn in 1H22. Deal volume has likewise slipped, down 17% from 1H22.

Higher interest rates and the subsequent rising cost of capital are causing many private equity and strategic corporate buyers to take pause and reassess their next moves. Many corporates have shifted their attention to strengthening balance sheets and paying down debt rather than pursuing expansive and costly M&A. Prohibitive financing rates have had a particularly chilling impact on private equity, with many funds finding it difficult to execute large leveraged buyouts – the result of which has seen LBO activity drop to some of the lowest levels since 2018.

For all the challenges facing dealmakers, there are some signs of green shoots emerging. Macroeconomic volatility remains a risk, but deals remain relatively robust and safely above pre-pandemic levels and a recovery in 2Q23 deal value bodes well after a soft first quarter.

Outlook 2024

The rebound in 2Q23 could be a sign that although uncertainty remains, markets may be bottoming out, leaving dealmakers with clearer visibility on the future earnings of target companies and better placed to price risk.

The most encouraging sign for investors is that inflation is beginning to cool. In the EU, inflation for June 2023 came in at 6.4%, down from 7.1% in May and well below the 9.6% recorded a year earlier. Particularly in the UK, June inflation came lower than expected at 7.9%, the slowest in more than a year, followed by 6.8% in July.

Lower inflation will help ease the pressure on central banks to continue upping interest rates, leaving lenders and investors in a stronger position to structure deals when rates settle, even if at an elevated level. Easing inflation has already helped to revive stock markets – the Stoxx Europe 600 Index is up by more than 8% for the year-to-date – and it is hoped this momentum will spill over into private markets and support an uplift in M&A valuations too.

Through the rest of 2023 and into 2024, several structural and strategic drivers will be at play in the European M&A market:

Corporate divestitures

Tougher macroeconomic conditions are pushing companies to reconfigure operations, divest unwanted assets, raise capital and focus on core business lines. An uptick in carve-outs will offer private equity dealmakers a welcome pipeline of deal prospects, as will ongoing public-to-private deals, especially in the UK, where US private equity firms have been particularly active during the last 12-18 months, taking advantage of a strong dollar to acquire listed UK assets at attractive valuations.

Tech

Digital transformation is another cornerstone of long-term dealmaker strategies, as firms use tech to catapult operations into the digital age. Tech deals have been and will continue to be a key driver of M&A in Europe – and indicators already show abundant deal opportunities in this industry for dealmakers ready to act (see heat chart on page 7).

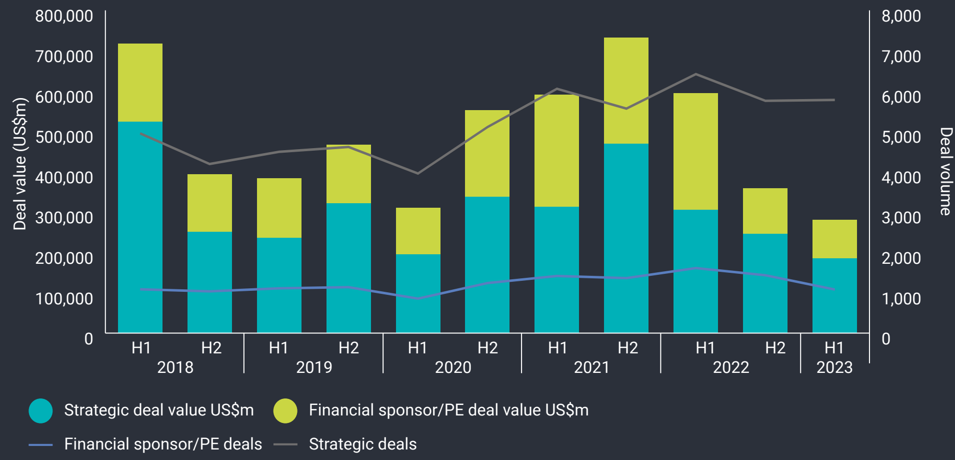
ESG and the energy transition

Dealmakers are also turning to M&A to accelerate decarbonisation and make progress towards net-zero carbon emissions targets. M&A will be one of the key funnels for capital to flow into renewables and energy transition projects at the required levels. Wider environmental, social and governance (ESG) concerns are also spreading into sectors other than energy, as investors and consumers become more socially and environmentally conscious.

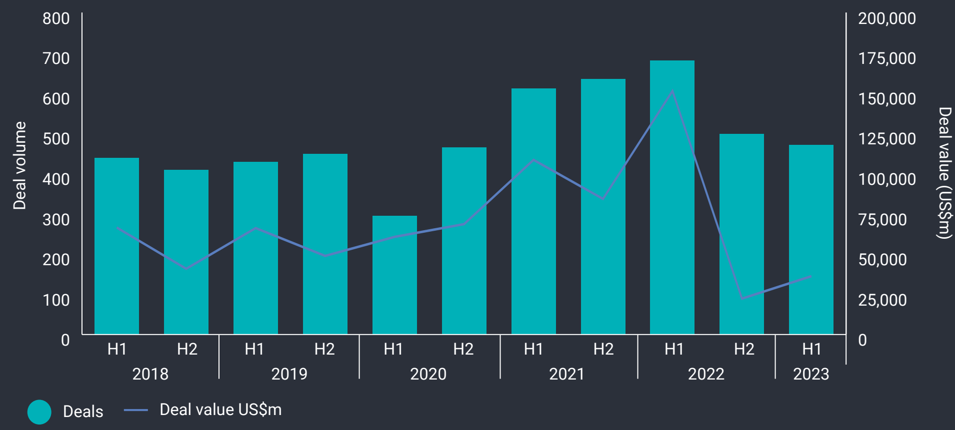
Private equity

Globally, private market dealmakers are also sitting on a record US$3.7tn of dry powder, of which US$1.1tn is sitting in buyout funds. Around three quarters of this buyout dry powder was raised within the last three years, so while buyout firms still have time to put money to work, they will have to start deploying capital war chests before too long.

Europe M&A



Europe LBO trends



Heat chart: Active M&A opportunities across Europe

	UK & Ireland	DACH	France	Nordics	Italy	Iberia	Benelux	CEE & SEE	Grand Total
TMT	121	97	65	55	28	43	19	121	**549**
Industrials and chemicals	98	100	39	54	61	33	25	73	**483**
Consumer	62	60	25	15	82	34	20	79	**377**
Pharma, medical and biotech	53	66	16	42	12	19	36	38	**282**
Business services	76	25	20	26	19	37	22	47	**272**
Financial services	62	22	34	14	24	17	22	54	**249**
Energy, mining and utilities	25	12	12	19	17	25	10	39	**159**
Leisure	41	8	5	8	14	12	10	18	**116**
Construction	7	13	3	6	8	12	4	28	**81**
Transportation	9	7	6	9	7	8	4	16	**66**
Real estate	4	2	1	5		10	2	9	**33**
Agriculture	1	1	5	3		4	2	14	**30**
Defence	1							1	**2**
Grand Total	560	413	231	256	272	254	176	537	2699

Europe offers abundant deal prospects for dealmakers ready and willing to take action today – and more opportunities are opening in various industries and across markets.

Indeed, amid persistent macro challenges, distressed assets in struggling sectors may become available at bargain prices. Additionally, rising labor costs and margin pressure are forcing weaker companies to consider consolidation. Stronger strategic players and nimble financial buyers will have plenty of chances to make bets on undervalued targets and assets that can be turned around with operational improvements, synergies and scale economies.

At present, Europe's technology, media and telecommunications (TMT) industry is set to be the most active sector for M&A in the coming months, according to Mergermarket's Intelligence Heat Chart for the region. Tracking companies for sale over the first half of 2023, the heat chart registered 549 TMT companies in play. This aligns with broader trends that show TMT as the top sector for M&A as dealmakers engage in a frenetic rush to enhance their digital capabilities and side-step competitors. Industrials and chemicals (483) and consumer (377) also offer large volumes of M&A opportunities today, as does pharma, medical and biotech, with 282 companies for sale.

In terms of the key markets, the UK and Ireland has the largest pipeline of potential deals with 560 companies for sale, followed by Central and Eastern Europe with 537 and the DACH region with 413.

Note: The Intelligence Heat Charts are based on 'companies for sale' tracked by Mergermarket in the respective regions between 01/01/2023 and 30/06/2023. Opportunities are captured according to the dominant geography and sector of the potential target company.

Deal focus: Mid-market M&A

With abundant consolidation prospects, quality companies and pockets of value, the European mid-market promises to remain a hotbed of M&A activity.

While mega-deals may dominate headlines, the vibrant European mid-market (deals valued between US$15m-US$500m) offers compelling M&A opportunities away from the spotlight. Even as mid-cap deals declined through 1H23, current activity remains on par with pre-pandemic totals as dealmaking in this segment of the market returns to more sustainable levels.

Both strategic corporate buyers and private equity are zeroing in on this arena to fuel growth and capitalize on value creation drivers.

For private equity firms, financing difficulties and recession fears have clouded larger leveraged buyouts, and general practitioners are mitigating risks by pursuing more conservative capital structures and smaller deals. Strategics face similar pressures, curbing appetite for large transformational deals. Several factors and value drivers will continue to capture dealmaker attention and propel mid-market M&A in the year ahead:

Consolidation

Fragmentation within many regional industries is creating opportunities, particularly in business services, industrial products and services, food production and agribusiness and healthcare services. Although they represent a major share of Europe's economic output, these industries remain divided among hundreds of small and mid-sized local champions compared to the more concentrated US landscape. Combining complementary mid-market providers enables dealmakers to capture synergies, gain operational efficiencies, leverage shared capabilities and accelerate growth.

Less complexity

Compared to lengthy, complex mega-mergers, mid-market targets offer a relatively straightforward path to M&A value creation. For one, mid-market deals feature simpler execution and integration given the smaller scale. While still requiring diligence and planning, assimilating a mid-cap target is inherently less intricate than a multi-billion-dollar deal. The risk of major disruption is reduced. Smaller deals also avoid much of the regulatory and antitrust scrutiny that mega-deals face, especially in concentrated sectors.

Valuations

Gaps between vendor and investor-pricing expectations are still being bridged, but there are signs that buyers and sellers are moving closer as valuations in the mid-market cool. According to the Argos Index, which tracks the prices of Eurozone deals in the US$16m to US$534m range, median EV/EBITDA multiples came in at 9.9x in 2Q23, the lowest level since the first wave of pandemic lockdowns and well below the 11.6x multiples recorded at the peak of the market. As valuations reset, buyers will see opportunities to invest in attractive assets at reasonable multiples, while higher interest rates and weaker growth will see sellers reset expectations when seeking investment.

> **The European mid-market presents promising M&A opportunities beyond the limelight. In the initial half of the year, we see both corporate buyers and private equity investors have displayed a strong appetite for growth within this market. Marked by consolidation potential, simplified deals, and reasonable pricing, it's regaining its pre-pandemic momentum. The UK, Germany, and France continue to stand out due to their resources and access to broader European prospects.**
>
> **Olivier Willems**
> Partner, Baker Tilly Belgium

Looking ahead: Rising distress?

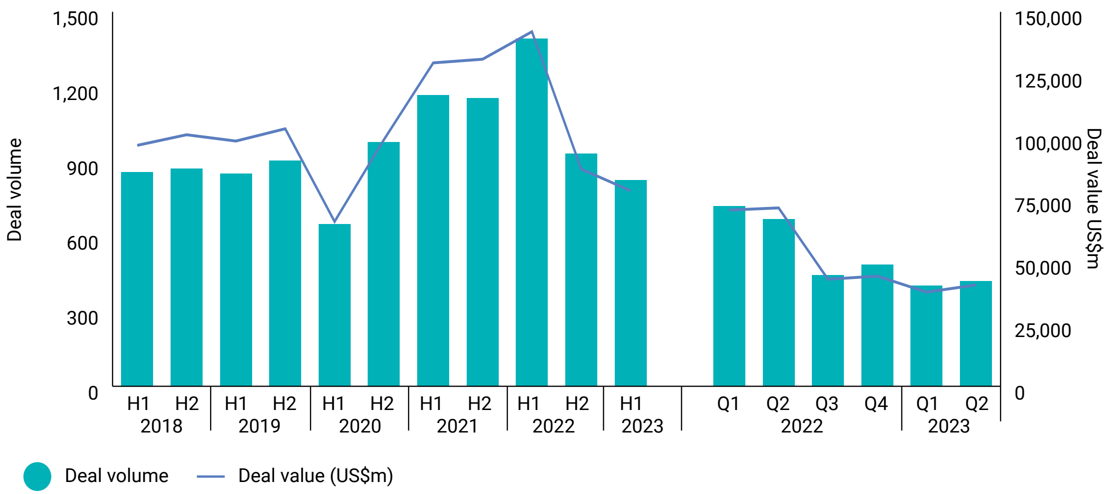
Financial distress is another factor on the deal radar. For smaller, mid-market companies, many may be sound operationally but have little option other than to turn to special situation investors and industry consolidators to restructure and replenish balance sheets as financing costs increase. In the UK, for example, many loans under the Coronavirus Business Interruption Loan Scheme (CBILS) were issued for a three-year term in a low-interest rate environment. As these loans are now reaching their maturity, a proportion of businesses with CBIL exposure may face challenges in repaying the loans, with approximately US$520.7m of CBILS loans either in default or arrears at the start of 2023.

Key markets

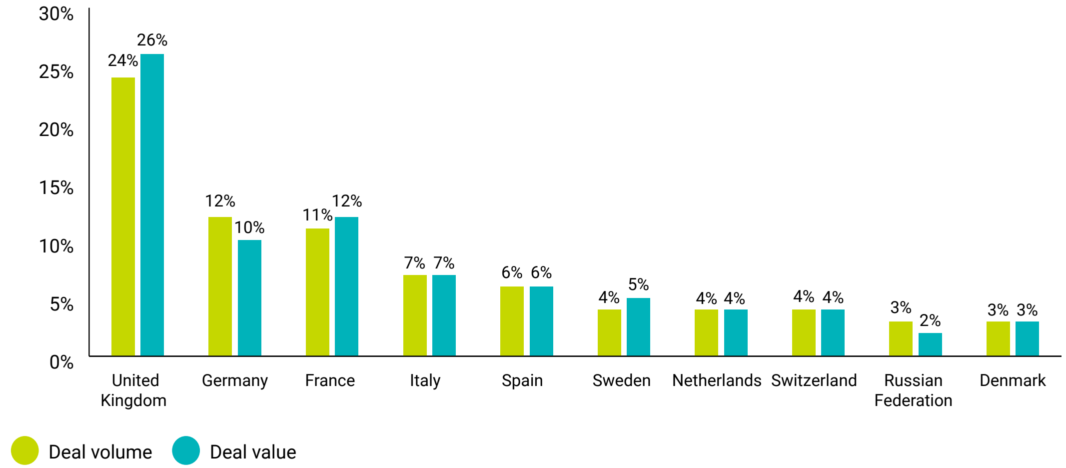
The UK, Germany, and France have delivered the bulk of mid-market M&A in 1H23. In particular, the weaker pound sterling following Brexit has further increased interest in UK-based companies.

Overall though, their large populations, skilled workforces, developed infrastructure and access to capital make these markets prime locations to find and grow successful companies. Equally, an optimal mix of size, wealth and innovation drive growth, as well as provide access to the rest of Europe for growth opportunities in other advanced economies and emerging markets.

European mid-market M&A



Europe M&A: Mid-market target geographies (1H23) – Top 10



Foreign inbound interest

European assets, technology and intellectual property – particularly in the mid-market – continue to present compelling value for overseas buyers.

Economic and geopolitical turbulence have made 2023 a particularly challenging year for offshore dealmakers as many become more cautious on investments in Europe. Regardless, many international buyers see the region's large consumer market, skilled workforce, robust and vibrant mid-market and advanced infrastructure as opportunities they cannot overlook.

North America

North America has remained the most active region for inbound mid-market M&A, even as activity has contracted significantly over the past 18 months. A softer pound and euro relative to the US dollar was a major driver of inbound activity in 2021 and 2022, encouraging US dealmakers to snap up attractively priced European assets.

As economic headwinds have intensified and the pound and euro have strengthened, US dealmakers have become more circumspect. However, European assets still present US corporates and private equity firms with attractive value relative to more competitive domestic markets – and many US firms continue to view deals in Europe as vital to expanding their global footprint and capabilities.

US buyers also see opportunities in Europe to acquire technology, IP and new customer bases, while ESG and climate capability have been another driver of cross-border European deal flow, as observed by the US$12.8bn acquisition of German heat pump manufacturer Viessman by US refrigeration and air conditioning business Carrier Global.

Asia Pacific

Inbound activity from Asia Pacific was relatively steady since 2020. Asia-based dealmakers remain motivated to invest in European assets in order to gain technology and grow domestic champions in new European markets. The relative stability and transparency of Europe's regulatory and legal frameworks has also appealed.

The coming months, however, could prove challenging as near-term risks cause Asia-Pacific buyers to be more prudent and selective with their European investments. Tightened screening of overseas investments by Beijing has slowed outbound dealmaking from China, and the economic slowdown there has caused many potential buyers to reconsider. A weakening yen and slowed economic growth in Japan are likewise constraining appetite for foreign deals.

Nonetheless, Europe remains well positioned as a destination for Asia-Pacific investment once conditions improve. The region's advanced innovation ecosystems, skilled workforces, and infrastructure are major draws and Asia-Pacific dealmakers are also keen to diversify away from US exposure given tensions around technology rivalry and trade.

Even in the face of worldwide uncertainty, European assets remain a magnet for foreign investors. Amid economic fluctuations, the region's vast consumer market, skilled workforce, and robust mid-market continue to entice overseas buyers. North America takes the lead in inbound mid-market M&A, pursuing European value whilst Asia-Pacific investors, mindful of near-term risks, still consider Europe a promising destination for investments once conditions stabilize.

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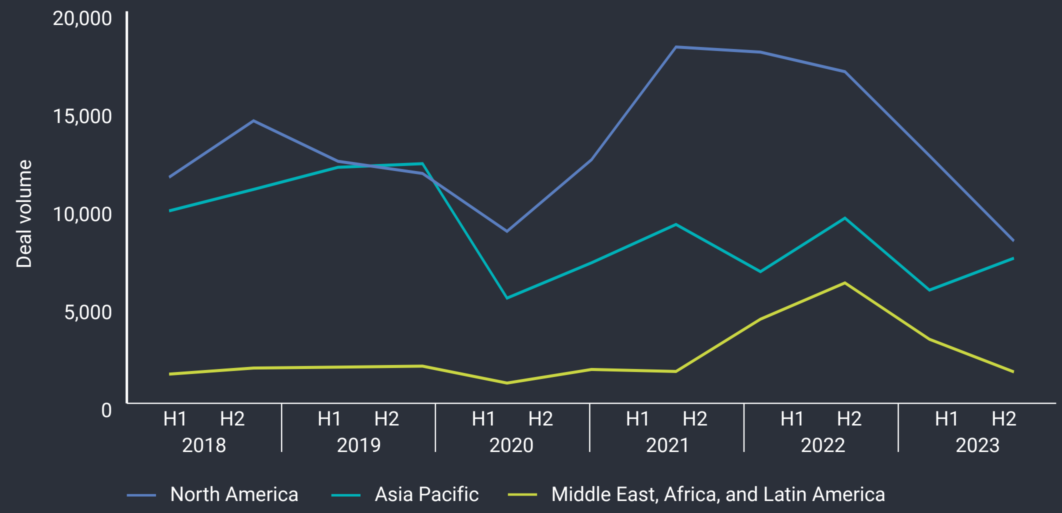
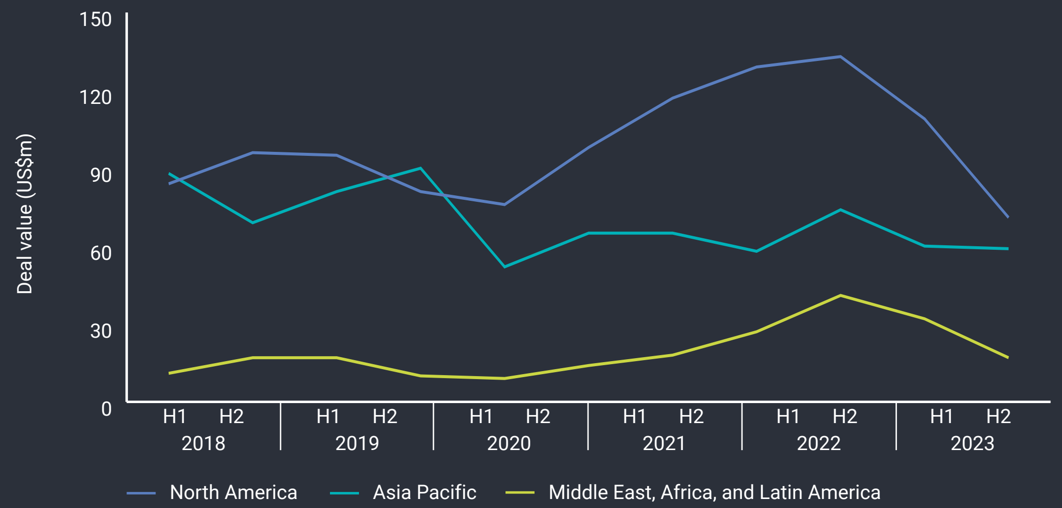
Europe M&A: Inbound mid-market deal volume



Europe M&A: Inbound mid-market deal value (US$m)



Sector spotlight: TMT

Ongoing digitalization and sustainability megatrends are increasing demand for nimble mid-market technology providers in emerging fields.

After rocketing to a record US$183 billion in 2H20, deal values in Europe's TMT space have come back down to earth. The multi-year decline has unfolded as dealmakers reassess their willingness to pay sky-high valuations – and for many, the time for overpaying for potential rather than performance has passed.

Regardless, competition for tech assets remains fierce as dealmakers look to augment capabilities. Established tech giants are seeking to consolidate power and tap into new opportunities like AI, while private equity firms pursue bolt-on acquisitions to bolster portfolio company value.

Nowhere has this been more apparent than Europe's mid-market, where TMT deals accounted for almost a third (29%) of mid-cap M&A in 1H23 and has historically been a primary industry for dealmaking. By comparison, the TMT sector accounted for 27% of overall M&A during the same timeframe.

Investment trends and opportunities

Indeed, the yawning gap in dealmaker interests and investment intentions between TMT and other industries in the mid-market speaks to the importance of these deals toward corporate strategies and private equity value-creation priorities. Several key trends and deal drivers have come to define mid-market TMT M&A:

Fast-tracking digital change. Digital transformation remains a major strategic theme – and M&A continues to be the quickest way to scale capabilities and accelerate expertise. Given their focused capabilities, mid-market innovators often provide better technology ROI than mature giants or untested startups. Their digital solutions integrate more seamlessly into existing operations – and their experienced staff multiply the value creation.

Deep tech advantages. Europe has rapidly emerged as a global leader in deep tech, with many mid-market firms making strides in complex engineering innovations. This is especially the case in the still relatively nascent but rapidly growing areas of automation, AI and quantum computing, which are disrupting and transforming business in all sectors.

Start-up successes. Europe has also benefitted from thriving technology and start-up hubs in London, Paris, Berlin, Stockholm, Helsinki, Copenhagen and Oslo, which have fostered the emergence of more than 150 unicorn companies (start-ups valued at more than US$1 billion), 47 of which attained unicorn status in 2022, despite a challenging backdrop. These fast-growing assets have made appealing targets for dealmakers.

Sustainability and green solutions. Emerging fields like IoT sensors, EV infrastructure, hydrogen, and industrial efficiency are all at the forefront of the energy transition – and acquisitions in these segments will create avenues to tap growing markets in the near term. Notably, many mid-sized companies may boast promising green technologies but lack the scale and commercialization acumen that dealmakers can provide through M&A.

Tech outlook: Down but definitely not out

Looking ahead, the TMT sector remains resilient even in the face of ongoing macro challenges. Risk appetite has undoubtedly shifted and more discerning buyers are less willing to invest large sums in technology assets that have yet to convert strong revenue growth into sustainable profitability.

For corporates, however, digitalisation remains an ongoing long-term strategic imperative, while private equity investors remain focused on deploying capital in technology and software assets with sticky, subscription-based revenues. And while TMT may not scale the heights of 2021 for some time, digital adoption is irreversible, and businesses will continue to turn to M&A to acquire capabilities. As such, the pace of TMT M&A may moderate but deal volume should stay strong.

In the evolving European TMT sector, we're witnessing a shift in deal dynamics. The landscape has transformed from soaring heights to careful evaluation, prioritizing performance over potential. Tech giants are in pursuit of AI-driven prospects, while PE firms target strategic acquisitions. While reaching new heights might take time, the deal volume is anticipated to remain robust.

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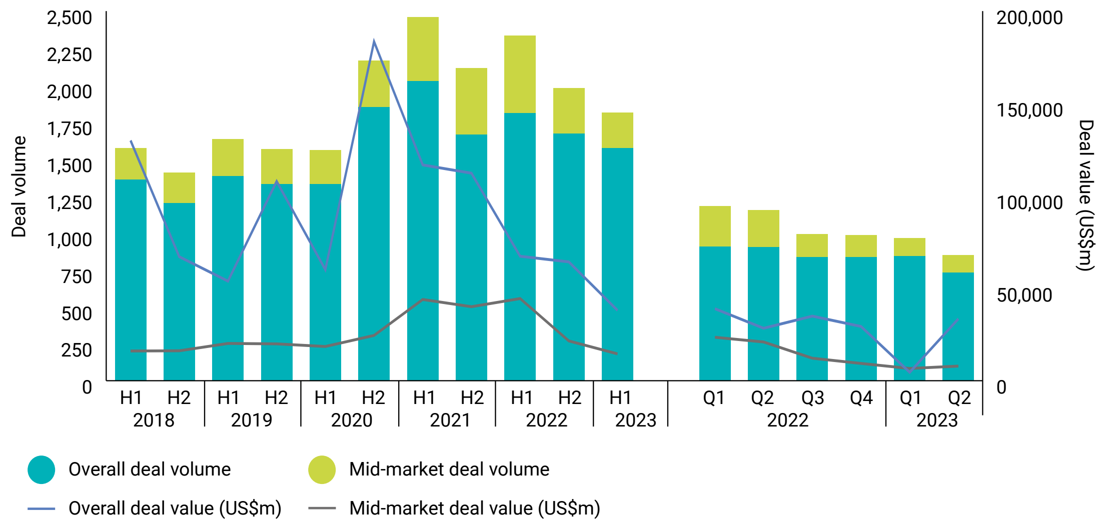
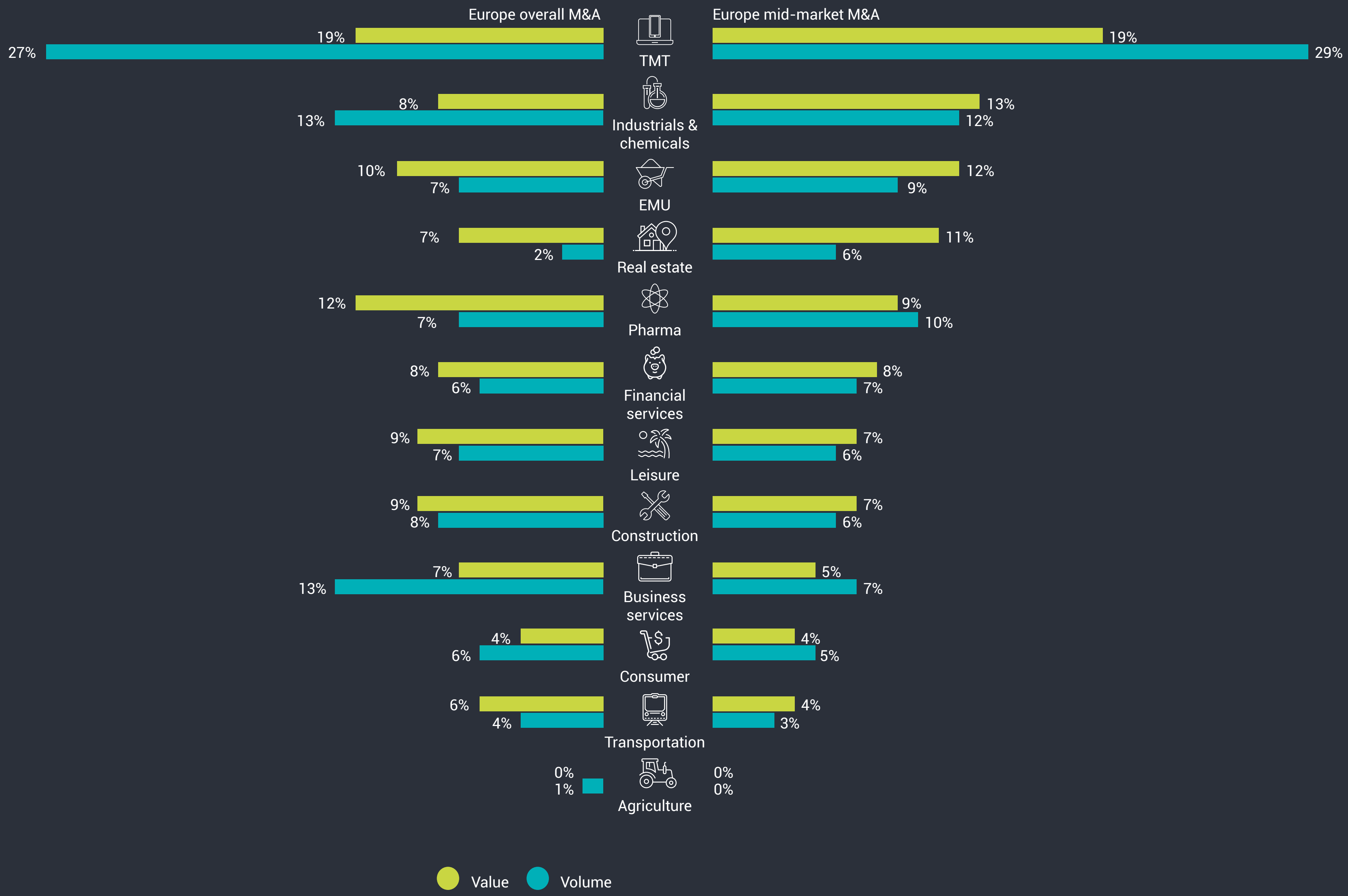
Europe M&A: TMT



Europe overall and mid-market M&A: Sector breakdown 1H23



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About

Mergermarket

Mergermarket blends market-leading human insights, advanced machine learning and 30+ years of Dealogic data to deliver the earliest possible signals of potential M&A opportunities, deals, threats and challenges.

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