



After M&A activity in the German market reached record levels in 2007, overall transaction volumes are likely to drop by 35% in 2008. For 2009, however, Lincoln International expects a rebound in the market and a significant increase in both number of M&A deals and overall transaction volume.

In the current year, M&A deals will be dominated by mid-cap and selected large-cap corporate sector transactions. Obviously, the implosion of the sub-prime mortgage market and the resulting credit crunch have had a negative impact on the German M&A market. Consequently, financial investors have struggled with financings and valuations.

Large German corporations such as Continental, EON, Linde or Merck still need to digest mammoth mergers. As a result, financial sponsors and German enterprises are primarily pursuing small and medium-sized add-on acquisitions rather than transforming strategic mergers.

While the current environment forces investors to become more selective about the quality of acquisition targets, there is plenty of opportunity for lucrative deals below a threshold of €500m. Especially industry verticals that are composed of medium-sized companies feel an increasing consolidation pressure. Examples include consumer retail, automotive, industrials, chemicals, med tech and business services.

Despite the strong euro, German businesses still represent very attractive targets. The reasons lie in competitive advantages such as their domination of global niche markets, technological leadership, a strong foothold in the largest European market and an ideal position to expand into Eastern Europe. However, traditional buyers will experience increasing competition from investors based in emerging markets such as China, Russia and the Gulf states.

While it is indisputable that there is high demand for Germany companies, market participants may raise legitimate questions about the availability of suitable targets for the expected M&A boom. Clearly, Germany still has a lot of mid-sized and larger family-owned businesses, which will inevitably come up for sale. But that is not the only reason. There are two more drivers that will fuel the deal pipeline.

First, there is anecdotal evidence that large auction processes were put on hold due to the uncertainty in the global economy. But once corporate confidence and liquidity in the debt markets return, these auction processes will be restarted.

Another factor is the above-average holding periods for German private equity portfolio companies. As the market catches up with a backlog of planned disposals, we could see an exit-avalanche. Therefore, we are expecting to see around 250 new divestment processes in the next 18 months. Predominately they will be mid-cap deals between €25m and €250m and will enter the market as structured auctions run by investment banks.

Second, we are clearly experiencing a trend where public German industrials are considering divestitures of under-performing assets. DAX and MDAX companies need to focus more on value-enhancing portfolio decisions than in the past. Otherwise, they could become victims of activist hedge funds or hostile takeovers attempts. For the next two years, Lincoln International expects around 30 equity carve-outs relating to under-performing business units.

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