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European M&A Report

Q1 2020

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In partnership with KPMG, Liberty Global Transaction Solutions, ACG Association for Corporate Growth

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Introduction

Despite European M&A activity starting the year in strong shape, the generation-defining COVID-19 crisis has ground M&A activity to a near halt, the consequences of which will be felt in the coming quarters. M&A logistical processes have become virtually impossible, and seller's valuation assumptions are being questioned. We expect European carveout activity to significantly pick up through the year as strategics prioritise the management of liquidity risks and sponsors seek opportunistic ways to deploy their €508.3 billion in European private capital dry powder. Cross-border M&A will take a hit as de-globalization intensifies due to companies re-engineering supply chains and placing premiums on resilience as opposed to efficiency. The ''all in'' approach we have seen from various European governments and central banks will see a number of nationalisations occur with greater entanglement between the public and private sector.

B2C companies in hospitality and real estate are confronting challenging times amid COVID-19. Despite the promising opening to the year, we expect dealmaking to slow considerably as demand dries up and recessions bite. Hospitality companies have seen revenues drop significantly in the near term, and real estate activity has been put on hold due to lockdowns. Long-term investors could seek out devalued targets that fall into financial trouble throughout 2020.

IT firms specialising in service provision and cybersecurity may be more insulated from looming recessions. People are leveraging online solutions for daily life now more than ever, and companies need to ensure they can nullify new threats and cope with extra demand securely. Cybersecurity companies may continue to attract premium valuations as their importance in society grows. Financial security associated with large-scale service providers could attract smaller IT businesses in the near term.

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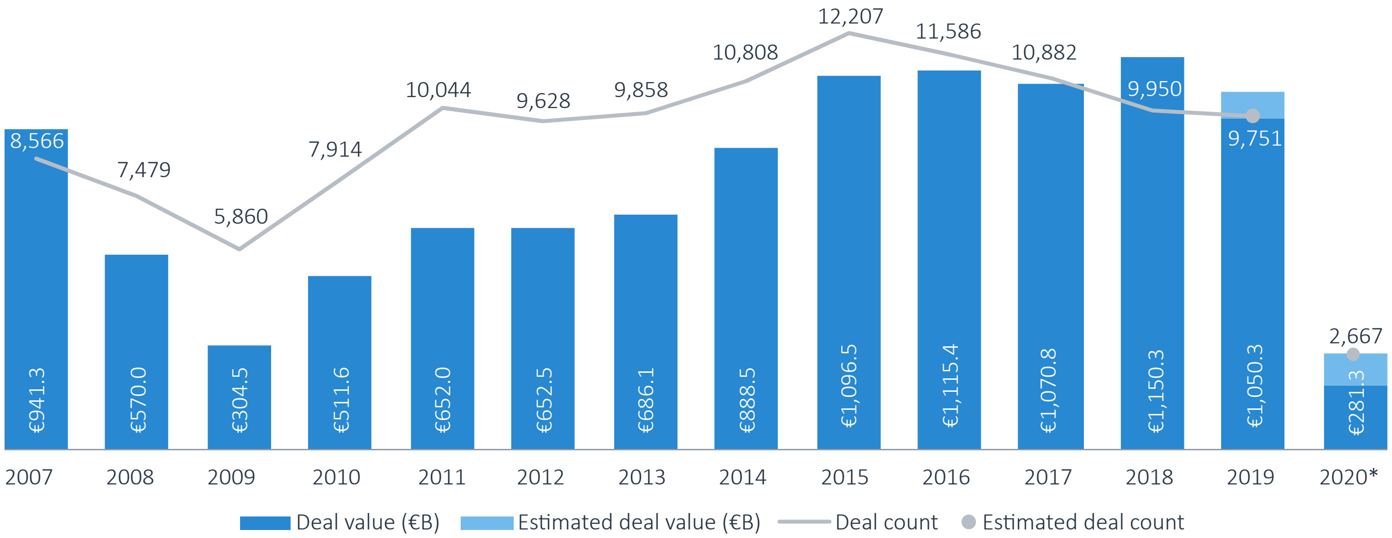
Overview

M&A activity



Source: PitchBook | **Geography:** Europe
*As of March 31, 2020

The impact of the pandemic-induced slowdown will be realized in the coming quarters, but European M&A activity managed to start the year in strong shape. 2,667 transactions closed in Q1 2020 worth €281.3 billion, YoY upticks of 15.6% and 11.0% respectively. A few factors contributed to the healthy period of M&A activity. First, the vast majority of transactions that closed were negotiated in 2019 when the economic outlook was strong. Additionally, M&A value in the quarter was bolstered by lofty deals sized between €1.0 billion and €5.0 billion, while volume was supported by several deals sized between €250.0 million and €500.0 million.

The European M&A market enjoyed a bull run in aggregate transaction value between 2015 and 2019, eclipsing €1 trillion each year and peaking at €1.2 trillion in 2018. At times, it seemed the industry was immune to geopolitical uncertainties or external shocks as investors were buoyed by strong macroeconomic fundamentals and favourable financing conditions. While all cycles come to an end, and dealmakers were expecting a downturn, nobody envisioned such a devastating and generation-defining crisis. With COVID-19 ripping through the European economy during the backend of Q1 2020, M&A activity has ground to a near halt and will likely remain subdued through the remainder of the year as most companies focus on managing the crisis rather than pursuing growth through acquisitions. Some M&A advisors have reported that up to 90.0% of their mandates have been put on hold.[1] This is likely to be reflected in the coming quarters' data as the intense market volatility has made buyers and sellers extremely cautious and sceptical of the macroeconomic outlook. Deals that are in their early stages are likely to be paused or outright cancelled as investors look to break agreements via material adverse change (MAC) clauses or a Force Majeure event. For example, EQT (STO: EQT) scrapped its €1.3 billion buyout of New Zealand-based Metlifecare (NZE: MET), citing COVID-19 concerns. The hesitation to pursue deals will persist in certain sectors such as hospitality, travel and entertainment until a vaccine is created or mass testing occurs on a global scale, restoring a semblance of social and economic stability. While deals will still occur out of necessity for those who move into distressed territory, we anticipate a new normal is forming, with investors expectations and motivations looking considerably different.

As COVID-19 viciously spread across Europe, dealmakers rushed to close deals that were already at an advanced stage. Chief among them was US-based REIT Digital Realty's (NYSE: DLR) €7.6 billion acquisition of Netherlands-based Interxion (NYSE: INXN), which was the solitary mega-deal to close in Q1. The combination will create the second-largest European data center provider, with Digital Realty taking over Interxion's 53 data center facilities in 11 European counties.[2] In an attempt to push the deal over the line quickly, Digital issued a further €1.4 billion ($1.5 billion) in bonds to pay off Interxion's debt and also approved a €1.00 ($1.10) per share cash dividend to its common stockholders including Interxion's.[3]

1:"'This Is a Tsunami': Up to 90% of M&A Deals Are on Hold During Pandemic," Financial News, Paul Clarke, March 24, 2020
2:"Data Center Blockbuster: Digital Realty's InterXion Acquisition Nearly Complete," CRN, Mark Haranas, February 28, 2020
3: "Digital Realty Closes Its Acquisition of Interxion," Data Center Knowledge, Yevgeniy Sverdlik, March 13, 2020

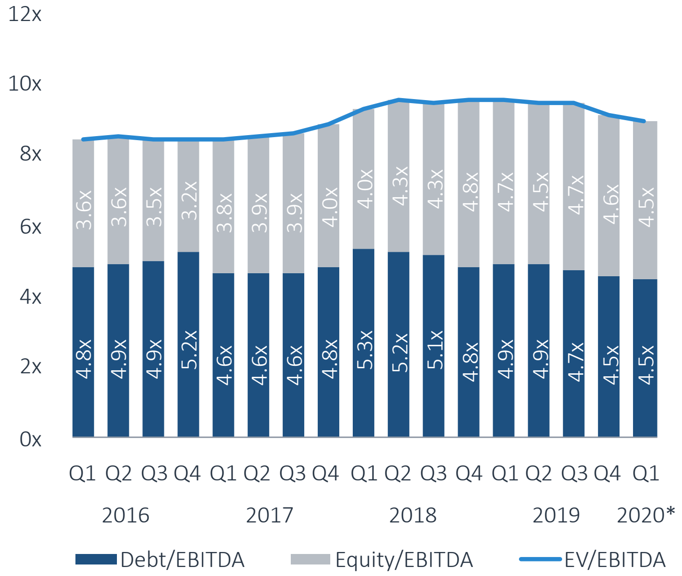
Overview

The European lockdown, travel restrictions and social distancing have complicated M&A logistical processes. While we've seen the influence of AI, data analytics and automation grow on transaction activity, deal processes have always relied on a high level of human interaction for things such as on-site due diligence, management presentations and meetings between key company stakeholders. Although not impossible, closing a merger or acquisition completely remotely will be tough, especially for mega-deals, which depend more on face-to-face meetings over a long period. Also, dealmakers should expect delays in obtaining merger control approvals due to logistical difficulties, as we saw Italy and Spain suspend merger review deadlines, further weakening deal flow.

On the valuation side of things, entry and exit multiples have been completely flipped on their head due to COVID-19, and they are likely to come under intense pressure through the remainder of the year. Q1 2020 saw the median EV/EBITDA multiple come in at 9.0x, falling by half a turn YoY. The current impact of the pandemic on the European economy is somewhat murky, which challenges earnings forecasts and makes pricing transactions extremely tricky as a result. For example, CVC Capital Partners recently announced it would be postponing an investment into Europe's Six Nations rugby tournament given the lack of clarity about the financial hit they face from no broadcasting and matchday income due to COVID-19. Acquirers are trying to buy time and extend processes to gain a better understanding of the landscape, as stock markets plummeted over 20% in Q1 and securing debt financing becomes more expensive. Sellers, on the other hand, are seeing business plans become obsolete and valuation assumptions challenged. Companies are laser-focused on conserving liquidity, keeping their workforce healthy and productive, and seeking ways to continue business activity. Any M&A plans will likely be paused until the uncertainty abates, putting further downward pressure on valuations.

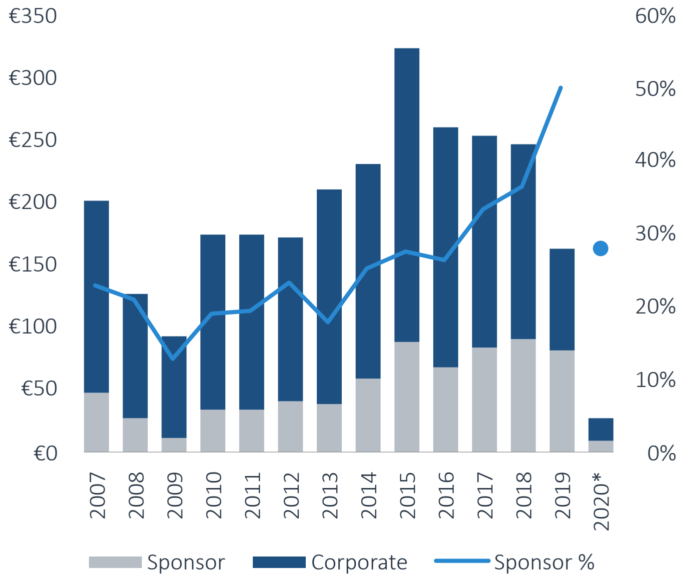
Although the immediate pipeline for M&A will likely see hikes in rescue transactions and restructurings, we expect European carveout activity to significantly pick up in the coming quarters. Strategics will prioritise the management of financial risks, while sponsors will focus on saving portfolio companies and thereafter seek opportunistic ways to deploy their €508.3 billion in private capital dry powder. The turmoil will create favourable buying opportunities for those with strong balance sheets and cash ready to deploy. We do foresee corporates disposing of highly performing assets in addition to noncore assets, as companies race to shore up liquidity needs. Additionally, the abysmal stock market performance in Q1, which saw the FTSE 100 fall around 25.0%—its largest drop in over two decades—will further encourage carveout activity, as dealmakers look to

Median rolling four-quarter M&A EV/EBITDA multiples



Source: PitchBook | **Geography:** Europe
*As of March 31, 2020

Carveouts and divestitures (€) by backing status



Source: PitchBook | **Geography:** Europe
*As of March 31, 2020

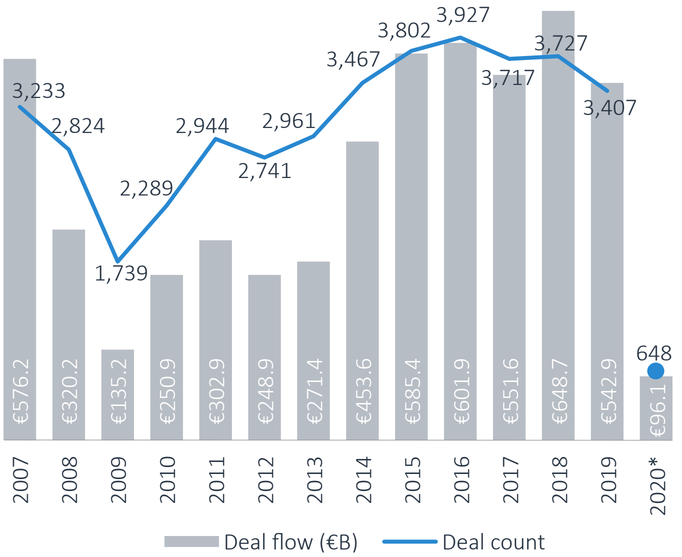
acquire fundamentally strong businesses which will have a tough 18–24 months at heavy discounts. For example, in Q1 Germany-based ThyssenKrupp (ETR: TKA) announced the largest sponsor-backed European transaction in a decade. The conglomerate agreed to sell one of its best-performing assets, its elevator division, for €17.2 billion to a consortium of sponsors led by Advent International and Cinven. ThyssenKrupp's poor stock market performance—which saw its share price more than halve in two years—its rising pension obligations, and a dwindling demand for

European steel forced the company to seek liquidity options. It should be noted, carveouts are typically large in nature and complex to execute. While we do see activity picking up, the European leverage finance markets will have to reopen, as divestitures typically rely on financing from the high-yield debt and leveraged loan markets. The ECB, in an unprecedented move, has decided to accept junk debt as collateral for loans, and it is expected the central bank will start buying non-investment grade debt as the Federal Reserve has, which will further aid carveout activity in Europe, as financing conditions improve.

With global travel restrictions and border closures in place, we expect cross-border M&A to take a hit in the coming quarters. A new normal is likely to develop post the pandemic in which de-globalization accelerates as companies pursue methods to re-engineer supply chains and focus on domestic acquisitions. European cross-border M&A activity in Q1 came in at a seven-year low on a quarterly basis, accounting for 640 closed transactions worth €100.8 billion—YoY declines of 23.9% and 38.4% respectively. We have seen a slew of major European economies take measures to protect domestic companies from foreign takeovers. For example, Spain has introduced policies that require foreign buyers to seek authorisation from the government if they wish to control or increase their participation in a domestic company by more than 10%. The Italian government has taken measures to strengthen its powers in protecting against foreign takeovers in a variety of sectors including healthcare, energy and financial services. Furthermore, Germany is reportedly planning on instating rules to block foreign takeovers that interfere with the country's national interests. Nonetheless, we still did see substantial cross-border deals close in Q1, including the acquisition of Netherlands-based Eneco, a provider of natural gas and electricity, for €4.1 billion by consortium led by Mitsubishi (TSK: 8058). Bankers have reportedly seen a sharp spike in Asian interest for European discounted assets, but with European countries and companies on the defensive, it will be interesting to see how they navigate this headwind.

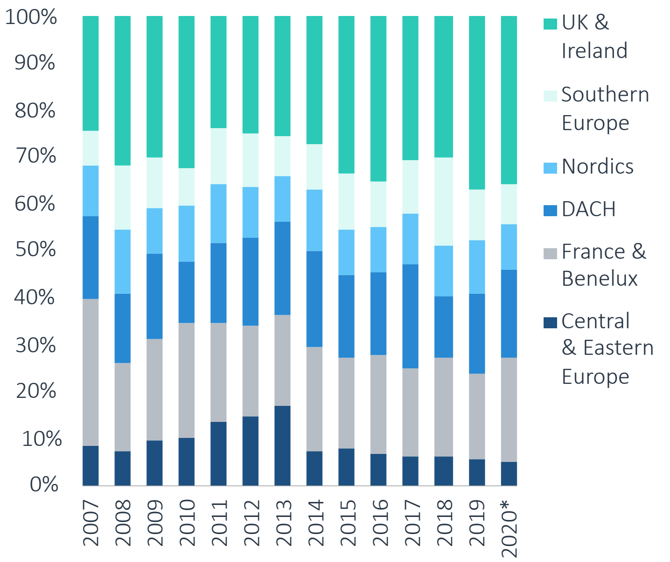
While no European region is escaping the coming downturn in M&A activity, the DACH region had a strong first quarter, accounting for €35.7 billion in closed deals, a YoY uptick of 11.0%. It was the only region to post gains in M&A value YoY. This was in part driven by Aroundtown's all stock €3.1 billion acquisition of Germany-based TLG Immobilien (ETR: TLG) to create Germany's largest commercial landlord. That said, the "all in" approach we have seen from various European governments and central banks in trying to maintain economic stability amid the crisis has caught our eye. We predict a number of nationalisations will occur through the year, as European nations fight to protect industries such as travel, IT and healthcare on national security, solvency and public interest grounds. For example, Italy is pressing forward with the nationalisation of airline carrier Alitalia, after 11 years of private ownership. The rail networks in the UK are effectively under government control as the franchise system has been paused, and Germany moved quickly to quell any rumours the US would have exclusive access to a vaccine being developed by Germany-based CureVac. The shape of the European M&A recovery will largely depend on the effectiveness of state and central bank stimulus to key sectors throughout Europe, which will probably see greater entanglement between the public and private sector in a new normal.

Cross-border M&A activity



Source: PitchBook | **Geography:** Europe
*As of March 31, 2020

M&A (€) by region



Source: PitchBook | **Geography:** Europe
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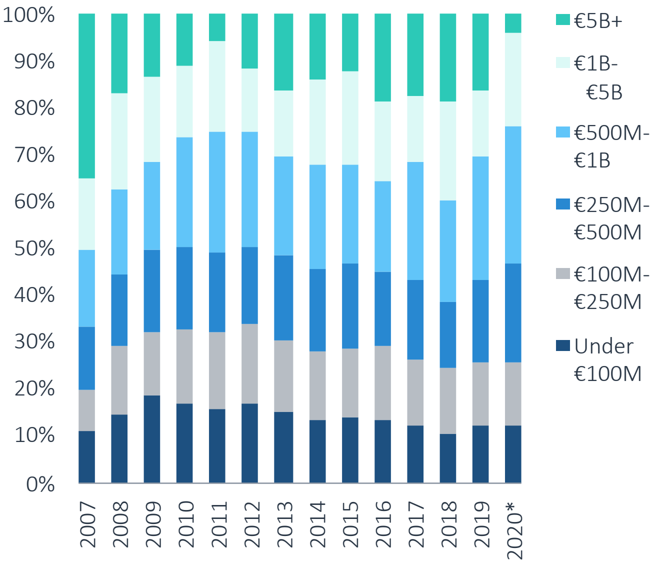
M&A by size and sector

M&A (€) by size



Source: PitchBook | Geography: Europe
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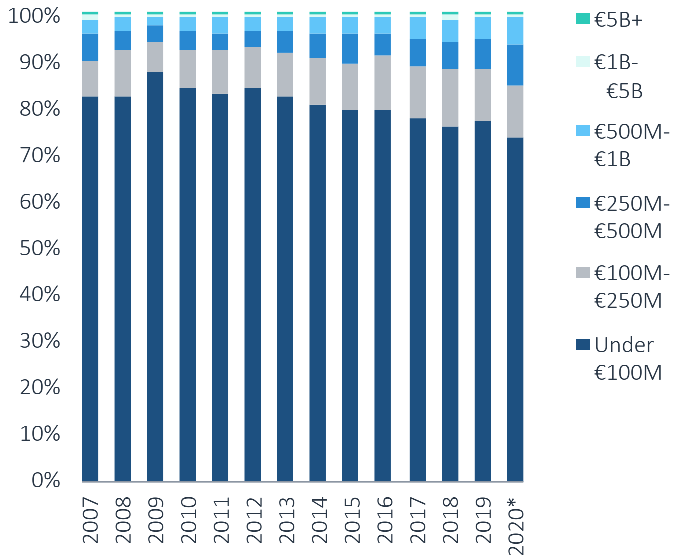
M&A (#) by size



Source: PitchBook | Geography: Europe
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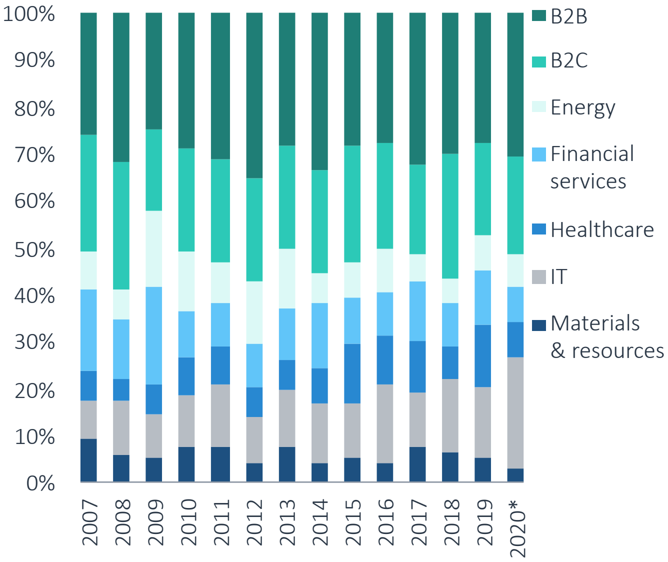
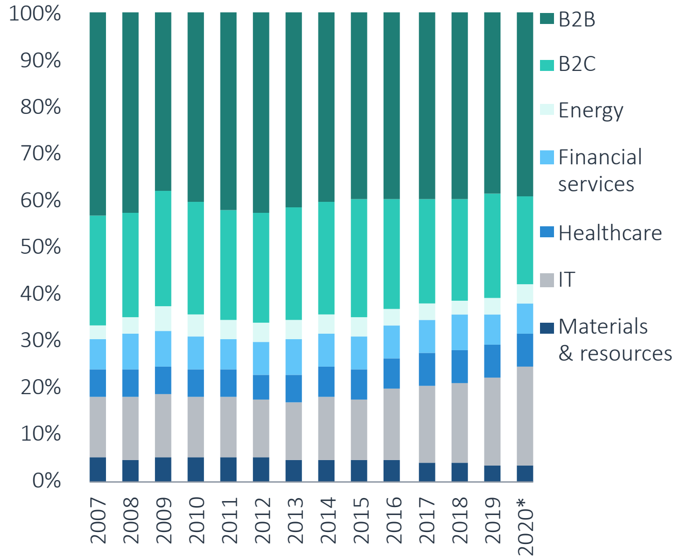
M&A (€) by sector



Source: PitchBook | Geography: Europe
*As of March 31, 2020

M&A (#) by sector



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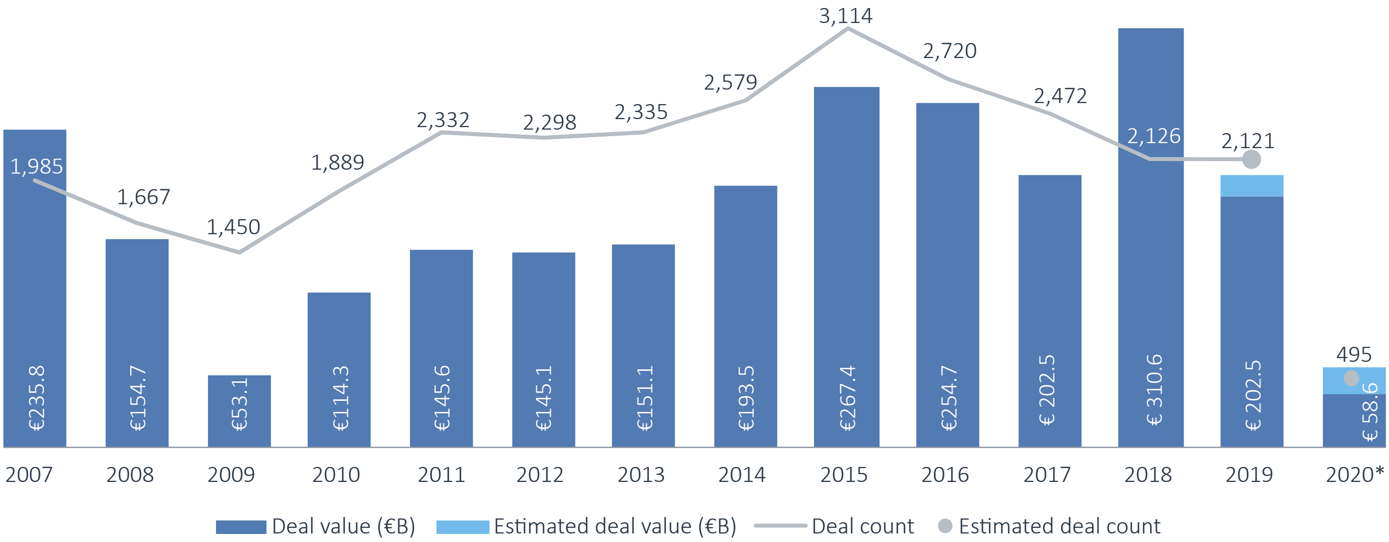
Spotlight: B2C—real estate and hospitality

B2C M&A activity

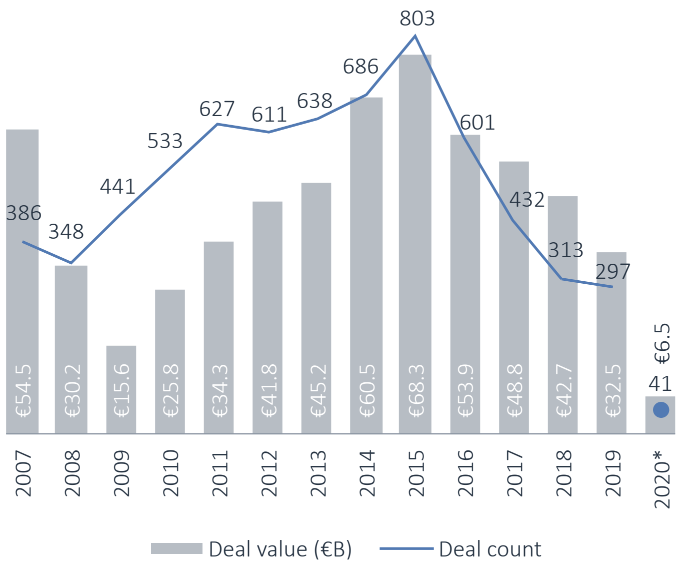


Source: PitchBook | **Geography:** Europe
*As of March 31, 2020

Between 2015 and 2019, B2C M&A deal value exceeded €200 billion each year. In Q1 2020, the total reached €58.6 billion, but despite this promising opening, we expect dealmaking through the rest of the year to slow considerably across the continent, as companies contend with the repercussions from a sweeping recession. Consumer-facing B2C companies are experiencing difficult times amid COVID-19, as traditional cyclical businesses face heightened uncertainty. Consumer demand has always fluctuated, but necessary closures and limitations on freedom of movement—which have never been seen during peace times—are dragging more businesses into financial trouble. The hospitality and real estate sectors, which include restaurants, bars, hotels and living accommodation, saw revenues drop rapidly following the lockdowns as consumer confidence plummeted 11.6 points across the EU to -22.0, near the lows from the GFC.[4]

Stonegate Pub's €1.5 billion take-private of Ei Group closed in Q1 2020, after the CMA determined it did not pose danger of monopolisation. The pub industry was already in a precarious position, as consumers opt for healthier lifestyles and have shifted towards cheaper alcohol from supermarkets for consumption at home. Interest pertaining to property ownership in the sector has been prominent, illustrated by the acquisition of

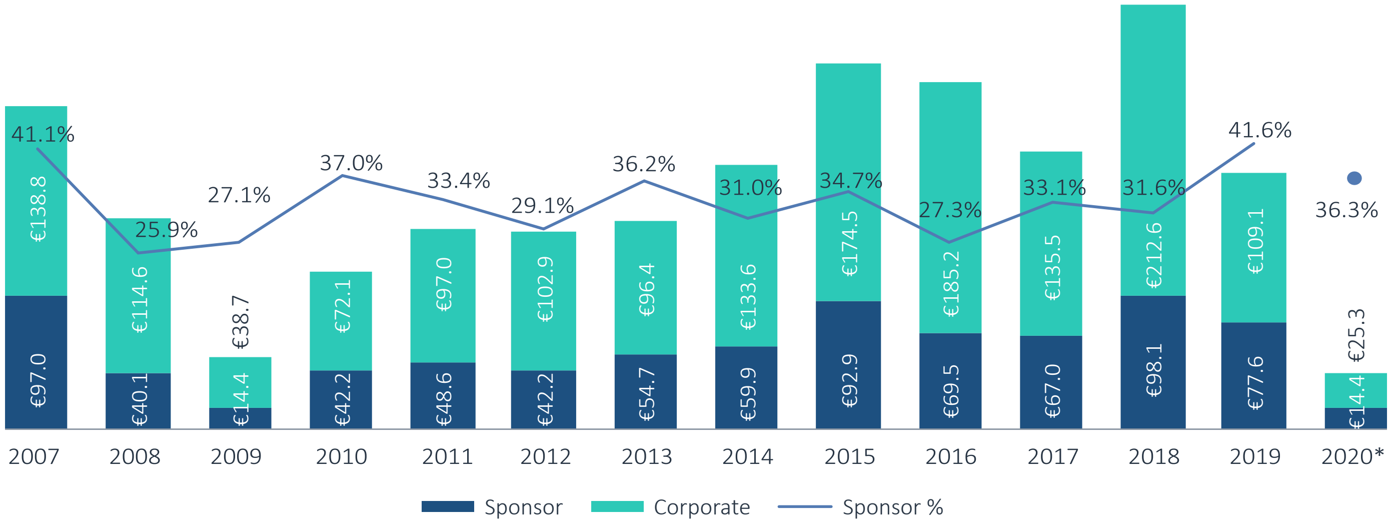
B2C carveout and divestiture activity



Source: PitchBook | **Geography:** Europe
*As of March 31, 2020

4: Consumer Confidence Indicator, European Commission, April 2020

B2C M&A (€B) by backing status



Source: PitchBook | **Geography:** Europe
*As of March 31, 2020

Green King in 2019, which also involved its substantial real estate portfolio. Pubs and restaurants in cities are exceptionally sensitive to consumer demand and tend to be in expensive locations. COVID-19 has forced some establishments to shut down indefinitely, creating short-term panic concerning high costs from rent, wages and wasted stock. Certain businesses have started delivery services but are generating only a fraction of typical revenue. We believe additional consumer-facing food and beverage companies could fall into administration as lockdowns continue and fear of infection rises, with more rescue deals taking place in the next few quarters.

Since peaking in 2015, B2C corporate divestitures have declined every year in terms of value and count. Carveouts totalled €6.5 billion in Q1 2020, largely due to Galliford Try's (LON: GFRD) €1.3 billion carveout of its housebuilding arm Linden Homes to Bovis Homes (LON: BVS). UK housebuilders have performed well in recent years, as government initiatives have aided activity despite gloomier outlooks surrounding Brexit. Cautious predictions from 2019 now look pale in comparison to the effects from the pandemic, and it has been reported that private development in London could drop in excess of 50% if construction sites remain closed until July. The novel coronavirus has transformed short-term conditions in the housing sector, and the drop in value and volume due to a prolonged recession could eat into years of growth since the GFC. Conversely, cash-rich, longstanding investors may finally see this as an opportunity to snap up contracts in the sector, in anticipation of the eventual long-term rebound in prices.

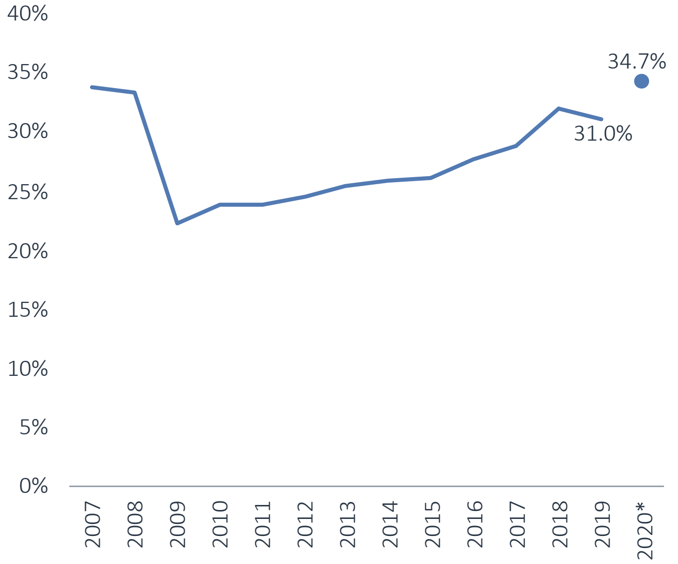
B2C sponsor-backed activity comprised 36.3% of total deal value in Q1 2020, as capital has entered the M&A market from alternative asset classes in recent years. In Q1, PE giant Blackstone (NYSE: BX) and real estate specialist Round Hill Capital sold Czech Republic-based Residomo for €1.3 billion to property management company Heimstaden. Similar deals are likely to decrease in the near term due to COVID-19, from both sell-side and buy-side perspectives. Expansionary capital outlays will become far less attractive for corporates dealing with weakened financial performance. PE managers will want to delay exits, as valuations fall in the short term, eating into returns built up over multiple years. Strategic acquirers will be more selective and will want to ensure their house is in order before moving into new markets. Furthermore, devalued targets struggling with reduced earnings may not benefit from potential disruption created by ownership changes. All factors will force stakeholders to wait and see what impact COVID-19 has on their respective businesses, and their dealmaking desire will consequently subside.

We believe cross-border B2C deals are likely to decrease at a greater extent due to economic and travel implications created by COVID-19. During the last two years, approximately one in three B2C deals involved cross-border investors, and this continued in Q1. One such deal involved the sale of Poland-based Orbis Hotels (WAR: ORB) by France-based hotel operator Accor. Accor sold Orbis to AccorInvest, the strategic real estate investing arm of the group. In 2018, Accor opened the share capital structure of AccorInvest to institutional investors including sovereign wealth funds such as Saudi Arabia's Public Investment Fund. Consumer-facing hotel groups are dealing with drastically reduced occupancy rates, and the deal demonstrates an innovative way to extract liquidity from assets and leverage long-term investors who have the resources and eagerness to invest in such portfolios.

Regionally, the UK & Ireland led the way in Q1 2020 and contributed 38.3% of B2C deal value. A notable deal for the region involved the €782.9 million sale of the iconic Ritz Hotel in London to a private Qatari investor, recently revealed as Abdulhadi Mana Al-Hajri. Qatar-based backers have invested heavily in the London real estate market, deploying an estimated €17 billion since 2007. The deal was announced on the same day the hotel closed for the first time in its history due to COVID-19. Uncertainty from Brexit did not prevent the deal's execution; however, the Ritz was reportedly initially valued at €1 billion, and the final figure reflects a significant discount. The deal also illustrates international investors remain confident that real estate tied to prestigious brands, based in unique locations steeped with history, will continue to have a long-term enduring appeal to investors and consumers during volatile times.

After a cancelled IPO in 2019, Logistrial Real Estate was acquired for €800.0 million by Union Investment Group in Q1 2020. Germany-based property group Garbe planned to list Logistrial to take advantage of the boom in the German real estate market and interest generated from TeamViewer's (FRA: TMV) and EQT's (STO: EQT) listings. However, public equity volatility scuppered the plans. The finalised deal presented a less risky option for Garbe and will result in Union Investment expanding its footprint across Europe. Confidence in European public equity performance was subdued in 2019, and we believe this fear will deepen during 2020. We could see further M&A occurring instead of listings, especially in the B2C sector where earnings and share prices are exceptionally receptive to ongoing consumer demand.

Cross-border B2C M&A (#) as proportion of total B2C M&A



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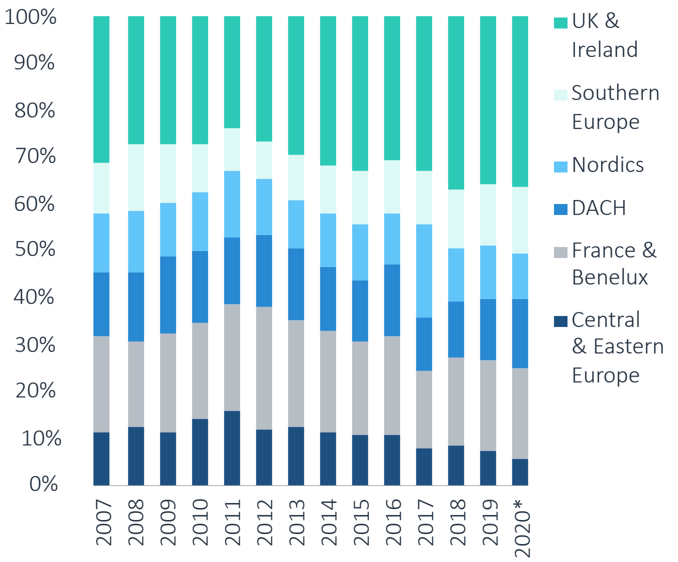
B2C M&A (#) by region



Source: PitchBook | **Geography:** Europe
*As of March 31, 2020

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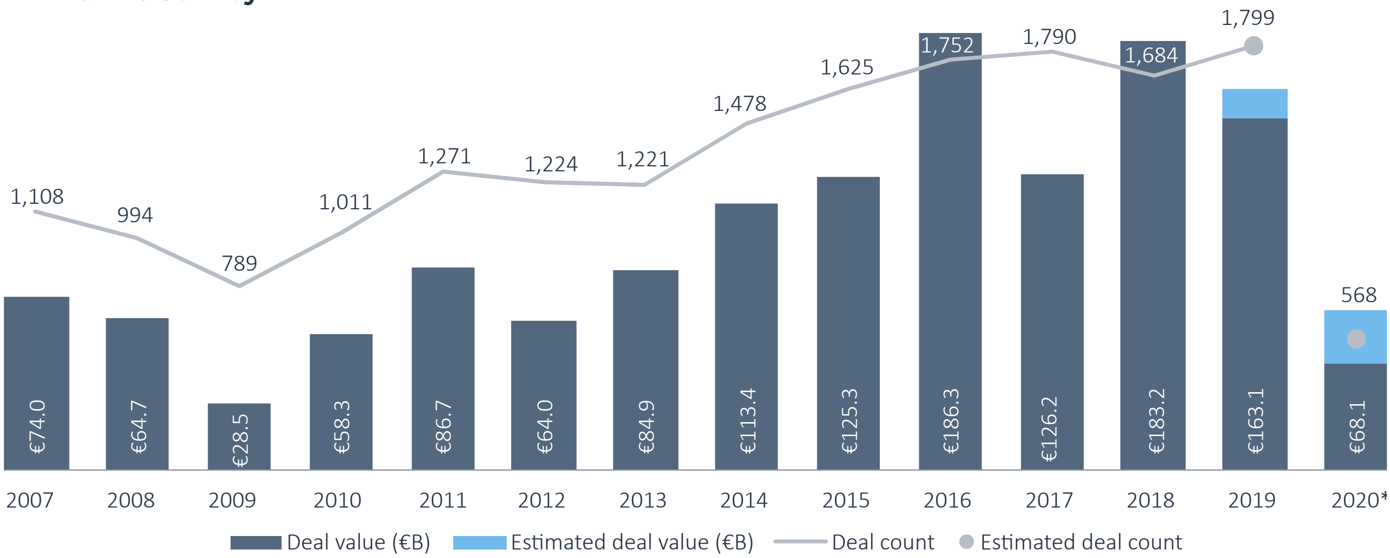
Spotlight: IT services and cybersecurity

IT M&A activity

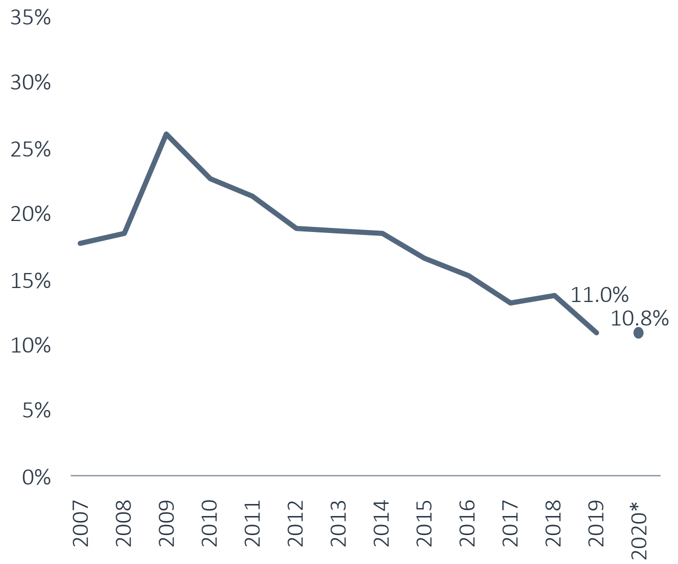


Source: PitchBook | **Geography:** Europe
*As of March 31, 2020

European IT M&A has developed robustly in the last decade and continued into 2020, raking in €68.1 billion in the first quarter. Europe does not hold the quantity and scale of the US's industry-wide IT giants, but European IT companies have been maturing in the last decade and improving their financial positions for potential deals. COVID-19 has thrown economies into turmoil, and while many sectors are being adversely affected, opportunities may arise for IT firms specialising in service provision and cybersecurity. Lockdowns have meant brick-and-mortar businesses that do not provide essential groceries or pharmaceuticals have been requested to close to prevent spread of the novel coronavirus. Consequently, business, educational and social activities have been shifted online as schools and offices close, driving IT service usage to climb higher.

IT corporate divestitures declined from 22.7% of all deals at the start of the last decade to a low of 11.0% in the year ending it, comprising just 10.8% in Q1 2020. Divestitures have become less popular as IT companies' strong financial performance has triggered horizontal and vertical integration across business units. However, carveouts are still taking place and could provide lucrative investment opportunities in a sector that may be more insulated from the upcoming economic slump. In Q1 2020, UK-based fibre optic infrastructure provider CityFibre

Carveouts and divestitures (#) as proportion of total IT M&A



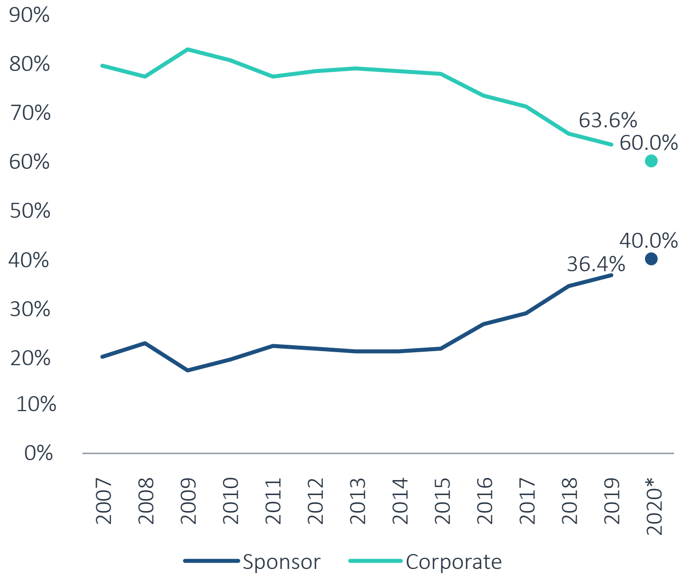
Source: PitchBook | **Geography:** Europe
*As of March 31, 2020

acquired TalkTalk's (LON: TALK) Fibre Nation unit for €224.5 million. The deal was put on hold during the 2019 UK general election, as discussions centring around the nationalisation of BT (LON: BT.A) and free fibre-based broadband thwarted attempts to finalise the deal. The deal may have greater significance now as internet usage spikes, and pressure mounts on network providers to ensure customers can benefit from reliable connectivity at fair prices. Major broadband providers in the UK including TalkTalk have lifted data caps during COVID-19, and it will be interesting to see how IT companies balance increased demand and service provision along with higher associated costs in 2020.

One of the largest European deals in Q1 2020 was the €3.3 billion take-private of UK-based cybersecurity specialist Sophos. US-based PE firm Thoma Bravo conducted the buyout and has been extremely active in IT in recent years. Investors have placed importance on companies that focus on cybersecurity as the subsector has grown in significance and greater quantities of valuable data are shared online. The price per share represented a sizable 168% premium on the IPO share price from 2015. While negotiations took place prior to disruption from COVID-19, the terms of the deal indicate cybersecurity companies continue to attract premium valuations. Furthermore, the prominence of cybersecurity in society is likely to increase as companies and individuals utilise online applications to navigate the challenges to everyday life posed by COVID-19. We believe several sectors are facing unprecedented demand-side revenue challenges, while cybersecurity companies will benefit from having to protect increased web traffic from threats.

Insight Partners' €4.6 billion buyout of Veeam, a Switzerland-based data backup provider, was another sizable deal involving US sponsors in Q1 2020. US investors have consistently identified M&A targets within Europe as key growth opportunities. Insight Partners is a seasoned software investor, having invested in TeamViewer, whose IPO was one of the largest in Europe in 2019. As a result of the deal, Veeam will become a US-based company with a US-based leadership team and will accelerate the launch of its hybrid cloud product offerings. However, in the near term we expect brand new scaling efforts in high growth sectors to flatten. IT departments are currently facing increased stress to ensure data remains accessible and safe, and this could lead to companies investing in existing operations to improve resilience. Moreover, maintaining business continuity and data protection of current physical and cloud network infrastructure for data backup companies could become far more critical during the lockdowns, rather than launching new products without in-person guidance.

IT M&A (#) by backing status



Source: PitchBook | **Geography:** Europe
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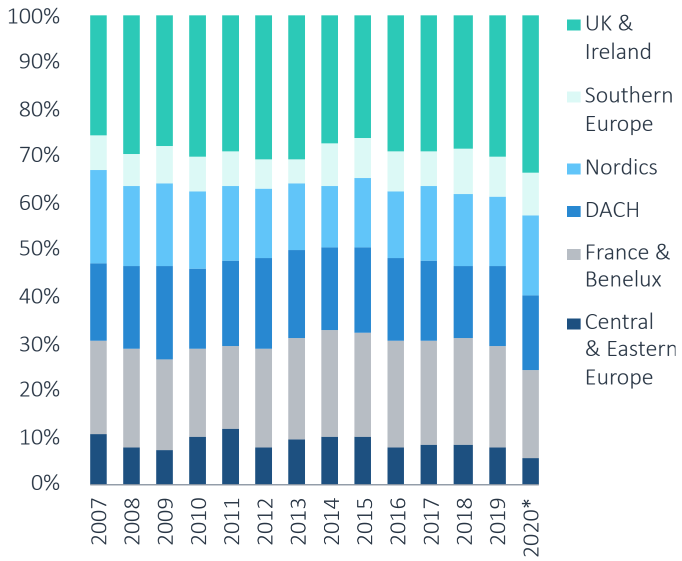
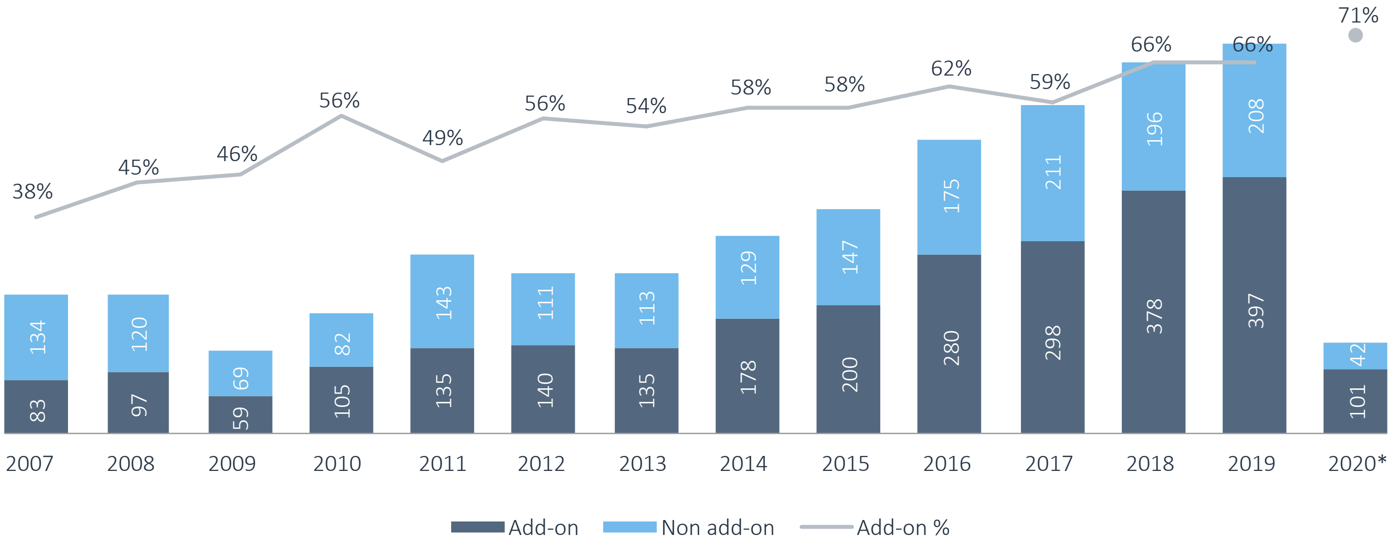
IT M&A (#) by region



Source: PitchBook | **Geography:** Europe
*As of March 31, 2020

Add-ons (#) as proportion of IT buyouts



Source: PitchBook | **Geography:** Europe
*As of March 31, 2020

The UK & Ireland had a solid quarter for IT deals, accounting for €14.4 billion in deal value. American Tower's (NYSE: AMT) €1.7 billion acquisition of UK-based Eaton Towers, a telecommunication tower operator, was a significant contributor towards the UK total. Furthermore, it added to the €23.0 billion in total value for European IT deals involving North American investment in Q1 2020, the strongest quarterly showing on record. The quantity of European M&A with North American investors has been growing since 2017 and ticked upwards to 21.4% of all deals in Q1 2020. The deal closed at the start of 2020 before COVID-19 reached Europe and North America, and it was expected to trigger further cross-border consolidation regarding European and African tower operators. However, this is unlikely to occur as recessions surface and dealmaking is halted. American Tower is one of the largest global REITs and tower providers in the world, and we feel international infrastructure market leaders with robust balance sheets could explore consolidating assets, as struggling smaller companies aim to bolster financial security amid the downturn.

Add-on IT deals have grown in popularity during the last decade and represented 70.6% of overall IT deal count in Q1 2020. One notable deal was software service provider Advanced's €90.0 acquisition of Tikit from BT. It was the former's fifth acquisition in 12 months as it targets delivering a full suite of software services. Although it is a relatively small M&A deal, it shows how a clear buy-and-build strategy can be implemented successfully in a relatively short period of time. Add-on acquisitions are smaller in size and geared towards targets that add value through specialisation as well as favourable merging characteristics with the underlying platform business. Tikit focuses on legal and accounting online software, and amid current working conditions, firms will be operating with funds and exchanging confidential information remotely with more frequency. This will make them a prime target for cyberattacks, which could result in greater investment in this sector going forward. Smaller add-ons could also present an alternative to costly mega-deals amid the economic dip as capital provision and overall dealmaking become tougher.