European Deal-Making in 2020: Insights on Selling, Buying and Opportunities for Investors

MACRO THEMES DRIVING CHANGE IN EUROPE

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It is difficult to start without stating the obvious: 2020 has changed society at its core. The fundamental paradigm shifts caused by the COVID-19 pandemic are as global as they are all-encompassing.

There are great challenges facing businesses across Europe. The urgent need to pivot, rethink and adapt to the new normal created by the pandemic, combined with social and environmental pressures that have built over the last decade have reached a breaking point—putting political stability and economic systems at risk. Furthermore, one cannot ignore the factors that are emerging on a macro level: recession, unemployment, inflation, defaults and Brexit.

However, this changing backdrop also brings significant opportunities for corporates and PE investors. The time of economic recovery offers a chance to do it better, to build it stronger and to do less harm. We see a host of new opportunities to recover, gain competitive advantages and become ready to outmaneuver future uncertainties.

More than ever, companies' fortunes are intrinsically tied to their ability to navigate challenges. Investors are increasingly refocusing their investment lens and adopting a more holistic approach after having focused on dissecting financial data and cash flows for much of the last few decades.

Emerging themes and key trends

In our view, there are three main themes that are likely to shape the new post-pandemic paradigm and drive investment and deal activity going forward:

1 Acceleration of digital transformation
The new normal is tech-enabled, AI-powered and data-driven

Digitized business models and the ability to harness technological advances are now imperative for companies to remain relevant and to succeed in the future. Digital transformation helps counter the effects of the pandemic and aids businesses in getting back on their feet. It also makes it possible to optimize operations, streamline processes, enhance the customer experience and improve decision making. Digital transformation encompasses a wholesale change throughout the organization and across activities, in addition to reshaping the role of workers and the entire value chain.

2 Development of resilient, transparent and digitized supply chains
Evolving to work better and give companies a real competitive, and Environmental, Social and Corporate Governance (ESG), advantage

Supply chain visibility is among the top strategic priorities for companies across the globe, yet it is surprising how many organizations are unprepared in the face of disruptions to supply, as evidenced during recent events.

For businesses large and small, an understanding of the entire supply chain will become ever more critical due to changes in consumption patterns and ongoing digital transformation. The pandemic has not only exposed how dependent we have become on transnational supply chains in the globalized age, but also accelerated established trends linked to technological advances, environmental regulation or interventionist trade policies.

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3 Focus on sustainability as a core tenet of business
Convergence of environmental, social and economic imperatives

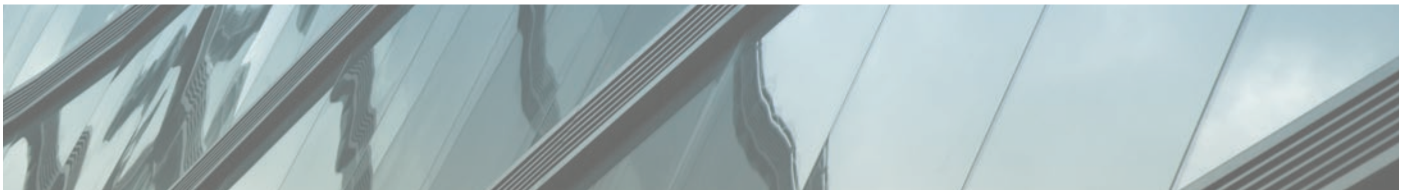
The pandemic has turned the spotlight on sustainability. ESG is now rapidly moving up corporate agendas and driving long-term strategies and growth plans. Regulation is accelerating to address growing imbalances between corporate success and social needs; sustainability reporting is becoming mainstream; and the United Nations Sustainable Development Goals are increasingly used as a framework and as evaluation criteria.

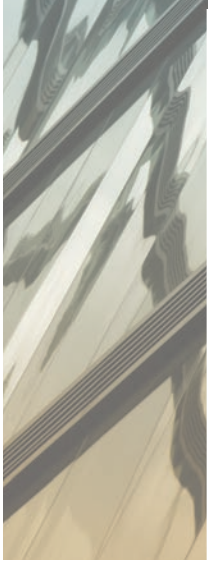
Public and private investors increasingly see ESG issues as clear financial risks and focal points of their strategies, and European governments are beginning to invest in key national industries, creating strategic equity positions in business.

Implications for European M&A

The pandemic negatively impacted deal activity across Europe, and we anticipate transaction volumes to remain lower than normal over the next twelve months. However, as companies revamp their strategies to win the post-pandemic future, and as private market investors continue to raise funds, we nonetheless expect to see a flurry of activity as we slowly emerge into a new normal.

While the next few months certainly will provide a degree of uncertainty, emerging trends and opportunities are increasingly becoming clearer, with the societal impact of COVID-19 shoring up long-term investment potential for private market investors looking to ignite their dry powder in the remainder of the year and early next.





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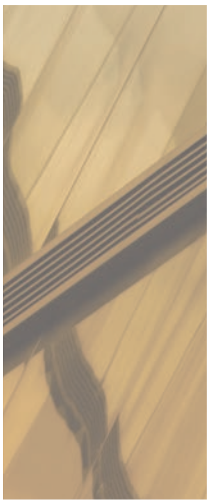
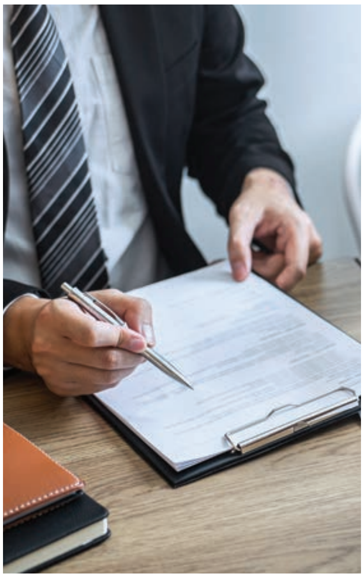


	H1 2019		H1 2020		% Decrease in deals completed between H1 2021 & H1 2020
	Mid-market deals completed	% of total European mid-market deals completed	Mid-market deals completed	% of total European mid-market deals completed	
TMT	377	22%	309	23%	-18%
Consumer	177	10%	121	9%	-32%
Industrials	257	15%	213	16%	-17%
Healthcare	217	13%	162	12%	-25%
Business Services	423	25%	364	27%	-14%



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BUSINESS SERVICES NEED TO ADAPT TO THE CHANGING LANDSCAPE

Contributor:
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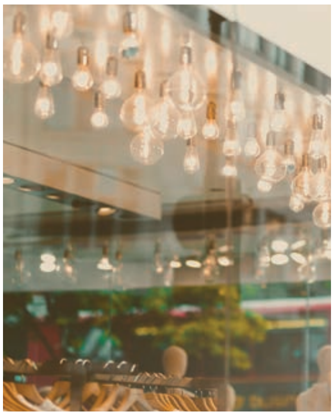
In their search for sustainable growth, investors in business services companies have worked hard to understand the impact of COVID-19.

Among the hunches, speculation and educated guesswork, certain trends appear to be playing out. The HR department has taken on additional responsibility for those working at home with implications for the wider market, and wellness and wellbeing have been prioritized. Flexible working patterns have accelerated the use of distance learning models in corporate training. Hiring and assessments have been done remotely and at scale for the first time by employers of all sizes. Meanwhile, health and safety compliance continues its rapid migration from locally-held, manually-populated excel spreadsheets to high-end digital platforms that drive usage through clever user experiences. Many of these trends will continue, and those facilitating these valuable services stand to gain advantages from being early adopters. Those unable to adapt will face a tough future in the highly competitive HR sector.

As the UK government moves to address the onset of high unemployment, we expect major initiatives to promote productivity and re-skilling as well as incentives to invest in areas with the highest skill shortages such as engineering, sciences and technology. Outsourced service providers of all kinds should benefit from this—the government support is not exclusively an opportunity for the largest companies. We anticipate plenty of investment opportunities to arise in this field in the coming months, but only investors with conviction and who are agile enough to respond will catch the most valuable, early stages of this market.

Turning to deal craft, some tasks previously deemed impossible to undertake remotely are seeing signs of change. Private equity houses have been able to complete investments virtually and without meeting management teams in person, something many would have never sanctioned pre-2020.

While severely impacting volume in some subsectors, the pandemic has also changed the way some deals are structured, such as increasing numbers of cashless mergers, as well as the use of earn-outs and deferred proceeds. If valuations remain relatively high, the recent trend of investors asking for increased reinvestment from management will continue, as will the reliance on warranty & indemnity insurance to mitigate known and unknown risks. The best services assets will always buck the trend, but for many processes it seems like there will be a reweighting of risk towards the sellers in the coming twelve months when compared to the seller-friendly market of 2019.



CONSUMER INDUSTRY, AN INDICATOR OF ECONOMIC CHANGE

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The consumer industry is often seen as an early indicator of economic change. As markets emerge from COVID-19 lockdowns at differing times, all eyes will be on subsectors to gauge the health of the economy.

The consumer industry is often seen as an early indicator of economic change. As markets emerge from COVID-19 lockdowns at differing times, all eyes will be on subsectors to gauge the health of the economy.

Encouragingly, a proportion of subsectors within the European consumer industry have either benefited from or recovered quickly from COVID-19, such as producers of staple foods, direct-to-consumer e-commerce enabled businesses, certain beauty product categories and pet food. While discretionary spend curtailed during lockdown, demand for necessary products and pseudo-necessary products purchased online skyrocketed. Further, with reduced consumption, recognized brands and quality products have come out on top. As different generations shelter under one roof, adoption of sustainable brands with environmentally-friendly packaging are seeing increased demand.

Looking ahead, these bright spots will attract the attention for potential purchasers. Many of the changes in consumer behavior during the pandemic will be long-lasting, and investors will find opportunities in brands that have aligned their practices with these tailwinds.

The hospitality sector was heavily impacted by the pandemic but is seeing promising signs of recovery. According to OpenTable, Germany saw 80% capacity in restaurants compared to pre-COVID-19 levels within 30 days of re-opening. Likewise, government backed schemes like "Eat Out to Help Out" in the UK breathed life into the historically slower market trading days, but with such support temporary, the long-term impacts on the industry remains to be seen.

One direct-to-consumer business that has attracted the interest of private equity investors is luxury goods. Like many industries, luxury goods companies struggled in 2020, but at the same time new—and promising—trends emerged during lockdown. As people stay home and seek comfortable, yet stylish, items, there has been an uptick in sales of activewear, loungewear and homewares, according to a recent Vogue article. Additionally, shoppers are willing to purchase "investment pieces" that have lasting value.

Looking ahead, e-commerce capabilities will be critical to success, but in-store experiences will not lose their luster when in-person shopping returns. This especially holds true for when tourism, and the resulting shopping, begin again in earnest.

The luxury goods sector has been in a period of consolidation over the past 10 years because M&A can help create economies of scale—opening the door to prime physical locations, the latest technology and top-notch talent. Additionally, diversity created through consolidation allows luxury goods companies to create financial resilience—enabling them to better withstand dips in sales. Even after the 2008 financial crisis, luxury goods spending continued and brands that offered diverse items, from a high-priced handbag to a T-shirt, excelled in the following years.

Consolidation of medium-sized luxury businesses over the next three years will be driven by the cash flow pressures placed on them following larger players' investments in digitalization and an overall omnichannel experience to create global scale and ubiquitous brand appeal. Larger conglomerates are well positioned to purchase these medium-sized companies, further benefiting from economies of scale.

The opportunity for private equity investors, especially in Italy and France, is to purchase, grow and sell luxury suppliers, luxury services companies and up-and-coming brands. For emerging brands, this can be through a "plug and play" strategy, where PE can sell to larger luxury conglomerates, filling a gap in their brand families and realizing the brand's potential through the buyer's global reach.

RESILIENT EUROPEAN HEALTHCARE SECTOR GAINS MOMENTUM

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The European healthcare M&A market has been adversely affected by a number of external factors in recent years. Trade and currency wars between the U.S. and China, Brexit, changes in underlying regulatory environments and obvious signs of a recession are adding to the political rise of populist parties worldwide. Subsequently, this has brought a high level of uncertainty to capital markets, market participants and the European healthcare M&A environment. Furthermore, the pandemic resulted in a perfect storm scenario in 2020.

> *The healthcare sector has always been a priority investment for most financial sponsors due to its long-term growth drivers and resilience.*

Nevertheless, the healthcare sector has always been a priority investment for most financial sponsors due to its long-term growth drivers and resilience. Its resilience has been evidenced very clearly during COVID-19, and therefore it is no surprise that investors plan to increase their weighting towards healthcare at the expense of more cyclical sectors.

Sectors and related sub-verticals in healthcare (including healthcare services, medical technology, healthcare IT & digital health, specialty pharma and life sciences) show resilience, sustainability and further consolidation activities to gain market share, strengthen the pipeline, expand geographic reach, bolster both top-line and cost-take out synergies—and, in some cases, fuel new growth momentum due to an adapting business environment. We will see more convergence between healthcare and technology resulting in a rapid development of new business models. Moving along the value chain becomes an imminent need and challenge for market participants.

> *Sectors and related sub-verticals in healthcare... show resilience, sustainability and further consolidation activities to gain market share, strengthen the pipeline, expand geographic reach, bolster both top-line and cost-take out synergies.*

In the UK, healthcare payor dynamics are key, as is demand resilience, sometimes at the expense of growth. As such, it is no surprise that social care, certainly at the specialist end, is in the spotlight given its secure funder dynamics, stable and growing demand as well as statutory requirements to provide for children or adults in need. In the UK, there are five or six specialist residential care companies in or coming to market. Other examples of subsectors with secure payor dynamics include NHS dentistry, pharmacy and ophthalmology (including cataract surgery). The veterinary sector has also yet again shown its resilience, and as such we expect strong interest in all subsectors serving the broader animal health space going forward. Additionally, pharma outsource services again is seeing significant interest with a healthy number of mid-market opportunities in the market, or coming to market, due to its resilience during the pandemic and the continued benefit of long-term outsourcing from big pharma.

DIGITALIZATION AND DISTRIBUTION DRIVE INDUSTRIALS SUCCESS

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It is impossible to generalize about the industrials industry as a whole, but a few key themes have emerged or become more pronounced since the emergence of COVID-19. The commercial aerospace and automotive sectors have predictably suffered because of the effects of COVID-19 on their customers. However, even sectors hardest hit by the pandemic will find opportunities in mid-size companies seeking to diversify by leveraging their expertise in other markets or expanding to new geographies. Corporate carveouts reshaping operations around core businesses will also contribute to the emergence of new champions in the industrials space.

Large parts of the manufacturing and distribution infrastructure have shown remarkable resilience, thanks in many cases to decisive management actions. There has been an often-repeated pattern of businesses that were shut down or partly shut down for four to six weeks, but after that, and in conformity with local regulations, they have gradually come back to nearly full capacity. One consequence of furlough-type arrangements has been the gradual re-employment of staff. This has, however, in many cases involved a proportion of the staff – say 15% – not being re-employed, and therefore businesses are operating with a lower cost base than before COVID-19.

Two important and related themes – digitalization and the role of distribution – have come to prominence over the last six months. The limitations of travel and face-to-face supplier-customer interaction have highlighted the attractions of businesses that can interact with their customers online. There have been clear examples, for instance in building products manufacturing, of businesses with an efficient online customer interface winning share from those that do not. Similarly, distribution businesses that have a branch network and also a strong online presence have seen the branch ceasing to be the 'shop window,' but instead the depot for a 'click and collect' or 'click and deliver' model.

In some geographies, opportunities will also abound for renewable or alternative energy players and companies offering energy saving solutions to a construction marker that is in dire need of insulation materials and services. For example, France's €100 billion economic plan will particularly favor the green transition.

The other segment that has shown resilience is industrial technology, that collection of businesses providing automation, measurement, control and testing in industrial processes. It is benefitting from a long-term trend towards the more efficient use of materials and labor and has also been aided by a recognition that lean manufacturing processes have coped better with the restrictions imposed due to COVID-19. It is notable that the share prices of Hexagon (HEXA-B.ST) and Renishaw (RSW.L), the two leading European industrial metrology companies, have increased by 28% and 51% respectively since the beginning of 2020.

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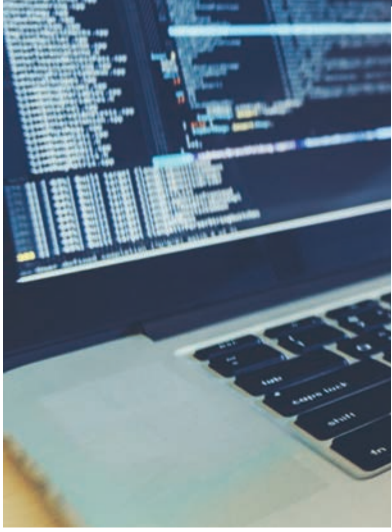


BRIGHT SPOTS IN TMT DURING THE PANDEMIC

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While the number of transactions and opportunities has reduced as COVID-19 continues to affect the global environment, there is a strong appetite for "COVID-19 proof" or even "COVID-19 winner" companies. In a number of technology, media & telecom (TMT) segments, there is resilience and great activity caused by a combination of business models, the critical need of tech services and an accelerated switch from offline to online activities.

One bright spot during the pandemic has been software. With increased pressures on all companies and industries to accelerate their digitalization strategies, proprietary software companies and outsourced software developers have performed particularly well through the pandemic to date. As such, there has been a significant increase in interest from trade buyers and investors in software companies as well as companies providing IT and communications infrastructure and service providers with resilient, high recurring services revenues.

Managed service providers (MSPs) are benefiting from their clients' need to upgrade IT, communications infrastructure and software to facilitate increased digitalization across their business. Throughout the pandemic, MSPs also ensured that their corporate clients' staff and colleagues were able to communicate and work effectively together—first at home, and now with the emerging hybrid working environments of part-time at home and part-time at the office.

Businesses able to capitalize on these software and managed services trends are commanding stronger valuations than before the beginning of the pandemic, especially with the increased appetite for quality tech assets simultaneously shortening processes.

Unsurprisingly, businesses able to capitalize on these software and managed services trends are commanding stronger valuations than before the beginning of the pandemic, especially with the increased appetite for quality tech assets simultaneously shortening processes. As a result, to be successful in processes, investors are advised to deepen their understanding of businesses and markets ahead of formal processes, not only building a rapport with management teams, but also speaking to knowledgeable advisers, consultants and industry executives. Conviction needs to be built early to reduce the dependence on vendor due diligence reports and improve the certainty to close. Investors need to be highly selective when assessing opportunities and will need the internal procedures in place to be able to move quickly.

Additionally, private equity can benefit from another recent trend: the significant acceleration of PE-backed companies' build-up strategy in a context of lower organic growth. In H2 2020, three of our closings in France, to date, are exits to such acquirers, both in the U.S. and Europe. In one of these deals, Lincoln advised Alkemics on their series C fundraising. Alkemics, a pure SaaS model, is the leading European supplier-retailer collaboration platform, already working with France and the UK's largest grocery retailers.

UK

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Macro-level factors, such as recession, unemployment, inflation, defaults and Brexit, are heavily influencing UK government policy. As various financial support schemes start to wrap up in Q4, businesses brace for the economic impact. In their place, there will likely be a raft of schemes to kick-start the economy to avoid a long-term financial downturn. One of the big winners here will be infrastructure, both physical and digital. Coined the "Prime Minister's infrastructure revolution," the government will look to invest in ongoing projects from transport to 5G. Indications are the potential level of investment will rival that of post-2008 with experts suggesting private sector investment could play a critical role.

SWITZERLAND

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Despite the strong slowdown of deal activities in Q2 2020, the Swiss economy has recovered relatively well, and the M&A appetite remains robust for the right deal. "COVID-19 immune" or "COVID-19 robust" assets in healthy sectors such as TMT, healthcare and selected business services companies are receiving strong and broad interest while also demanding premium valuations. Also, in sectors with a more profound drop in current trading in Q2, a premium valuation may be possible subject to the uniqueness of the target and the interest of trade buyers.

In the coming months we expect a pick-up of deal announcements, though lower than previous years, as the confidence in the outlook grows on both sides of the table. Whereas private owners and private equity may remain cautious on launching a sell-side process currently, we continue to see strong disposal activity by corporates for non-core activities.

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GERMANY

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Looking ahead, the competition between private equity investors and strategic acquirers for healthy and profitable targets will further increase. Additionally, valuations in sectors like healthcare, technology, e-commerce or business services will remain at a high level. This trend will be reinforced by the fact that private equity raised record sums in previous years for investing in German companies. In comparison to the last financial crisis in 2008/2009, private equity has a much stronger investment pressure today as many financial investors found great success during or immediately after the crisis.

However, the COVID-19 pandemic will also offer interesting opportunities in Germany. Many medium-sized companies are currently seeking capital to revive or further expand their business models, especially in terms of digitization. In addition, there will be larger corporates which have to dispose of non-core activities to finance their main business, and for those carve-out deals, experienced financial sponsors are the ideal buyers. We also believe that we will see significantly more minority and co-investment transactions carried out with family businesses or strategically complementary companies.

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ITALY

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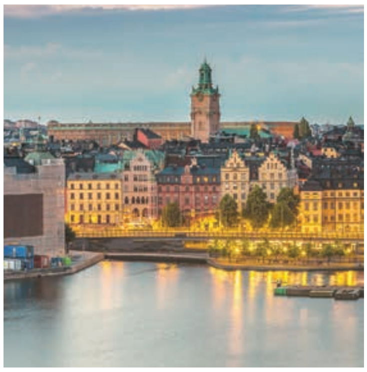
Similar to other European countries, the Italian economy is facing unprecedented headwinds but is buoyed by the support of the European Central Bank (ECB) Pandemic Emergency Purchase Programme (PEPP) and the Italian government's state aid packages.

We anticipate M&A volume and value to experience a significant dent in 2020. However, resiliency in select opportunities is possible. As almost everywhere else, Italian companies active in healthcare and TMT have shown positive growth and strong M&A deal flow. Recognized food brands and consumer products have benefited from increased online revenues, and industrial companies in specific segments, such as those supplying the energy and healthcare industries, have shown resiliency throughout the pandemic.



NORDICS

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Deal activity in the spring was the lowest on record since the financial crisis. Due to the disruption, there is presently a shortage of quality assets as momentum is picking up. The excess demand presents a great opportunity for well-prepared owners looking to launch in the second half of 2020 or first half of 2021.

Large volumes of near-term PE exits were paused in the spring, and while some of these assets will have taken a hit and may not return as an exit anytime soon, other assets that have fared better will take their place in the exit schedule. Looking at the entire portfolio of all sponsors in the Nordics, we expect to see a number of these assets being marketed in late 2020 and 2021 on the back of a regained momentum in the debt market and a strong equity market.

A number of factors speak well for a rarely seen market opportunity for Nordic sellers being able to approach the M&A market in late 2020 or early 2021. With a shortage of quality assets, a strong equity market, increasing appetite in the debt market and a significant increase in interest from trade buyers, the timing for an accelerated exit process has seldom been better.

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BENELUX

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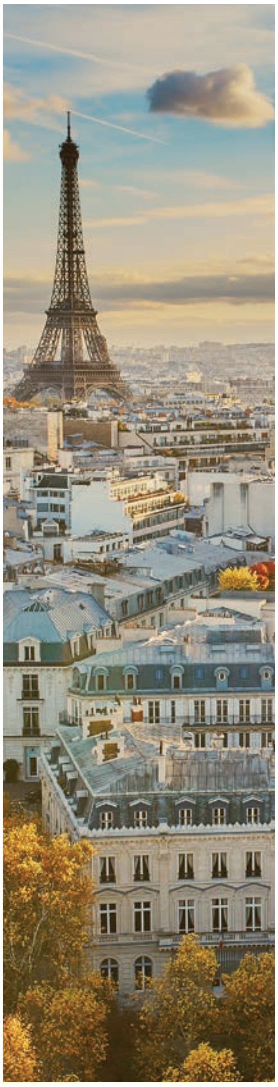
For the remainder of the year, we expect the market to be open for assets of quality, mostly in healthcare, software and certain business services sectors. These assets will be hotly contested as the overhang of dry powder of both strategic and financial investors remains. In addition, we expect that some sale processes that were halted in Q2 will come back to market, provided they can prove limited impact of COVID-19 on the underlying business. As government measures fade away, some businesses will need balance sheet restructuring which in turn may lead to further M&A activity.



FRANCE

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François Rispoli, Managing Director

The sharp decline in deal numbers during H1 reflects a challenging wider macro-economic context, with GDP expected to contract by over 8% in 2020. There are, however, signs of recovery as the French economy gradually reopens.

We are confident in the long-term attractiveness of France to both international and domestic buyers. Inbound cross-border deal volumes did fall in H1 2020, but we have seen an uptick in deal interest from foreign buyers recently. Domestic deals are led by private equity firms who benefit from large piles of dry powder after a cautious first semester. This situation has led to a contrasted M&A market—transactions in "pandemic proof" sectors such as technology or healthcare have been on the rise and negotiated at enhanced multiples, while most transactions within strongly impacted sectors like retail, tourism or aerospace have been put on hold.

As sentiment improves, we see deal activity showing more encouraging signs since the end of the lockdown. As we round out the year, we could see some recovery in activity; although with the current resurgence of COVID-19, no one is sure how long it will take for a full recovery to take hold. French M&A processes previously paused are now coming back live. There is plenty of private equity demand, and some strategic buyers are now on the offensive.

There is plenty of private equity demand, and some strategic buyers are now on the offensive.

SPAIN

Contributor:
Iván Marina, Managing Director | CEO Spain

In Spain, the economic and social impact has been particularly intense since mid-March due to the relative economic weight of the sectors that were most directly affected. The new recovery plan will enable the country to mobilize an unprecedented volume of investment with the goal of modernizing key strategic sectors such as the agro-industry, biotechnology, green-energy and tourism.

The dynamics within the M&A market are quite similar to the ones being experienced in the rest of Europe, marked by excess liquidity and severe competition for quality assets. We believe there are still untapped opportunities, especially around mid-size companies with significant exposure to international markets. This has been the case recently in the food and animal sectors, where private equity funds have invested heavily. We expect corporate carve-out and M&A activity fueled by refinancing processes to accelerate during the coming months.

In a way, competition amongst debt funds for investing in the strongest credit profiles has become even fiercer than pre-COVID-19. Winners will be borrowers combining robust market drivers, a flexible business model (COVID-19 has been a remarkable test) and a well-articulated credit story.

COMPETITION AMONG DEBT FUNDS HEATS UP

Contributor:
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From a financing perspective, there is liquidity available to support M&A activity at a macro level. Banks are better capitalized than in the last recession, and credit funds are well established in many European jurisdictions with vast amounts of dry powder and deployment often behind budgets. Since March, completed new financings have primarily involved companies with no material financial underperformance from COVID-19; however, some processes have now kicked off or been revived where prospective borrowers faced significant disruptions. Circumstances are scrutinized, but the financing can be structured on a partial or full look-through basis, adjusting for the COVID-19 impact.

Further good news for deal making is the appetite alignment between equity and debt investors. We expect continuing focus on recurring revenue business models and segments of the technology & software and healthcare sectors. Other sectors can also meet financiers' eye. Leverage of 5x-6x is not unheard of for industrial businesses with a unique regulatory, automation or energy efficiency angle. In a way, competition amongst debt funds for investing in the strongest credit profiles has become even fiercer than pre-COVID-19. Winners will be borrowers combining robust market drivers, a flexible business model (COVID-19 has been a remarkable test) and a well-articulated credit story.

LENDERS IN EUROPE ARE OPEN FOR BUSINESS

Contributor:
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The COVID-19 pandemic showed is full effect in the European LBO market in Q2 2020 as many side processes were put on hold.

In that environment, we see debt funds continue to increase their market share. This may also be driven by the fact that most banks were busy with handling applications for the government aid program (e.g. "KfW-loans") and their own portfolio work.

Pricing and other terms have now returned to more "normal levels" compared to the peaks seen in April/May—however terms have not returned fully to pre-pandemic levels.

Lenders say they are open for business and will look at new deals, but they are generally very picky. Most lenders are concerned about a second wave of COVID-19 and therefore hesitant to lend against companies with a COVID-19 exposure.

We expect an increase of covenant resets and restructuring in H2 2020 when the positive Q1 quarter impact will be reduced in the covenant calculations. Lenders are generally supportive of companies and are actively looking for a constructive solution. However, in more severe cases (e.g. liquidity constraints), lenders will expect a meaningful contribution of the shareholders.

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