# A NEW STATE OF PLAY

## EUROPE AND MIDDLE EAST M&A OUTLOOK 2023

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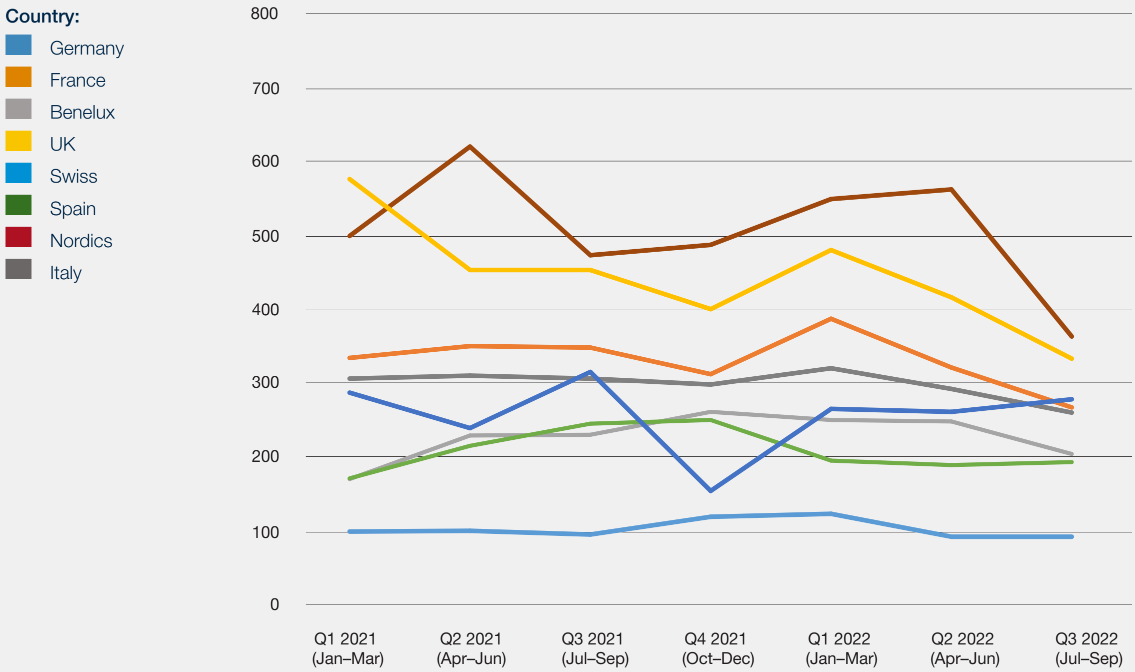
# Introduction

Merger and acquisitions (M&A) in Europe and the Middle East have seen a marked slowdown in 2022 as corporate and financial acquirers turned cautious amid rising economic anxiety.

Dealmaking in the region dropped by 11% from January to October 2022, compared with the same period of 2021, according to MergerMarket data[1]. Private equity-led activity took the biggest hit, falling by 23% in value in the period, and contributing heavily to the overall decline.

While M&A activity remained resilient in the first months of 2022, it lost momentum as macroeconomic conditions deteriorated throughout the year. This was reflected in the third-quarter numbers, which plunged sharply compared with the prior quarter.

## Number of quarterly deals per country




Comparisons with 2021 – an extraordinarily robust year for M&A given the strong economic rebound following Covid and abundant liquidity in the market – should be made with caution.

However, there is no doubt that the M&A backdrop has changed fundamentally, with surging inflation, rising interest rates and a higher cost of financing applying the breaks to the acquisition frenzy of the past few years.

If these challenges persist over the coming months, then we could see a more significant underperformance vis-à-vis the recent historic average. Conversely, an improved economic environment can quickly reverse this downward trend and put deal levels more in line with pre-pandemic years.

In this article, we will explore the reasons behind the recent cooldown in deals, the key trends in the M&A market in 2022 and how they are likely to shape activity in 2023.

[1] Compiled by A&M's Insight Center.

# M&A Activity in 2022

Multiple economic and financial headwinds have complicated dealmaking globally in 2022. Europe in particular has been beset by its unique set of challenges, including a severe cost-of-living crisis, monetary tightening and the ongoing war in Ukraine. The latter has disrupted the supply chains and energy markets in the region more than in any other.

Official forecasts predict an even tougher period in 2023, with growth in the 19-nation euro zone projected to slow to 0.5%, from 3.1% in 2022 and 5.2% in 2021, according to the International Monetary Fund (IMF). Headline inflation is expected to remain stubbornly high in 2023, at 5.5% from an average of 8.1% in the previous year, according to the European Central Bank (ECB).

Another key deterrent to dealmaking has been the tightening of credit conditions, with banks pulling back the financing of leveraged buyouts amid rising interest rates and a broader risk-off environment. Leveraged loans issued to fund PE acquisitions have largely dried up across Europe and the Middle East. When available, the EBITDA multiples which can be financed have dropped, meaning a higher equity cheque and therefore reduced returns for PE houses. Large-cap deals have been particularly affected, dragging deal value numbers down.

## By the numbers

This worsening backdrop for M&A was reflected in the third quarter figures more than in any previous quarter in 2022. Diclosed value of deals in the period dropped 35% compared with the third quarter of last year, according to MergerMaket data. In number of transactions, there was a 25% year-to-year decline.

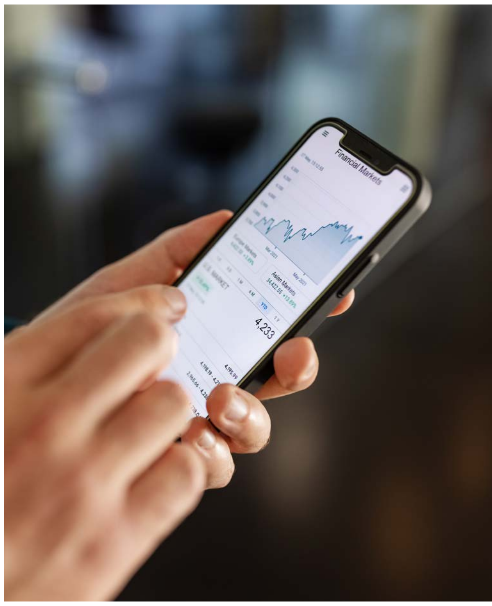
Again, the slowdown in PE dealmaking was more pronounced than that of the overall market, with deals plunging 65% in value and 33% in numbers in the third quarter versus the same period of 2021. In comparison, corporate-led deals declined 12% and 16% over that quarter.

These numbers may suggest a healthier level of appetite among trade buyers compared to their financial sponsor counterparts. This could be partly explained by the difficulties faced in underwriting debt for the leveraged buyouts that sustain PE activity, as mentioned previously. In addition, the market dislocation may be creating more opportunities for corporate buyers – especially those with large cash reserves – to invest in assets seen as good strategic fits.

Examples of recent transactions completed by trade buyers include Thermo Fisher's acquisition of Nordic Capital-owned The Binding Site, a UK-based specialty diagnostic platform. In the mid-market, French glass manufacturer Verallia bought Allied Glass from PE house Sun European.

Looking at year-to-date[2] overall numbers, M&A deals declined 11% in both value and volume compared to the same period last year, to €1.02 trillion and 3,639 transactions respectively.

Anecdotally, we saw a clear bifurcation in the M&A market in relation to the size of the deals, especially after the summer. Large-cap transactions have seen a sharp decline as public debt markets closed down, whilst mid-cap activity has proved more resilient. One of the main reasons for that is the availability of funding for smaller deals via cash-rich private credit funds.



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## Countries & sectors

Dealmaking in specific countries has largely mirrored the region-wide trend, easing off considerably throughout 2022 compared with the previous year.

In the Middle East however, the number of deals decreased only slightly from 366 in the nine months to September 2021 to 343 in the nine months to September 2022. Companies in Israel, United Arab Emirates and Saudi Arabia were the most targeted by buyers, accounting for 54.2%, 20.7% and 9% of total deals in the region.

Middle East activity was positively impacted by the strong macroeconomic environment, as oil exporting countries benefited from recovery in oil prices post-Covid and the Russia-Ukraine conflict. Dealmaking also continues to be supported by regional governments' efforts to diversify their economy and shift away from dependency on oil, including fiscal reforms aimed at bolstering cooperation between the private and public sectors.

As the economic climate grew tougher, we observed that the majority of M&A activity across both Europe and the Middle East concentrated in recession-proof sectors including software & technology and healthcare. Infrastructure transactions have also been a bright spot.

For high-performing companies in those industries, high multiples are still available.

In other sectors, many sellers are still opting to wait out the market instead of selling at lower prices, leading to a growing number of pulled processes. However, more recently, we saw that slowly but surely the sell-side is starting to lower their price expectations, in line with the new deal environment.

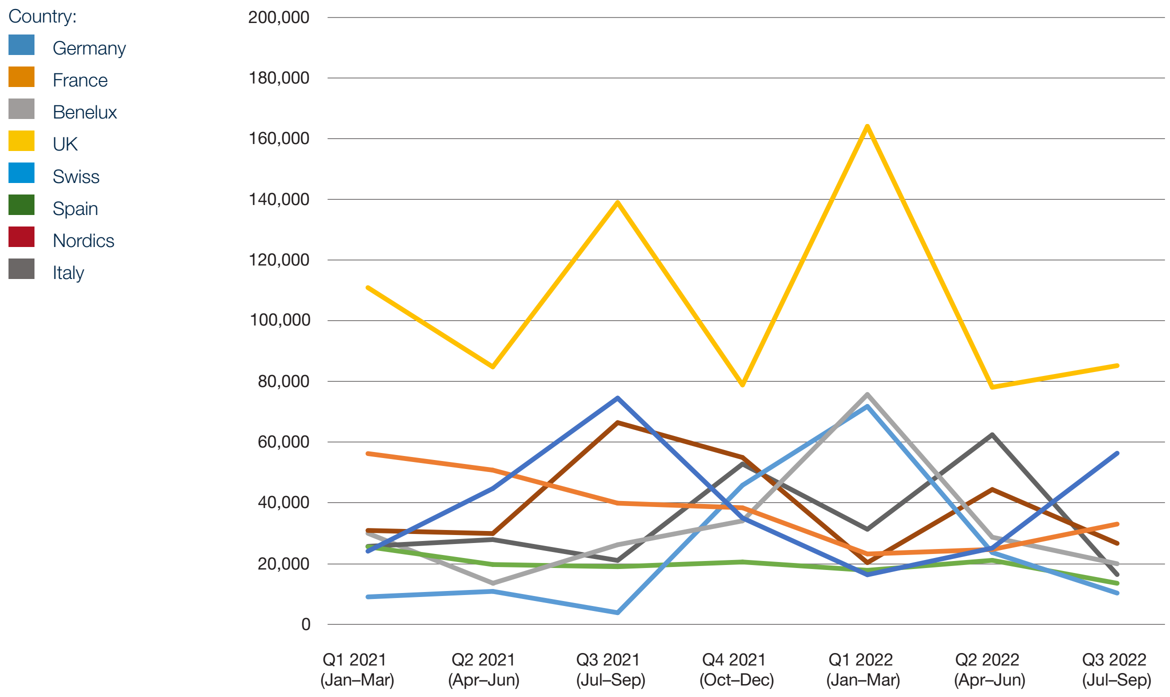
[2] YTD numbers refer to the period between January and October

# 2023 Outlook: A new dealmaking environment?

We expect that the same headwinds that plagued activity in 2022 will continue to slow the M&A market in 2023, especially in the first half. For European dealmaking environment in particular, one critical driver in our view is how the war in Ukraine will evolve in the coming months, given its direct impacts on energy prices for countries in the region.

Better visibility in the second part of the year regarding companies' performance outlook, public-to-private opportunities, distressed situations and generally lower valuations may create new opportunities and release pent-up deals. However, in this more complex environment, timelines of deals will likely be longer and risk execution higher.

## Disclosed deal value EUR (m)



# Other trends shaping the M&A market in the months to come include:

**Dry powder**
While in the short-term strong corporate buyers may have an advantage, financial sponsors still have high levels of dry powder to deploy and will remain an important player in the market. Dry powder reserves at PE firms stood at around $1.2 trillion as of Q3 2022, down from a record of $1.8 trillion at the beginning of that year, according to Pitchbook data. As the pace of fundraising slows and the economic backdrop changes, we expect funds to be more selective, preferring high-margin and cash generative businesses as well as investments aiming at consolidating their current portfolio.

**Bolt-on acquisitions**
As long as the financing market remains shut and large-cap opportunities continue to be scarce, sponsors might turn to smaller, bolt-on acquisitions instead. These add-ons can increase value of PEs' existing businesses, especially as traditional growth routes available to portfolio companies are cut off and exit options narrow. Investing in known businesses and platforms may also make more sense for PE in times of uncertainty.

**Smaller deals**
With public debt markets closed, middle-market M&A should continue to fare relatively better compared with large-caps given the availability of financing through private credit funds. PEs' renewed focus on buy-and-build growth strategies could also drive more activity in the mid-market space. Targeted sectors include insurance brokerage, which has seen growing consolidation in Europe recently as PE firms actively roll up smaller players.

**Distressed M&A**
Perhaps unexpectedly, we have not seen a significant uptick in distressed M&A opportunities in Europe so far in 2022. This might change in 2023 as the economic turmoil weakens balance sheets, forcing companies to sell assets and restructure operations, thus creating opportunities for distressed M&A.

**Carve-outs**
We expect carve-out opportunities to ramp up as choppier economic waters force large businesses to refocus their strategies and divest non-core assets. In addition, activism investment continues to be a powerful driver, with many investors able to initiate positions at lower prices in a weak stock market. For PEs, carving out a business unit, though more complex in nature, can offer superior returns compared to stand-alone acquisitions.

**ESG**
Corporate and financial acquirers are increasingly looking at targets with an ESG lens, a trend that is only likely to accelerate in 2023 and beyond. Issues related to environmental impact, board diversity, governance, and supply chain management, among others, are now integral to investment committees' decisions and can 'make or break' a deal. They can also affect the availability of funding, potentially giving sponsors' an edge when looking for debt financing.

**Winners and losers**
Willing buyers will continue to pivot to more resilient sectors such as TMT and healthcare in 2023. These businesses are better able to weather the economic turbulence because of their recurring revenue models or/and their ability to pass on rising operating costs from inflation more easily. TMT is also expected to generate a large share of deals given the continuing trend of digitisation within companies. Infrastructure assets will also be especially targeted, as many companies in the sector can offer stable cash flows and downside protection due to its tangible, asset-heavy nature. Companies whose business models rely on discretionary spending, however, will likely continue to be avoided by acquirers given rampant inflation and cost-of-living crisis hitting consumers in Europe.

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