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CORPORATE FINANCE ADVISORY

Business with the Germans

How should French businesses approach the largest European market?

2018 / 2019

The M&A appeal of 'Made in Germany'

Germany represents an exciting opportunity for business, being Europe's largest market and one of the most advanced industrial economy's in the world, however market penetration for foreign actors is not always so straightforward. Doing business there requires genuine experience and specialist skills. Experience shows that the most effective way to gain ground is through cross-border acquisitions. Moreover, French buyers are often ideally placed, given Germany's geographical proximity and highly complementary culture.

Key insights:

- The German business landscape is unique, in that the market is characterized by a very large number of small and mid-sized enterprises (Mittelstand). These highly skilled businesses are often family-owned – it is common for them to have been in the family for three or four generations. They also tend to have strong entrepreneurial cultures, long-term strategic outlooks (meaning they are frequently undercapitalized), and value secrecy and independence above all else. All in all, they are not always straightforward to access or understand for foreign players.

- Given the growing importance of the German market, acquiring these Mittelstand businesses has become a strategic priority for many foreign players, who are seeking to secure a long-term presence to this market, and access to its best-in-class equipment and products to increase their own attractiveness. This is fueling French buy-side demand for German assets: transactions are sharply on the rise, as the French seek out new customers, markets and enhanced product portfolios.

- Although there is no magic formula and each deal will have its own strategic logic and challenges, there are a number of ways French buyers of German assets can ensure smoother and more successful acquisitions.

- Successful deal-making in Germany requires a specific approach that is in alignment with counterparty expectations and the German cultural mindset. Carefully tailored M&A rules of engagement need to be followed.

- Pre and post-deal challenges tend to be more complex in cross-border transactions, due to cultural, legal and geographic differences. Having the right people in the right place, and most importantly providing the right advice is essential.

Nicolas Balon
Franco-German Partner, Capitalmind

"Germany is an attractive market which many French players find a challenge. A common approach is to replicate home country business strategies and M&A approaches, but these moves often fail as the German Mittelstand has its own codes. Experience and knowledge of cultural pitfalls are the keys to success."

Key takeaways

Mittelstand

A broad group of privately-owned German businesses (often in the 3rd or 4th generation of a family) that generate revenues from a few million to up to €1bn. Highly secretive and long-term business cultures (Nachhaltigkeit), which prize independence, an entrepreneurial mindset, local roots and social responsibility

Transformation

The Mittelstand is starting to change as German business owners become less reliant on family succession in their exit outlooks (nowadays, children tend to have different career pathways to their parents).

Product leaders

Germany leads the world in product quality (eg. equipment), and incremental innovation.

Private Equity

Although Germany is Europe's largest economy, private equity involvement is still at a very low penetration rate compared to France and the UK. (Financial investors have been focused primarily on large and medium-sized deals.) There is therefore a very limited M&A culture within the Mittelstand market, unlike France and the UK.

M&A

Deals are sharply on the rise – French acquisitions of German assets have doubled since 2014, and the story is a similar one for buyers from China and the United States.

France

Within the EU, France is the biggest acquirer of German businesses.

German opportunity

The German business landscape is unique, in that most of the country's productive capacity is made up of SMEs. These highly skilled Mittelstand are often family-owned, and have a quite different approach to deal-making and corporate transactions.

Germany is one of the world's top destinations for foreign capital, ranked third in the world behind the United States and China*, thanks to its central location within Europe, its large corporate power base, its highly skilled labour force, and its unwavering focus on productivity, reliability and innovation. The M&A story is even more impressive: between FY14 and FY16, total deal-value on German assets almost doubled, reaching €51bn.**

The economy's main engine room is its industrial sector, which includes some of the world's best known public companies and brands: producers of automobiles, machinery, pharmaceuticals and chemicals. But what makes the German economy unique is the massive number of mid-sized companies, which have been the economy's key growth driver for decades – virtually all German companies (more than 99%) are SMEs, locally known as Mittelstand. These players are often leaders in quality, reliability and innovation, and have become attractive targets for foreign investors in recent years. However many are also family-owned and tend to have conservative long-term business outlooks, poor succession planning, and a quite different approach to deal-making and corporate transactions.

For example, they are often reluctant to sell to foreign investors, and legacy issues related to future ownership and management are often prioritized over more conventional transaction details. 'Relationship banking' is also preferred. Doing business with these German actors requires specialist skills, high level connections and detailed on-the-ground local knowledge.

* KPMG Business Destination Germany (2017)
** KPMG Business in Germany (2017)
Central Intelligence Agency : The World Factbook

German Economy Snapshot (2017)

Population: 82 million
GDP: €3.1bn
GDP global ranking: #4
GDP/capita: €35k
GDP by source:
- Services: 69.3%
- Industries: 30.1%
- Agriculture & Fisheries: 0.6%

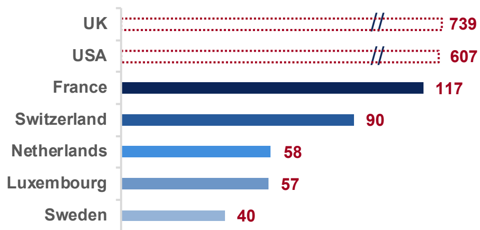
Unemployment rate: 3.5% (December 2017)
Main export partner: USA
Main import partner: China

French buyers

Within the EU, France has become a key acquirer of German assets. In 2017, there were 117 reported German acquisitions by French buyers.

Over the last couple of years, we have seen a spike in French buy-side demand for German assets. Germany is often the first step that French corporates and midcaps with geographic growth ambitions make, due to its proximity and large and prosperous markets. Also, as French players extend their reach beyond home markets there is a need to grow their product portfolios to serve international customers' diverse needs. German midcaps, with their exceptional and often specialised product offerings are often ideal targets.

Acquisitions in Germany (2017)

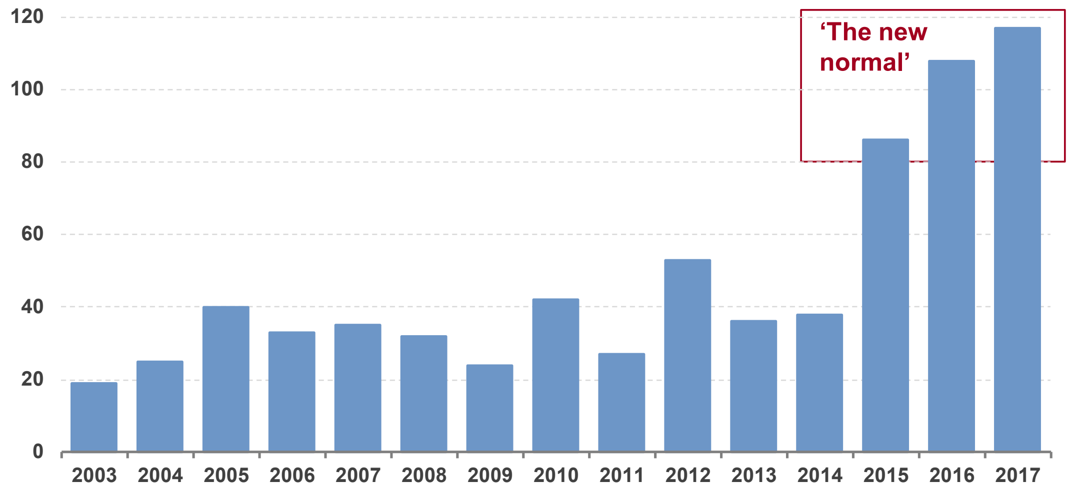


Source: PWC

France targets Germany

French strategic players have ramped up their German acquisitions (tripling since 2014), in an effort to widen their markets and enhance capabilities. As a general rule, French corporates and midcaps have greater scale and distribution networks while Germany's Mittelstand have leading know-how, which often makes these deals mutually beneficial.

Volume of German businesses acquired by French corporates

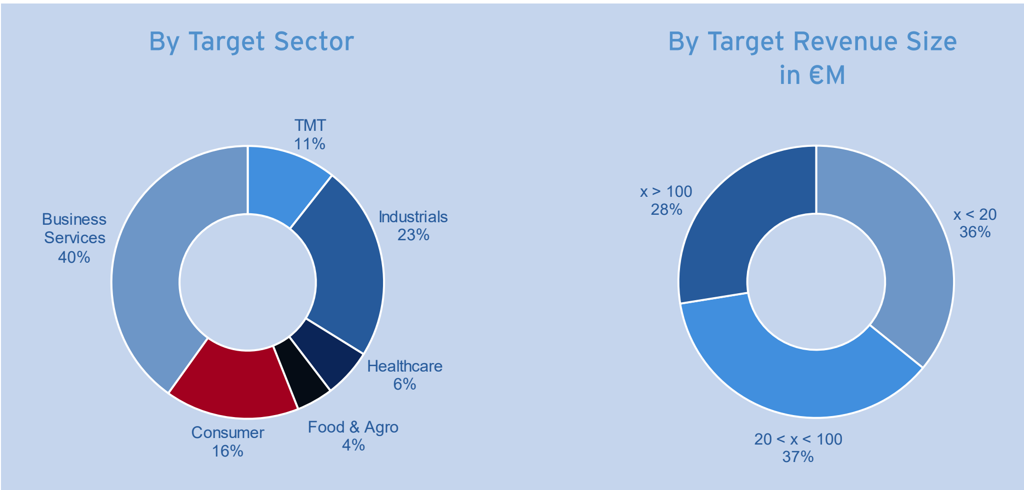


Source: PWC

France: sector targets

French buyers are targeting all German sectors, however the two most popular are Business Services and Industrials. Also, some 73% of all transactions since 2012 have been with smaller German players - companies with revenues <€100m.

German Targets Acquired by French Businesses



Source: Capitalmind research, based on 253 and 156 deals respectively with available data over the 2012-2017 period

Recent deals

FRENCH BUYER		GERMAN ACQUISITION
LEGRAND Sales 2017: €5.52bn A global specialist in electrical and digital buildings' infrastructure - offering products and solutions for commercial, residential and industrial buildings. Strategy: to expand its international reach by boosting international growth, and to expand its offer by placing innovation at the forefront.	May 2018	**MODULAN** Sales 2017: €8m A successful family-owned German company that develops and manufactures high-quality equipment for data centers. Deal delivers: expands Legrand's product portfolio in the field of IT systems installation, and reinforces its presence in VDI cabinets facilities intended for data centers in Europe, North America and Asia.
EUROFINS SCIENTIFIC Sales 2017: €2.97bn A leading global provider of analytical, testing and related support services to the pharmaceutical, food, environment, AgroScience and consumer product industries. Strategy: aims to be the world leader in bioanalysis; committed to pursuing a dynamic growth strategy by expanding both its technology portfolio and geographic reach.	May 2018	**PHAST** Sales 2017: €24m A leading service provider in the pharmaceutical products industry, supplying the biotech and pharmaceutical market with leading-edge TIC services. A strong footprint in Germany and Switzerland. Deal delivers : complements Eurofin's product testing capabilities, expands its geographic footprint and strengthens its global scientific leadership in the biopharma product testing market.
BISCUIT INTERNATIONAL Sales 2017: €350m A historical European industrial company in the sweet biscuit market that specializes in no-name biscuits across 11 segments, supported by proprietary production technologies. Strategy: expansion of its product offering and geographic footprint through both external and organic growth. Its international growth strategy includes consolidating its market share abroad.	Dec 2017	**A&W FEINBACKWAREN** Sales 2017: €19m A scaled manufacturer of dry-baked products with 300 employees - owned by kuchenmeister GmbH. Deal delivers: consolidates a fragmented European market and grows its geographic footprint and market share in Germany. This acquisition also makes Germany its third most important market in terms of revenue.
SOCCOTEC Sales 2017: €700m One of the leading providers of TIC services in the construction and infrastructure sectors. Strategy: backed by Five Arrows and Cobepa, Soccotec is pursuing its European growth with an acquisitive strategy in construction and public works; the goal is to become the European leader.	Oct 2017	**ZPP INGENIEURE** Sales 2017: €13m German-based company specialized in project management and inspection services for the transport and energy infrastructure industries. Deal delivers: expansion of Socotec's geographic footprint and an extension of its expertise in the infrastructure and engineering industries.
THESEO Sales 2017: €6.4bn Industrial and finance (investment) actor in the French oilseed and protein sectors – engaged in human foods, animal feeds and renewable chemistry. Strategy: international expansion of its biosecurity business in order to reach critical mass; and investment in additional NPD and market authorizations.	Jan 2017	**EWABO** Sales 2017: €14m Formulation, manufacturing and marketing of biosecurity products for livestock (pig & poultry). Deal delivers: access to the critically important pig market in Germany; accelerates the company's growth projections to create a clear international leader in pig & poultry biosecurity products.

The rules of engagement

Successful deal-making in Germany requires a specific approach that is in alignment with the counterparty's expectations, as well as the German cultural mind-set. This is the case for both family-owned businesses and also large German corporates, who tend to have a highly formal approach, adhering steadfastly to the 'M&A rules of engagement'.

Germans do not like surprises, and will do anything to avoid them. Most aspects of German living and working are defined and regulated by structure – rules, laws, and procedures are evident in all aspects of German social and economic life. They have become masters of planning and are extremely thorough in their organization. The culture prizes forward-thinking - knowing what will be happening at a specific time on each day - and the world of M&A is certainly no different. Best to adhere strictly to the M&A rules of engagement, even if this means a lower degree of flexibility. Sudden changes in business transactions, even if they improve the outcome, are often unwelcome.

German proverb:

Alles muss in Ordnung sein

Everything must be in order

Business etiquette

Cultural stereotypes are not always fair or useful, but understanding German business etiquette can be the difference between what makes or breaks a deal. The little things count for a lot in Germany.

Punctuality:
Although some allowances are made for foreigners, tardiness never leaves a good impression in Germany. Even five minutes does not go unnoticed, and can discredit you before you have even started. Best to be on time. This goes for payment promises as well.

Communication:
Small talk is used, but never indulged. Germans usually avoid personal questions, as well as the subject of politics. They present themselves in a thoughtful and straightforward manner – not flashy or showy. It is not normally appropriate to invite a German business owner to lunch for the first meeting, but expect them to talk frankly about critical issues. Hierarchy is valued and decisions are often taken in a methodical and highly procedural fashion, which can sometimes slow things down.

Greetings:
Germans always shake hands with the most senior person first, then work their way down the pecking order, making eye contact and addressing everyone by their last name, not their first. They also use titles (including educational doctorates) wherever applicable: "Dr Schullenhauser, Herr Maurer, Frau Fabich…"

Patience:
Germans don't like to rush, least of all an important transaction. They take time to think offers through. However when they say they will get back to you they will. And on time.

Winning strategies

Although there is no magic formula and each deal has its own strategic logic and challenges, there are a number of ways French buyers of German assets can ensure smoother and more successful acquisitions.

Experience:

There is no substitute for experience. Having 'been there and done that' before is always going to help, which includes hiring advisors familiar with the German culture, and ideally German speakers, as not all Mittelstand business owners speak English. Experience in the target's regional and local market is also essential. Pre and post-deal challenges tend to be more complex in cross-border transactions due to cultural, legal and geographic differences.

Preparation & planning:

Meticulous preparation and planning is important in any deal, but especially when foreigners want to acquire or partner up with a German *Mittelstand* business. Again, the right advice is critical as you only have one chance to make a good first impression. Proper preparation saves potential losses down the road.

Straight talking:

Having identified a German *Mittelstand* opportunity is one thing, making contact with its owners and catching their attention is quite another. Oftentimes we see French acquirers take a 'strategic approach' to selling to German business owners by explaining their acquisition project. But doing this is not nearly enough, as Germans tend to value more concrete benefits in a project than acquirers' strategic goals.

Be aware of cultural differences:

Successful M&A is all about details. To get there you need to be prepared for cultural differences, and to avoid these pitfalls as much as possible. Deal breakers can be simple cultural misunderstandings. Tread carefully when tackling details on legal, human, financial and confidentiality matters.

Points of view

Lutz Hartman
Partner at Belmont Legal

Lutz has 20+ years of experience in Franco-German dealmaking. He is Franco-German himself, and excels at overcoming the various cultural and legal differences that are common in these cross-border transactions.

Lutz – you have advised on over 50 Franco-German deals in your career, and many other cross-border deals. What's so specific about advising Franco-German projects compared to other cross border deals?

"Geographically speaking, our two countries are very near but we are totally different with regard to business behaviour. A French company is structured differently and acts and thinks differently to a German company, which has consequences in nearly every practical management decision."

What's the most common misunderstanding you face from a legal point of view?

"We need to explain to French investors that, compared to France where the SA (AG) is mostly used, we generally use the GmbH (Sarl) for companies. In addition, the structuring of power of attorneys (délégations de pouvoir) is fundamentally different. For legal reasons, a French manager that delegates (for example, for health issues) should not interfere with this subject afterwards so that he does not become liable again. In Germany, he needs to control and supervise the agent. I can tell you this is a big difference in the everyday life of companies."

What about from a non-legal point of view?

"We often see French investors in Germany surprised by the rather weak financial data collected by German managers and business owners. They tend to run the company just on cash – and experience problems when cash is short. French companies normally have much more complex and detailed financial analysis tools. German controllers often become annoyed when they need to fulfil the information requests from the new French mother company.

And of course, I will not leave the car out! For German mid-management up to top management, the car is THE exterior sign of success. So dear French investors: Don't cut on the car budgets, you will lose talent! "

Points of view

Pierre de Bartha
Co-Founder and managing partner at JPB Consulting

Pierre has over 30 years of experience in the field of Franco-German post-merger integrations. He has assisted major Franco-German integration projects such as Air Liquide/Messer Griesheim, Siemens Transportation Systems/Matra Transport International, Faurecia/Leistritz, BMW/Auxilec, Thomson/AEG, Aesculap/Bbraun, EDF/EnBW, Euler/Hermes, BNP-Paribas/Dresdner Bank, Dachser/Gravelot, Otto Versand/3 Suisses, Valeo/ITT Automotive.

Pierre, what does M&A mean to you?

"An opportunity for cross-fertilization but the problem is that they often fail. Every M&A process is marked by one firm belief: 'take the best of both worlds, and generate the optimized added value'. While this is indeed sometimes true, in most M&A processes it turns out to be wishful thinking. Business cultural differences and harsh realities are much more insidious than acquirers realize."

Is that especially true in transactions between the French and the Germans?

"Far greater than one might think. In Franco-German M&A, the French typically hope to absorb some of the famous 'German rigor', while the Germans in turn wish to gain agility from the so called 'French flexibility'. But in reality, most post-merger integrations are experienced as relations between 'dominant versus dominated' or 'buyer versus bought'. This results in the proliferation of what we call 'emotional viruses': disruption of former reference points, uncertainty, fears, conflicts of interest, diverging motivations, change resistance, and so on."

Is that not true for all cross-border integrations?

"Yes, emotional viruses are universal in nature, but their handling are culturally bound, resulting in managerial practices that are interpreted differently according to one's business-cultural beliefs. In practical words, intuitive and reactive management, constant (emulation) pressure, centralized power, performance evaluation of managers according to French criteria such as synthesis ability, reactivity, creativity and 'débrouillardise' (exacerbated resourcefulness), are although state of the art practices in France, the '5 capital sins' in German perceptions. Doing it 'right' in one business culture thus leads to misunderstandings, misinterpretations, judgement of intentions, false debates and the triggering of parasite reactions in the other culture."

So what is the way forward: the goal?

"The major issue in a post-merger integration is to minimize costs and time; to help concentrate on real management issues such as true conflicts of interest and disagreements. Moreover, as cross-border transactions have ramped up in recent years, it has become even more critical to expertly deal with these challenges head on. After a cultural and mindset assessment, our focus is for instance to identify and coach so called bridge-heads & tandems and institutionalize relational monitoring, to ensure optimized sustainability."

"Culture eats integration strategy for breakfast!"

Private Equity

German businesses receive very little investment from private equity when compared to their European neighbours. This low penetration rate is due to the importance of the Mittelstand in the German economy, and their culture of secrecy and independence. These challenges are surmountable, however.

Germany is unloved by private equity:

Private equity involvement in the German market has been lacklustre in recent years, accounting for a small fraction of 'funds raised by region of management' and 'investments as a % of GDP' - far lower than its neighbours in the UK/Ireland and France/Benelux. [See Figures 1 and 2.] This is surprising, given that Germany is the largest economy in Europe, performing strongly, and home to some of the most advanced product portfolios in the world.

Why?

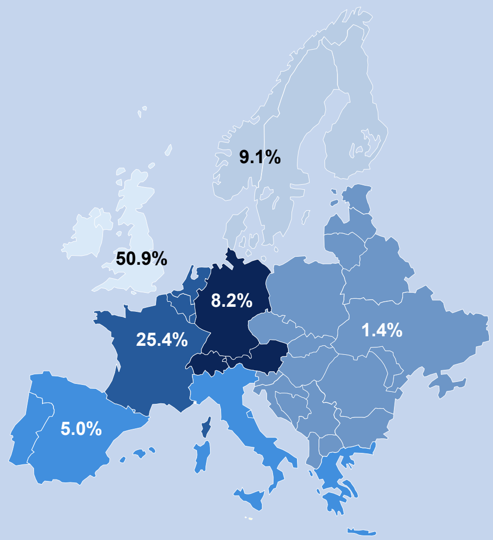
German businesses have a culture of secrecy and independence, which has made life difficult for many foreign financial investors. Notwithstanding, we are seeing private equity players succeed when they pair up with advisors who are in tune with the German market and genuinely connected (local offices and longstanding relationships with owners).

Private equity involvement in Germany:

There are 214 local and international private equity firms now operating in Germany, however there are still only around 100 buy-outs being made in the domestic market each year. The lion's share of deals (~90%) is going to the venture capital and growth capital markets. [See Figure 3.] This can be partly explained by the thriving start-up market in Germany, but also by the secrecy and independence issues within the Mittelstand. Interestingly, we are seeing more interest from foreign private equity firms in the German growth story. Also, with Brexit now on the table we expect a ramp up in private equity investments going forward.

Private Equity funds raised in 2017 by region of management

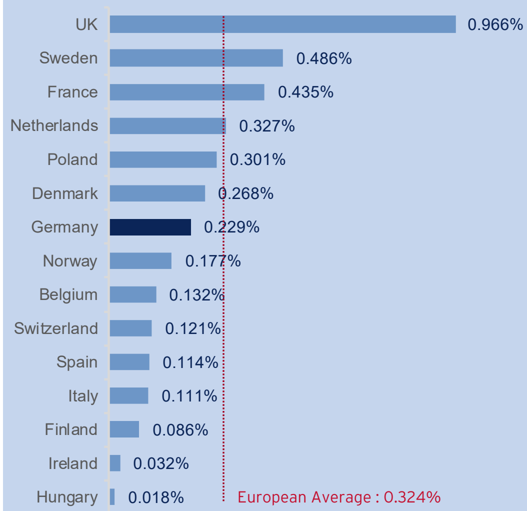
(Total amount of €91.9bn in Europe VS €73.6 bn in 2016)



Source : Invest Europe - 2017 European Equity Activity

Private Equity 2017 investments as % of GDP

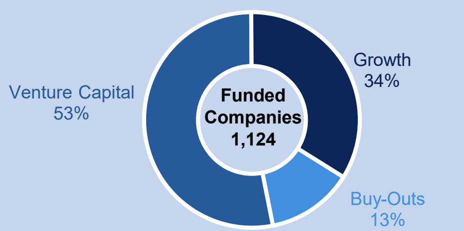
Top 15 European countries excluding Luxembourg



Source : Invest Europe - 2017 European Equity Activity

Investments in Germany in 2017

By investment stages



Source : BVK

Our selected Franco-German (DACH) deals

French corporates BUYING German businesses

- THESEO acquired EWABO (THE HYGIENE COMPANY) — Livestock biosecurity
- Groupe Blondeau acquired BOOMEX — Firelighters
- Spigraph acquired DICOM from HANNOVER Finanz — Document capture solutions
- AREVA acquired PN ROTOR (PROKON Nord) — Rotor blades
- Groupe Gorgé acquired DeltaMed (TURNING IDEAS INTO MATERIALS) — 3D printing materials
- Damartex acquired Afibel (la femme élégante) from ARCANDOR — Online retailer of "senior" products
- alpha acquired EURO PART — Industrial vehicles

French corporates SELLING TO Germans

- oleon (A NATURAL CHEMISTRY) NOVANCE sold its alkyd resins business to WORLÉE seit 1851 — Alkyd resins
- AREVA sold Areva Parafoudres to TRIDELTA — Surge arresters

Other Franco-German situations

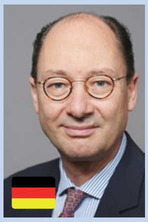
- T-Systems sold its French "Systems Integration" activity to NOVIA — IT systems integration
- AIR LIQUIDE sold Cryotherm — Vacuum super insulated containers
- alos solution sold to KYOCERA — Document management solutions

Contact us

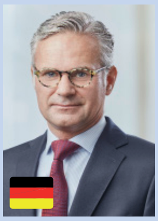
Capitalmind has extensive experience in advising Franco-German deals. Also, since 2016, we have further strengthened our presence in Germany with a 20+ team based in Wiesbaden (Frankfurt).

We can help you achieve your strategic ambitions, assembling highly experienced local teams with sectorial expertise, as well as a wide array of financing options.

Nicolas Balon
Partner (Franco-German)
+33 148 24 62 97
nicolas.balon@capitalmind.com



Hans Bayer
Partner
+49 711 259 85 49
hans.bayer@capitalmind.com



Ferdinand R. Schulhauser
Partner
+49 611 95 15 131
robert.schulhauser@capitalmind.com

Thorsten Gladiator
Partner Debt Advisory
+49 611 205 48 22
thorsten.gladiator@capitalmind.com

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CORPORATE FINANCE ADVISORY

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's-Hertogenbosch, The Netherlands
Reitscheweg 49
5232 BX 's-Hertogenbosch
T +31 (0)73 623 87 74

Paris, France
151, boulevard Haussmann
75008 Paris
T +33 1 48 24 63 00

Frankfurt, Germany
Sonnenberger Straße 16
65193 Wiesbaden
T +49 611 205 480

Amsterdam, The Netherlands
Vreelandseweg 7
1216 CG Hilversum
T +31 (0)73 623 87 74

Copenhagen, Denmark
Strandvejen 60
2900 Hellerup
T +45 20 433 373

Berlin, Germany
Schumannstrasse 17
10117 Berlin
T +49 611 205 480

www.capitalmind.com