capitalmind
CORPORATE FINANCE ADVISORY

Business with the Germans

How should French businesses approach the largest European market?

2017 / 2018

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.

- The *Mittelstand* is undergoing transformation, much like the French market did in the 90's, as business owners progressively shift their focus away from family succession to more flexible exit outlooks.

- 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 dealmaking 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. 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 dealmaking 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 dealmaking 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 (2016)
**KPMG, Business in Germany (2016)

German Economy Snapshot (2016)

Population: 82 million
GDP: €3.1bn
GDP global ranking: #4
GDP/capita: €40k
GDP by source:
- Services: 68%
- Industries: 25%
- Construction: 5%
- Agriculture & Fisheries: 0.5%
- Misc.: 1.5%

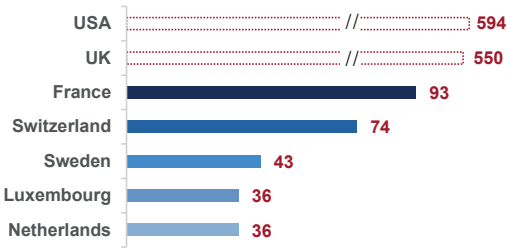
Unemployment rate: 3.9% (April 2017)
Main export partner: USA
Main import partner: Netherlands

French buyers

Within the EU, France has become a key acquirer of German assets. In 2016, there were 93 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 (2016)

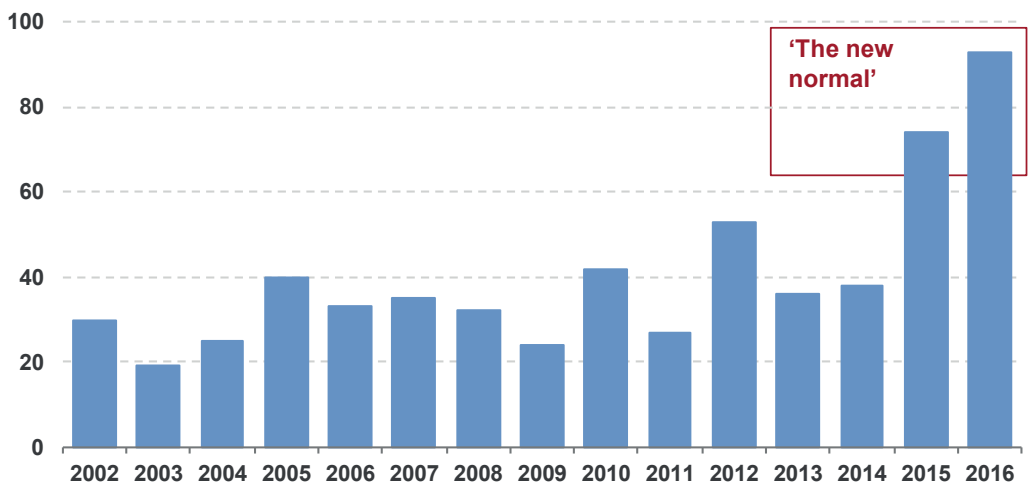


Source: PWC

France targets Germany

French strategic players have ramped up their German acquisitions (doubling 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 product know-how, which often makes these deals mutually beneficial.

Volume of German businesses acquired by French corporates

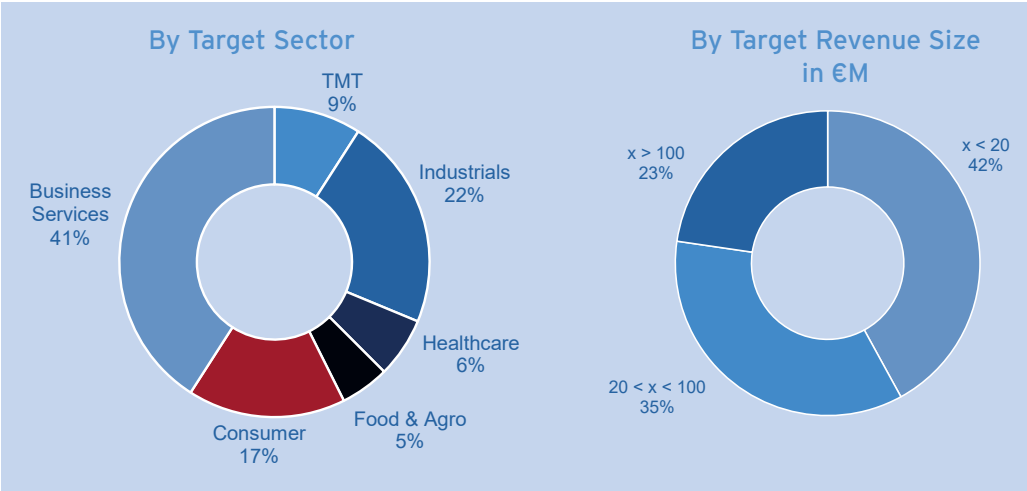


Source: PWC

France: sector targets

French buyers are targeting all German sectors, however the two most popular are Business Services and Industrials. Also, some 42% of all transactions since 2012 have been with smaller German players - companies with revenues <€20m.

German Targets Acquired by French Businesses



Source: Capitalmind research, based on 176 and 119 deals respectively with available data over the 2012-2016 period

Recent deals

FRENCH BUYER		GERMAN ACQUISITION
EUROPCAR Sales 2016: €2.23bn Activity: provides car rental services for (short and medium terms) to both business and leisure customers across Europe and the globe. Strategy: expand its international markets via both acquisitions and organic growth, and to consolidate its leading position in the European market.	May 2017	**BUCHBINDER** Sales 2016: €200m Activity: Germany's number 5 in low cost car and utility vehicles rental. The company has an extensive network of 152 stations. Deal delivers: improves Europcar's penetration of the low-cost segment, and now makes Europcar the market leader in vans & trucks in Germany. There are also a number of revenue and cost synergies.
SPIE Sales 2015: €5.2bn Activity: a global engineering services company in energy(oil&gas)andcommunications-electrical,mechanical, heating, ventilation and air-conditioning. Strategy: expand its engineering services network and capabilities right across the globe via serial acquisitions.	April 2017	**LÜCK** Sales 2016: €130m Activity: Lück Group provides holistic building technology services, with a particular focus on data-centre solutions. The company has 1,000+ employees in 18 locations across Germany. Deal delivers: expands SPIE's mechanical and electrical services capabilities in Germany, building on its network and strengthening its positioning.
GROUPE GINGER Sales 2016: €150m Activity: provides technical engineering services in the construction industry (eg. surveys, testing, assessments, diagnostics & project management). Strategy: pursuing an external growth strategy geared around specialized engineering services and data-handling expertise. Its key markets are France, Germany and Poland.	April 2017	**LEHMANN PARTNER** Sales 2016: €8m Activity: an infrastructure engineering company specialized in city and road infrastructures. Deal delivers: advanced technical and scientific capabilities, and creates a comprehensive and global road-engineering offering. Lehmann will benefit from Ginger's extensive network, to hasten its growth.
THESEO Sales 2016: €6bn Activity: industrial and finance actor of the French oilseeds and proteins sectors, engaged in human foods, animal feeds, renewable chemistry. Strategy: international expansion for its biosecurity business (called Theseo) to reach critical mass, invest more in NPD and market authorizations.	Jan 2017	**EWABO** Sales 2016: €10-15m Activity: formulation, manufacturing and marketing of biosecurity products for livestock (pig & poultry). Deal delivers: access to critical German pig market, accelerator in the company's growth project to create a clear international leader in pig & poultry biosecurity products.
JACQUES BOGART Sales 2016: €106m Activity: creation / distribution of perfumes & cosmetics. The group operates perfume shops. . The company also operates a chain of perfume shops (73 in 2016). Strategy: expand its international retail network (especially in Germany), in order to accelerate its growth and consolidate its market position.	Dec 2016	**PARFUMERIES H.C** Sales 2015: €30m Activity: the family-owned company operates a chain of fragrance and cosmetics stores in northern Germany, including 80 shops, 7 franchises, and some 400 employees. Deal delivers: an expanded retail footprint (almost doubles points-of-sale for Jacques Bogart) and provides scope to extend German retail network.

The rules of engagement

Successful dealmaking in Germany requires a specific approach that is in alignment with the counterparty's expectations, as well as the German cultural mindset. 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.

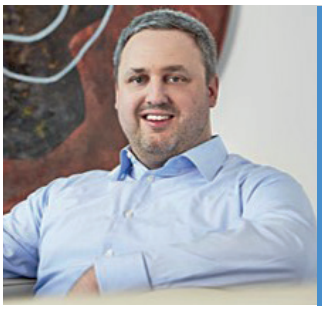
Experience:
There is no substitute for experience. Having 'been there and done that' before is always going to help, which includes hiring advisors familiar with the German culture, and ideally German speakers, as not all Mittelstand business owners speak English. Experience in the target's regional 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 deal-making. 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?

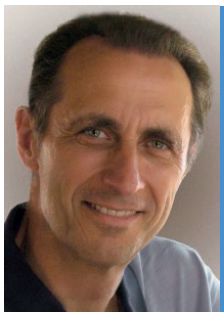
"We need to explain to French investors that, compared to France where the SA (AG) is mostly used, we generally use the GmbH (Sarl) for companies. In addition, the structuring of power of attorneys (*délégations de pouvoir*) is fundamentally different. For legal reasons, a French manager that delegates (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 as a management consultant, 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." As I often say, "Culture eats integration strategy for breakfast!".

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."

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?

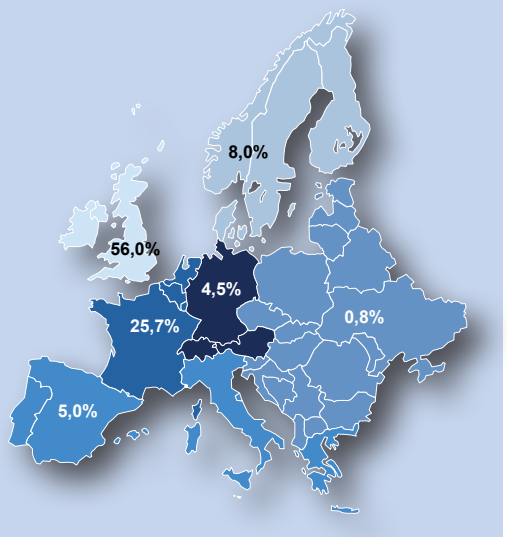
German businesses have a culture of secrecy and independence, which has made life difficult for many foreign financial investors. Notwithstanding, we are seeing private equity players succeed when they pair up with advisors who are in tune with the German market and genuinely connected (local offices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

Private equity involvement in Germany:

There are over 200 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, as business owners are no longer systematically demanding that their heirs take over, which is giving rise to more acquisition opportunities. Brexit is expected to be another tailwind going forward.

Private Equity funds raised in 2016 by region of management

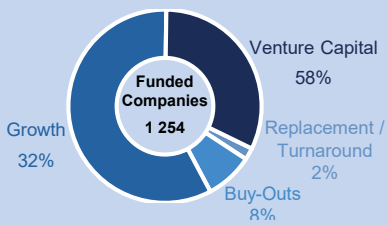
(Total amount of € 73,6bn in Europe)



Source : Invest Europe - 2016 European Equity Activity

Investments in Germany in 2015

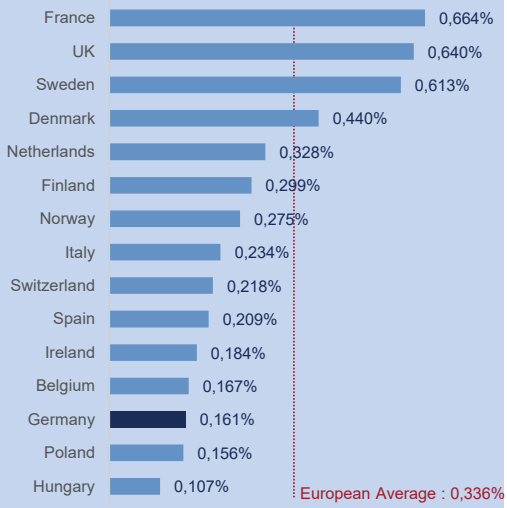
By investment stages



Source : BVK

Private Equity 2016 investments as % of GDP

Top 15 European countries excluding Luxembourg



Source : Invest Europe - 2016 European Equity Activity

Our selected Franco-German (DACH) deals

THESEO acquired EWABO THE HYGIENE COMPANY
Livestock biosecurity

Groupe Blondeau acquired BOOMER
Firelighters

Spigraph acquired DICOM from HANNOVER Rückversicherung
Document capture solutions

AREVA acquired PN ROTOR PROKON Nord
Rotor blades

Spigraph acquired ALOS Document Management
Document capture solutions

Damartex acquired Afibel la femme élégante from ARCANDOR
Online retailer of "senior" products

reel acquired Alesa from RioTinto Alcan
Material handling systems (aluminium)

oleon A NATURAL CHEMISTRY NOVANCE sold its alkyd resins business to WORLÉE seit 1851
Alkyd resins

AREVA sold Areva Parafoudres to TRIDELTA
Surge arresters

T-Systems sold its French "Systems Integration" activity to NOVIA
IT systems integration

AIR LIQUIDE sold Cryotherm
Vacuum super insulated containers

onfin merged with Cardinal Consulting
Financial Messaging

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.

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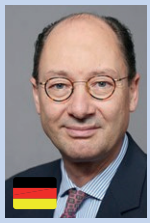

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capitalmind

CORPORATE FINANCE ADVISORY

Smart advice, by your side, worldwide

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- 200+ closed transactions in the last 5 years - 500+ since 1999
- Worldwide access to strategic/financial players and likely buyers
- Team of 60 experienced professionals in Europe; plus 300 worldwide, via our international partnership
- European Headquartered advisory firm, with offices in Benelux, France, Germany & the Nordics
- We have received numerous awards

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