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A note from Constantin M. Gall, Managing Partner Transaction Advisory Services, Ernst & Young GmbH

German executives look to proceed with M&A activity, even amid rising geopolitical uncertainty

After strong deal performance – including a record-setting second quarter – German executives surveyed in EY 19th annual *Capital Confidence Barometer* appear to be cautiously optimistic amid ongoing political and economic uncertainty that may color their merger and acquisition (M&A) intentions.

At the time of the survey, respondents indicated that they held a very positive outlook for the global economy, with 88% of German decision-makers expecting to see improvements ahead. Likewise, three out of four executives here said they anticipate domestic growth in the coming months. These indicators are encouraging, but clouds on the horizon suggest executives may have cause to temper their optimism.

Digital transformation remains a top-of-mind challenge for company leaders, as does ongoing sector convergence; almost one in three German companies consider these forces to pose continued risks to their business.

Of even greater concern is the evolving geopolitical environment. When we surveyed them, 39% of the respondents cited political and regulatory uncertainty as the largest threat to deal-making. It is possible that since then sentiment may have soured even more in light of the continued uncertainty around the UK plan to exit the European Union, as well as a result of industry earnings reports and warnings that have emerged in the meantime. Executives may also find they have underestimated the impact of global trade tensions between the US and China, as well as the worsening economic and political conditions across Europe. These factors converge to suggest more acute instability than earlier this year.

Yet, despite this volatility, 55% of German executives plan to pursue M&A in the next 12 months. This is down slightly from six months ago, but well above the *Capital Confidence Barometer* average of 46%. Further, as many as 94% of executives expect the market volume to grow in the next 12 months.

Interestingly, respondents cited the difficulty in identifying high-quality opportunities as a key challenge in dealmaking; 27% of German executives surveyed say they are having trouble finding attractive investments. This may reflect the higher cost of good quality opportunities; there is evidence of a lower number of acquisitions, but higher sums being paid. With less inventory on the market, available deals will be costlier as numerous investors compete to invest in promising companies, a trend that could well continue for the next couple of years.

Along with dealmakers, we will be watching carefully to assess the impact of these rising costs and mounting concerns around Brexit and other uncertainties that are reshaping our global and domestic deal environment. But we remain heartened that German companies are determined to forge ahead in their M&A activity, regardless of the uncertainty.

Macroeconomic and external environment

Strong corporate earnings and open credit markets point to a continued upswing in equity markets.

88%

of executives in Germany see the global economy as improving in the next few months.

73%

of corporate groups expect to see a further improvement in the domestic economy in the next few months.

94%

of executives expect the global M&A market to improve.

Buy and integrate

Executives see the M&A cycle continuing at elevated levels. While some executives look to pause dealmaking, for others, M&A remains an imperative.

55%

of executives expect to actively pursue acquisitions in the next year – the lowest in four years.

54%

of corporate groups expect to close the same number or more transactions in the next 12 months compared with the last 12 months.

27%

of executives say they are now having difficulty finding high-quality deal opportunities.

Major M&A themes

The potential impact of Brexit, trade and tariff issues are compelling some executives to pause their M&A plans.

36%

of respondents cite regulation and policy uncertainty as the biggest potential risk to dealmaking.

32%

now consider digital transformation, blurred industry boundaries and other disruptive forces to pose the greatest economic risks.

55%

of companies in Germany expect Brexit to have a negative impact on their own business in terms of investments and acquisitions outside the UK.

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EYG no. 000171-19Gbl
1808-2856410
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