Q&A

Dr. Holger Hofmeister is an M&A Partner at Skadden, Arps, Slate, Meagher & Flom LLP in Frankfurt. We asked him for his perspective on this latest M&A market data.

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What are your thoughts on early 2022 M&A activity, particularly coming off a historic wave of deals in late 2021? Have dealmakers exhausted themselves to some degree?

H.H: 2021 was an extraordinary and record-breaking M&A year in many respects. While some of the momentum has been carried over into Q1 2022, M&A activity overall has been slowing down in Q1 and in the first half of Q2. The reasons are obvious: developments and uncertainties resulting, directly and indirectly, from the military conflict in the Ukraine; ongoing supply chain squeeze; inflation; and rising interest rates. But nonetheless, M&A is very alive, and some sectors such as media & telecommunications (TMT), healthcare, and energy are less affected than others, such as industrials. There are many interesting targets out there, valuations are generally still high, and dealmakers are looking into many opportunities.

Please share your thoughts on the same question, with respect to PE. Do you think looming interest rate increases have dampened enthusiasm?

H.H: While the PE players are still sitting on a lot of dry powder, they, too, are facing the uncertainties described above and are generally rather cautious about it. Financing is generally an issue, and rising interest rates are not helpful.

Based on current sentiment, do you have a sense of what 2022 will look like in terms of deal volume? Does it seem like dealmakers prioritized (and finished) what they set out to accomplish last year?

H.H: The general sentiment and forecast is that deal volume will be down compared to 2021, presumably by quite a bit. But that should not come as a surprise given the 2021 deal frenzy. What will be more interesting is to see whether it will still exceed pre-pandemic levels. M&A remains very lively, and we see several factors that could also lead to a very busy M&A year, such as further digitization, increasing activist investor activity, ESG-driven pressure, the need for several hundreds of special purpose acquisition companies (SPACs) to do a deal by the end of 2022 and beginning of 2023, and ongoing corporate carveout activity.

Globally, where are you seeing the most positive sentiment among dealmakers? Where are you seeing potential slowdowns?

H.H: The overall sentiment is still optimistic, and the North American market will likely see increased interest and deal activity, especially from European corporates. A prominent challenging factor for cross-border deals is the evolving regulatory landscape and heightened scrutiny from antitrust and foreign direct investment authorities. Authorities are increasingly objecting to deals or at least requesting mitigation measures, and deals in critical sectors tend to take more and more time, including during adequate preparation and post-signing regulatory procedures and negotiations with authorities.

About valuations, both on the PE and strategic side, do you have a sense of the impact interest rate increases will have on buyers going forward?

H.H: Currently, valuations and prices are generally still high. Attractive targets are often marketed by way of auction processes that are very competitive. There is not much space for negotiating prices down. Buyers must deal with this, although there is some expectation that valuations will go down this year. Interest rates are only one piece of the puzzle, and irrespective of being a strategic or PE, a buyer's ability and willingness to do a deal will likely not be significantly affected by increased interest rates.

Software M&A enjoyed a big year in 2021. Do you see that positive sentiment rolling over into 2022?

H.H: The importance of software solutions, AI, and digitization in general across many sectors (including healthcare, automotive, fintech, and financial services) should continue to spur dealmaking in this sector. Strategics, PE players, and SPACs are potential buyers in a competitive market environment with a lot of rather young potential targets. However, valuation expectations of sellers—and, to a certain extent, regulatory scrutiny—may make it difficult for buyers to execute a deal.

What is your sense of software valuations going forward, particularly if Big Tech stocks have a rocky trading year?

H.H: The ongoing importance of software products and solutions for many industries and sectors as well as a generally competitive market environment will likely keep valuations up. Listed software companies may indeed continue to face falling or volatile share prices for the remainder of the year due to the overall developments. But shareholders will likely request a significant premium over the share price to accept any offer, and it will likely be very difficult for buyers to make a bargain.