PART

One

The Big Picture

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CHAPTER 1

The Global M&A Market: Current Status and Evolution

This chapter reviews the global merger and acquisition (M&A) market and traces its expansion. Transactions are segmented into several categories, with most deals being medium-sized, private transactions. There is no guarantee of success in acquisitions.

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AN UPWARD TREND, INTERRUPTED BY BOOMS AND BUSTS

M&A activity over the past 20 years has shown a marked growth trend, interrupted by peaks and valleys related to financial booms and busts. Volume spiked during the Internet bubble (1998–1999) and the private equity boom (2006–2007), only to drop significantly and then recover. Announced deals in the United States in 2013 totaled $1.1 trillion in volume, encompassing over 15,000 transactions. Figure 1.1 shows the trend line.

As the figure shows, the M&A market is a cyclical business. Activity is tied to several variables:

- Stock market valuations
- Availability of debt financing
- Optimistic views on the economy

When equity values rise in the stock market, an acquirer can offer his inflated stock to a seller as currency for the transaction. Using high-priced stock in a deal makes the transaction's mathematics more attractive for the buyer. Alternatively, if the seller doesn't want the buyer's stock, the buyer can complete an equity raise in the public (or private) markets, and provide the seller with the necessary cash. The end result is thus identical.

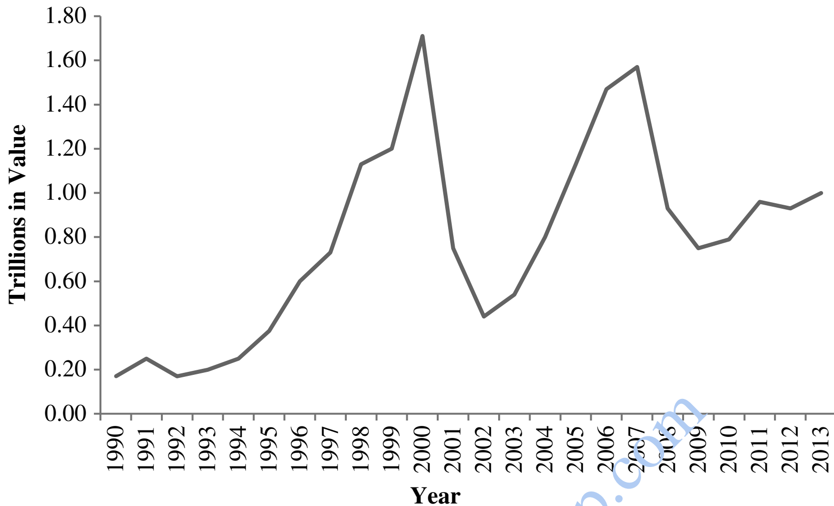

FIGURE 1.1 M&A Activity, 1993–2013, by Value in the United States
Data Source: Bloomberg and Reuters.

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For buyers to complete deals that make sense for their shareholders, borrowed money usually is part of the financing package. M&A activity is thus dependent on lenders—such as banks, finance companies, and bond funds—being open for business and willing to sign-off on the aggressive assumptions that often drive transactions.

High-priced stock investors, liberal lenders, and motivated buyers are all reflective of positive views on the strength of the economy, and this optimism promotes deals. Once a recession hits and the psychology goes negative, transaction volume dries up.

M&A ACTIVITY BY GEOGRAPHY

The United States and Canada represent a large share of M&A activity, and this continued to be the case in 2013. Typically, transactions are aggregated by four geographies. See Table 1.1.

The United States and Canada have about 22 percent of global gross domestic product (GDP), but they account for almost double that percentage in deal volume. Emerging markets, which are defined as countries having annual GDP per capita of US$9,000 or less, make up about 35 percent

TABLE 1.1 M&A Volume by Value, Year Ended December 31, 2013

Region	%
United States and Canada	44
Western Europe	21
Japan/Australia	12
Emerging Markets	18
	100

Data Source: Bloomberg.

of global GDP, yet their percentage of deals is much lower. We discuss these disparities in the next chapter.

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DEAL CATEGORIES

M&A is segmented into four broad categories:

1. Horizontal
2. Vertical
3. Strategic/Diversification/Conglomerate
4. Private Equity

A *horizontal deal* is when a company acquires (a) a competitor, (b) a firm doing the same business in a different geography, or (c) an enterprise engaged in a product line that is similar to that of the buyer. Recent horizontal mergers include: (a) El Paso/Kinder Morgan, two U.S. pipeline companies, $36 billion value; (b) Amgen (U.S.)/Onyx (U.S.), two drug firms, $10 billion; and (c) Valeant Pharmaceuticals (Canada)/Bausch & Lomb (U.S.), two health-care product firms, $9 billion. Horizontal is the most popular deal category because it presents the buyer with the fewest operating risks. The buyer knows the target's product line, suppliers, and customers, and it can institute cost saving measures with little disruption to the seller's operations. Furthermore, in the case where the seller is a direct competitor, the acquirer has the added benefit of potentially raising prices with minimal customer resistance. Perhaps three quarters of all M&A deals fit the horizontal category.

A *vertical transaction* occurs when a company buys a supplier, distributor, or customer. A coal-burning electric utility that acquires a coal miner is one illustration. Most industries have drifted away from vertical integration,

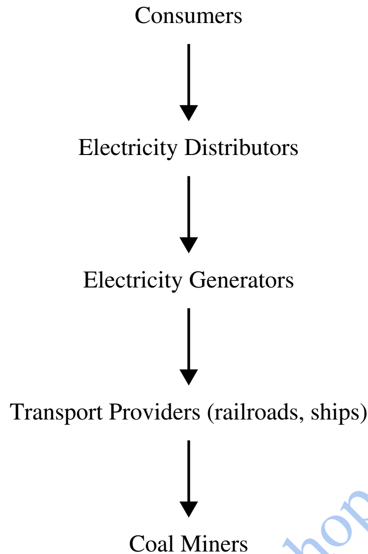

FIGURE 1.2 Vertical Industry Diagram: U.S. Electric Power

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with exceptions being the big oil companies, like Exxon and Chevron. So, vertical deals tend to be quite rare. See Figure 1.2.

Strategic, diversification, and conglomerate transactions take place when the buyer is engaged in a field that is unrelated to the seller. Sometimes, the buyer believes it has a set of strengths that can propel the seller's business (or vice versa), and the transaction is thus part of a grand strategy to boost the buyer's future. At other times, the buyer seeks to redeploy capital from its core business into another primary line, rather than disposing of the cash by paying higher dividends or repurchasing stock. Berkshire Hathaway, the insurance conglomerate, completed one of its many diversification deals when it purchased railroad Burlington Northern for $34 billion in 2010.

Strategic, diversification, and conglomerate deals represent about 10 percent of M&A activity.

Private equity participates in M&A principally through the leveraged buyout (LBO). An LBO is a transaction whereby a private equity fund (or a similar investor group) acquires a company and uses borrowed money to meet most of the cost of the deal. The private equity fund does not guarantee the loans, so the lenders look solely to the acquired company for repayment. Because an LBO is not a combination of similar businesses, the opportunities for an LBO to cut duplicate costs are minimal, and the investors rely on

new management, new operating tactics, or a rising stock market to boost values.

Through the LBO, private equity funds control many large U.S. corporations, such as Hertz Rent-A-Car, Hilton Hotels, and Caesar's Entertainment, and the funds have made substantial inroads into Western Europe. At the LBO peak in 2006, such debt-funded deals represented 30 percent of M&A activity, a figure that has since dropped to about 10 percent according to data generated by Capital IQ.

LARGE VERSUS SMALL TRANSACTIONS

Large transactions involving publicly traded companies garner most of the media attention, and they account for 60 percent of dollar volume, out of 30,000 to 40,000 global deals per year, based on my estimations and data services. Three quarters of transactions involve privately owned firms (or divisions of publicly traded companies) with annual revenue under US$100 million equivalent, and 97 percent of purchase prices are under US$100 million.[1] One big $10 billion deal, therefore, equals the value of two hundred $50 million deals.

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M&A: NO GUARANTEE OF SUCCESS

Despite all the hullaballoo surrounding M&A, numerous studies over the years have proven that over half of acquisitions do not increase the buyer's per share equity value. However, most buyer executives, investment bankers and other practitioners fail to take such studies seriously, and they think that their deal will beat the odds. Such action is a calculated risk, and it reflects the corporate view that M&A is often the fastest means of growth. Why spend years developing new products and cultivating new customers, when you can acquire both in a few months with an M&A transaction? For many corporate managers, this logic is compelling and the opportunity for a big score outweighs the risk.

M&A's acceptance by United States' operating companies and financial markets is facilitated by the government's light regulatory hand. Most deals involve competitors or similar businesses, yet U.S. authorities rarely challenge transactions on antitrust grounds. Compared to other jurisdictions, legal protections for those U.S. workers displaced by M&A cost-cutting are minimal; and, thus, acquirers can realize cost synergies with little government interference. For large public deals, federal and state regulations allow the buyer's stockholders a minor role. Management dominates the process even if the acquisition price appears overly generous and thus injurious to

the buyer's stockholders. Finally, the U.S. government welcomes foreign corporations to buy into the United States.

The U.S. regulatory attributes are lacking, to one degree or another, in foreign markets, which explains their relative lack of activity. We cover the differences in the next chapter.

NOTE

1. Bloomberg, "Global Financial Advisory—Mergers and Acquisition Rankings 2013."

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