The era of globalized M&A
Winds of change
All inquiries should be directed to any of the individuals at J.P. Morgan or Thomson Reuters listed below.

Sam Bridges  
Associate  
10 Aldermanbury, London EC2V 7RF  
0207 325 0545

Hernan Cristerna  
Managing Director  
10 Aldermanbury, London EC2V 7RF  
0207 325 4631

Vincent Flasseur  
Deals Intelligence, TR  
30 South Colonnade, London, E14 5EP  
0207 542 1958
# Table of contents

1. Introduction 2  
2. M&A Vs ECM 3  
3. Cross-border 5  
4. Deals consideration and valuation 8  
5. Sector analysis 14  
6. Private equity fund raising 17  
7. Summary observations 19
1. Introduction

In this research document we have examined the M&A cycle from a period starting from 1990 through to May 31 2009 to quantify the effects of globalization on M&A and the impact of macroeconomics. This timeline covers two very distinct cycles of M&A deal activity, taking a look at the telecoms bubble of 1999-2000 and the leverage bubble of 2005-2007. The report aims to reaffirm that high valuation bubbles are the precursor to a swift downturn and that rapid consolidation across non-cyclical sectors are on the whole prevalent during peak M&A.

Speculators have played a significant role in two cycles identified in this report. They contributed to the over-valuation of technology and telecoms stocks in the “dot.com” era and piled into commodities and real estate during the bull market of 2007 which again led to over valuation above normal inflationary rises.

The dot.com bubble origins can be traced back to around 1995 when venture capital spawned numerous technology companies which followed the rapid expansion of the internet. When these companies were IPO’d the demand from investors resulted in unrealistic valuations based on flawed earnings projections. The emergence of private equity in 2005 and highly leveraged transactions as a result of cheap debt was also accompanied by speculators fuelling real estate and driving up commodity prices. The tiger economies of Asia and the demand for oil and steel further added to the inflated commodity prices and sub-prime lending in the consumer market added to the dislocation in the credit markets. So the two M&A cycles we have identified were borne from very distinct bubbles and rapid global growth.
2. M&A Vs ECM

The correlation between the equity markets and global M&A was evident across global and regional analysis. Global deal value has been tracking the volatility of the equity markets, lagging on average by one quarter. This assessment is true by both value and number of transactions and has tracked the equities market since 1990. While growth in the equity markets encourages M&A to grow at similar rate, a consequence of falling confidence in the equity markets is that M&A activity dries up.

Exhibit 2.1

M&A value v. equity markets performance

Source: Thomson Reuters

Exhibit 2.2

M&A deals v. equity market performance

Source: Thomson Reuters
Looking at the US and Europe the correlation between M&A and the equities market was the same as the global view, however it was quite noticeable that spikes in certain quarters, for example in the fourth quarter of 1999, which the $111 billion acquisition of Warner-Lambert by Pfizer contributed disproportionally higher deal value than in more normalized quarters. The same was true for Europe when the fourth quarter of 1999 produced the biggest ever M&A deal in Vodafone’s acquisition of Mannesmann for $171 billion.

Exhibit 2.3
M&A value v. equity markets performance

Exhibit 2.4
M&A value v. equity markets performance

Source: Thomson Reuters
3. Cross-border

The era of cross-border M&A heralded in part the opportunity to grow outside the domestic market with protectionism against national interests diluted in a number of key markets. Cross-border activity is more prevalent in upturns as shown in the below exhibit, accounting for over 35% market share of all global M&A in 1999 and then accounting for 45% of all M&A in 2007.

Exhibit 3.1

The total number of cross-border deals peaked in both the dot.com bubble and the leverage bubble, topping out at around 3,500 transactions in both time periods.

Exhibit 3.2

European targeted cross-border activity by number of deals grew almost on a yearly basis from 1990 until 2000 tailing away until the upturn in activity from 2005-2007. Emerging markets (EM) cross-border activity grew from almost non-existent levels in 1990 and followed the same pattern of growth until 2000. North American cross-border activity has remained conservative in comparison to Europe and the emerging markets with the number of transactions flat until around 1994.
Exhibit 3.3

Cross-border M&A–US v. Western Europe v. emerging markets

Source: Thomson Reuters

US acquirors have also recorded lower cross-border M&A which accounted for a high of 34% in 2003 but has fallen every year since 2006 despite the accelerated growth in M&A at the time. European cross-border M&A as a percentage of the total peaked in 1991 with activity accounting for 75% of all M&A but in recent times has moderated to around 55% of total cross-border deal activity. Emerging markets acquiror cross-border activity has recorded year-on-year growth since 2004 with a marginal decline in 2007 but post 2007, activity in cross-border deals has outstripped the US for a second year in a row. Cross-border activity in 2009 year-to-date now stands at 28% of total M&A, with Europe falling to around 40%, we may yet see emerging markets become the leading region for acquisition based M&A.

Exhibit 3.4

Cross-border M&A by acquiror ultimate parent nation/region

However despite the percentage gains in cross-border activity as a total of M&A, as the market for deals declines further then value of cross-border also falls. The number of European cross-border deals by acquiror has recorded the highest fall of 56% from the second quarter 2007 until the end of May 2009 while the US fell by 49% and emerging markets by 37%. US cross-border deal value fell by 54% during the same time period with emerging markets falling 48% and Europe with a less severe fall of 21%.
The era of globalized M&A

Exhibit 3.5
Cross-border M&A by acquiror ultimate parent nation/region

Exhibit 3.6
Cross-border M&A by acquiror ultimate parent nation/region
4. Deals consideration and valuation

M&A as a percentage of GDP gives an indication of the relative overheating of the mergers and acquisitions market compared to the rest of the economy. Over the past two cycles global M&A activity consistently outgrew the World economy during two key growth periods (1999-2000) and (2005-2007). Equally, the level of announced M&A activity collapsed at a much faster pace than the World Economy upon each subsequent downturn. Looking back at the 1999-2000 peak, M&A as a percentage of GDP reached its upper limit after 7 years of continuous growth and stagnated for 2 years at 10% to finally collapse and return within 2 years to 4%. In contrast, between 2006 and 2007, whilst M&A was at an all time high level, the same ratio found a new upper limit at 8% and followed the same 2 year high-plateau pattern before suddenly collapsing with the credit crisis in 2008.

It is probably worth noting that, against the generally accepted conception, the level of merger activity reached during the first M&A TMT-driven bubble, though significantly smaller in absolute $ value was in fact of greater proportion relative to the world economy than the latest credit-driven cycle we’ve just gone through.

Based on the hypothesis that the M&A/GDP pattern could repeat itself global activity as % of GDP could reach 3.6%, 3.7% & 4.5% in 2009, 2010 and 2011 respectively, mirroring the upturn of 2002, 2003 and 2004. When matched with IMF GDP forecast for the same years this could mean that M&A activity could return to slow growth as early as this year and next and eventually reach US$2,622bn by 2011.

Exhibit 4.1

Source: Thomson Reuters
The era of globalized M&A

Exhibit 4.2
M&A considerations

The use of all cash consideration has grown on an almost annual basis except for 2003 with a peak in 2007 of 46% of total M&A. All share deals have declined almost at the same rate that cash grew from 2000 with a slight rebound in 2008 but falling to 7% of total M&A. Hybrid or mixed consideration of cash and shares has seen a surge from 2008 accounting for 28% of the total M&A.

Global bid premiums continue to grow despite the current downturn. The one month median is 33% compared to 22% at the height of deal activity in 2007.

Exhibit 4.3
Global bid premiums 1985-2009 year-to-date

The current high premiums can be explained by the two exhibits below. Taking exhibit 4.4 for example and we can see that the market has undervalued Eidos stock relative to the index performance. However the offer price in this example has factored in the stock undervaluation and the implied premium is reduced as the index performance picks up by week 6 (post announcement date). In exhibit 4.5 we can see that BPP has been undervalued when rebased against the index performance, so the implied premium would appear higher.
The upward trajectory of the dot.com M&A started in 1997 and ended in 2000 while the emergence of private equity started around 2001 and peaked in 2006. Globally TMT M&A activity for the period 1999-2000 rally accounted for 45% of the total M&A announced. Private equity accounted for about 22% of the total M&A market during a peak in 2006. In the US TMT accounted for 48.3% of all M&A while private equity equalled around 25.4%. In Europe, TMT made up 34.2% of total M&A and private equity accounted for 18.7%.
The era of globalized M&A

Exhibit 4.6

Global M&A drivers

- Global M&A ($bn)
- TMT acquisitions as % of total
- Buyside financial sponsor as % of total

TMT deal activity was driven by all share deals in the dot.com period and then cash accounted for 60% of all TMT deal value in 2007.

Exhibit 4.7

TMT M&A considerations

- TMT M&A ($bn)
- All share (% of total)
- All cash (% of total)

Source: Thomson Reuters
The global squeeze on the money markets from mid 2007 through to 2009 year-to-date has had major repercussions for M&A. Correlating against previous downturns on a global scale proved difficult but looking at a regional level and we saw similarities between the Japanese banking crisis and the global credit crunch.

The Japanese banking crisis of the 1990’s was caused by an overvalued Japanese stock market, financial liberalization and deregulation. By 1997 several large financial institutions failed and went into bankruptcy with the recapitalization and fiscal cost of repairing the banking industry estimated at about 12% of GDP. Financials accounted for about 70% of all Japanese targeted M&A in 1999, at the height of the crisis. The parallels between the Japanese crisis and the credit crunch which started in the summer of 2007 are quite stark. Liberalization of the financial market and the abundance of credit inflated a debt bubble which unbalanced the global economy. Coupled with low interest rates, low unemployment above inflation year-on-year growth in real estate, record earnings in the oil & gas industry and strong equity markets, pushed M&A to record levels during the second quarter 2007.

Source: Thomson Reuters
The era of globalized M&A

Exhibit 4.9

Japanese banking crisis

The cyclical nature of certain sectors has also had a profound impact on global M&A. TMT at its height in 1999 accounted for over 55% of total M&A deal value while the last peak of M&A in 2007, TMT deal value comprised of just 16% of total M&A. Financial institutions have on the other hand peaked either prior or post the height of M&A in 1999 and again 2007.

In the US, TMT followed the global trend of peaking in the 1999 boom and then declining in the last boom in 2007. Financial institutions appear to have no cyclical characteristics and tend to be volatile in activity.
5. Sector analysis

Exhibit 5.1

**TMT acquisitions**

Source: Thomson Reuters

Exhibit 5.2

**Financials acquisitions**

Source: Thomson Reuters

Exhibit 5.3

**TMT acquisitions**

Source: Thomson Reuters

Exhibit 5.4

**Financials acquisitions**

Source: Thomson Reuters
In Europe TMT again peaked in 1999 and fell away again during the last upturn in 2007. With lower debt to equity compared to other sectors, TMT is long overdue another round of consolidation.

Global healthcare has experienced 4 cycles of increased M&A activity, the first in 1995, the second in 1999, the third in 2003 and the last cycle started during the first quarter of 2009 and currently accounts for over 25% of global M&A. Utilities is not a cyclical sector with sustained periods of activity since 1990 but especially from 1995 until the present day.

US healthcare activity has been limited to 3 very distinct spikes with the latter spike forming part of the activity in the first quarter of 2009 and accounting for nearly 75% of the total deal value.
Exhibit 5.9

Healthcare acquisitions

Utilities acquisitions

Source: Thomson Reuters

Exhibit 5.11

Healthcare acquisitions

Utilities acquisitions

Source: Thomson Reuters

Exhibit 5.12

Healthcare acquisitions

Utilities acquisitions

Source: Thomson Reuters
6. Private equity fund raising

Despite the fact that the PE buyout market was adversely impacted immediately as a consequence post June 30, 2007, buyouts dropped away as the credit markets contracted and financing became difficult and expensive, however 2007 and 2008 were effectively the two largest years in history for PE and buyout fundraising in terms of capital committed to funds. Given that investors in PE are aware that PE investment is a comparatively long term game the shock to PE investment activity did not impact fund investment returns with anything like the same ferocity or velocity. Due to the cumulative effect of the PE boom in subsequent years of the decade PE firms were still delivering market-leading returns post credit crunch, the driving force behind them being able to attract unprecedented levels of fund raising.

These conditions now leave PE firms in an extraordinary situation whereby they have never had more ‘dry powder’ (unspent fund commitments) yet have barely ever had a more challenging environment in which to try to invest and realise investments with the virtual disappearance of the IPO market, sales to strategic buyers hampered by uncertain markets and low M&A activity and little access to cheap and easy leverage, the tenant on which the buyout business model has thrived.

The bulk of PE fundraising in the years leading up to, and subsequent to, the credit crisis, is buyout fundraising. In the dot.com boom, however, which peaked in 2000, the same year that the highest number of new funds have ever been raised, the majority of new funds were VC, and not buyouts. This was likely due to the desire to capitalize and invest in dot.com start-ups.

PE has, for a number of years, been considered to be a driver of M&A activity and this seems to be true in a negative as well as a positive sense as it is clear that PE fundraising strategy manifestly reflects the mistakes and does not predict or escape from the downturns in the market, but rather demonstrates clearly an over-exuberance in the boom market rather than any prophetic insight prior to the subsequent busts.

What is clear is that if anything like favourable conditions return to the credit markets there is all likelihood that PE activity will return as quickly as it disappeared as PE firms are finally able to spend the huge amounts of money for which they have commitments, and once again contribute something akin to the 20-25% of total M&A volume as per the years preceding the credit crisis. If they can take advantage of depressed exit multiples in the meantime and acquire assets at favourable values they may be able to offset somewhat the lack of leverage available which previously allowed for such successful returns.
Historical volumes of syndicated loans and leveraged loans illustrate the growing importance and availability of this asset class as a financing instrument for corporations. Barely affected during the previous M&A downturn (2001-2002) syndicated loans issuance grew for 5 consecutive years fuelled by the even faster growing leverage market culminated in 2007, just before the credit crisis.

Exhibit 6.1

Private equity fund raising

Source: Thomson Reuters

Exhibit 6.2

Leveraged loans issuance

Source: Thomson Reuters

Leveraged loans as % of total

Global Syndicated loans ($bn)  Leveraged loans ($bn)  Leveraged loans as % of total
7. Summary observations

Several important trends have emerged during the globalization of M&A:

- The correlation between the equity markets and M&A is self-evident. When the stock markets rally, it is inevitable that M&A activity increases in line with the pace of the equity markets.

- Bubbles are nearly always prevalent during peak M&A. We have seen this in the Japanese banking crisis which saw inflated real estate valuations. The dot.com bubble of 1999 and more recently the leverage and real estate bubble in 2007 have all fuelled M&A directly and indirectly.

- We should expect to see further M&A activity in sectors like healthcare and TMT which appear to consolidate during downturns.

- During the dot.com cycle, M&A contracted for approximately 8 quarters before M&A rebounded. The credit crunch cycle is so far through 7 quarters of contraction which could see total M&A bottom out during the second quarter of 2009.


- In M&A cross-border activity tends to outgrow or decline at a faster rate than the general trends.

- M&A is confidence-driven rather than opportunity driven as demonstrated by the surge and decline in activity relative to the broader macroeconomic environment.

- The percentage of cross-border M&A activity has been demonstrably high (above 20%) for the last two decades.

- Western Europe is the primary driver of cross-border activity. US targeted cross-border activity disproportionately deteriorates during downturns. As it stands US targeted activity accounts for only 10% of global cross-border activity, a level not seen since 1992.

- Emerging markets demonstrates growing maturity and currently outpaces the US market both in terms of target and acquiror cross-border activity.

- In real terms the most recent boom and bust in M&A was not as high as the previous dot.com boom as a percentage of global GDP.

- As expected the consideration of choice in the lead up to the dot.com bubble was in the form of all share deals whereas the leverage bubble was driven by cash only deals.

- The current high premiums are artificially high due in part to stock undervaluation.

- In 2000, TMT acquisitions accounted for up to 45% of all M&A activity. In 2006 financial sponsors accounted for up to 20% of total M&A, demonstrating the two drivers of the last two M&A cycles.

- The financial crisis in Japan in the late nineties led to rapid financial consolidation which culminated in financial targeted M&A comprising 70% of the total Japanese M&A market in 1999.

- Despite the fact that the PE buyout market was adversely impacted as a consequence of post June 30 2007, in fact 2007 and 2008 were effectively the two largest years in history for PE and buyout fundraising in terms of capital committed to funds.
Disclaimer

Note: The information contained herein is based solely upon publicly available information, including information provided by Thomson Reuters. All market statistics are based on deals announced through 01/01/1990 with data sourced on 31/05/2009. In contested transactions, only the highest offer is counted. Partial purchases are included if they exceed $100mm or involved an advisor. Data can change from quarter to quarter as a result of updates or reclassifications made by Thomson Reuters. Numbers in various tables may not sum due to rounding. Distribution of this report is permitted to J.P. Morgan’s Investment Banking clients, subject to approval by J.P. Morgan. This edition of the M&A Review reflects recent changes to achieve global standardization in our commentary. The most important of these is a shift to use of “target volume” rather than “involved volume” for European M&A. Although many track total European M&A activity by combining European target volume with European acquisition volume of non-European targets (“European involved volume”), this counts non-European target deals twice in any global analysis, i.e., in European volume and in the volume of the target region which, for Europeans, is primarily the United States, but also Canada and Latin America. With the “target” approach, all region totals add to the global total, but European volumes appear lower in this report than in past editions due to this change. We have also conformed our definitions of the TMT and industrials sectors globally by moving aerospace volume out of the technology sector (i.e., TMT) in the United States and into the industrials sector. We have standardized our analysis of premiums to measure the “one-day” announced premium and the “one-month” premium in both Europe and the United States. Throughout we use the “announced and not withdrawn” classification of Thomson Reuters.

Thomson Reuters makes no representation or warranty regarding the accuracy or completeness of any information provided in this report and any reliance you place on such information will be at your sole risk. This report does not constitute a recommendation to buy or sell securities of any kind. In no event will Thomson Reuters or its third party suppliers be liable for any damages of any kind, including without limitation, direct or indirect, special, incidental, or consequential damages, losses or expenses arising in connection with your use of the report. You may not distribute or sell this report to any third party without the consent of Thomson Reuters.

The following mergers and acquisitions analysis document is a research initiative and collaboration between Thomson Reuters and JP Morgan.

Copyright 2009 JPMorgan Chase & Co. All rights reserved.