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2010 M&A Update
Carol Sánchez, Christina Seeber, & Stephen R Goldberg
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Introduction

Most of 2009 was slow for mergers and acquisitions (M&A), due to financial turmoil and economic uncertainty that carried over from late 2008. But the deal market rebounded in the fourth quarter of 2009 and 2010 appears to be much better for M&A than 2009. Yet while the global economy shows signs of recovery, and many buyers and sellers are flush with cash, M&A activity may begin slowly in the United States in 2011 due to uncertainty about the business outlook and potential tax changes. In this article, we briefly review M&A activity in the first half of 2010, and look back on 2009. We comment on current deal making, suggest factors that may influence future deals, and conclude with expectations for the future.

M&A 2010 (Q1 & Q2)

Global M&A activity increased during second quarter of 2010, with the first half of 2010 faring significantly better than the first half of 2009. The total value of worldwide M&A transactions increased 9.4% in the first half of 2010, while the number of deals increased by 3.8% over the same period of the previous year. Global M&A activity increased 5.4% between the first and second quarters of 2010.¹

M&A activity in the US may have increased more slowly in 2010 than in the global market due to uncertainty concerning the pending expiration of tax cuts passed during the Bush Administration. While significant numbers of acquisitions are being discussed and prepared, few

¹ Thomson Reuters. (2010). *Mergers & Acquisitions Review, First Half 2010*. New York, NY.

final transactions have occurred because acquirers and acquirees are uncertain about how such consolidations, and possible new tax rules, will affect their business.

Despite this uncertainty, first and second quarter 2010 M&A activity in the US grew compared to the same periods in 2009. Total value of US M&A activity increased by 12.4% compared with the same period in 2009, with deals totaling \$451.4 billion in the first half of 2010.²

The Energy and Power industry showed the largest increase in activity from the first half of 2009, and the largest portion of M&A transactions -- 30% of the M&A activity by dollar value -- in US markets. Energy and Power rose 488.6% from Q1/Q2 2009 to a first half worth \$109.43 billion, and 356 deals. High technology came in second with a value of \$37.13 billion and 740 deals, the largest number of transactions. The Healthcare industry had 321 deals valued at a total of \$36.98 billion. The Financials industry finished the first half of the year with 396 deals with a value of \$34.31 billion.³ Exhibits 1 and 2 identify US most active industries for M&A in 2009 by number of deals and dollars, respectively.⁴

Trends in mergers and acquisitions suggest that they occur most when companies are in either poor or excellent condition. Companies falling between those two extremes are perceived to be less attractive, and those companies tend to sit on the shelf until market conditions improve.

Tracy T. Larsen, Vice Chair at Barnes & Thornburg LLP and an attorney specializing in middle market M&A, notes key reasons for increased buyer interest in acquisitions in 2010. First, some sellers who successfully navigated the financial crisis now want to sell their companies before the possible tax and economic uncertainties of 2011. Secondly, some buyers

² Ibid

³ Ibid

⁴ Ibid

are eager to return to the corporate growth train through acquisitions. Many acquiring companies also conservatively managed their business during the recession, and are now well positioned with cash to make acquisitions. Finally, buyers are feeling better about their economic future than they have since the 2008 financial crisis. Exhibit 3 summarizes reasons for M&A picking up in 2010 and expected to accelerate in 2011 after the economic and regulatory uncertainty clarifies.

Global 2009 M&A Activity

The global M&A market dropped significantly from 2008 to 2009, as the number of global M&A deals fell 15.2% from 29,677 to 25,168 transactions. The total dollar value of M&A decreased from \$2.006 trillion to \$1.646 trillion, dropping a dramatic 18.0% within one year.⁵ Exhibit 4 summarizes this data.

Some regions of the world fared well compared to others. North American deals increased 2.5% from \$860.1 billion to \$881.9 billion, while Central/South American deals increased 4.5% from \$72.7 billion to \$75.9 billion. Japanese deal activity increased in value by 7.1% from \$111.4 billion to \$119.3 billion, and deals in Asia Pacific increased by 1.5% from \$249.7 billion to \$253.5 billion. While these regions experienced increased value in M&A activity, the number of deals dropped. Deal numbers in North America, Central/South America, Japan, and Asia Pacific decreased 19.2%, 26.5%, 14.0%, and 9.5%, respectively.

Other regions of the world dropped in both measures. European deals were slow in 2009, falling in dollar value by 49.8% from \$974.5 billion to \$489.5 billion, and falling 16.2% in

⁵ Robert W. Baird & Co. Incorporated. (2010, January). *2010 Middle-Market M&A Outlook*. Milwaukee, Wisconsin. Retrieved from: <http://www.rwbaird.com/research-insights/insight/ma-market-analysis.aspx>

number of deals from 11,850 to 9,926. Africa/Middle Eastern deals fell in both categories, 25.2% from \$58.9 billion to \$44 billion, and the number of deals dropped 17.8% from 762 to 626.⁶

US 2009 M&A Activity

M&A activity declined significantly in the United States in 2009 on the heels of the financial crisis in late 2008. The dollar value of US M&A activity fell 1.7%, decreasing from \$777.4 billion in 2008 to \$764.1 billion in 2009. The number of US deals also fell, dropping 17.6%, from 9,497 in 2008 down to 7,826 in 2009. (Baird) US middle-markets were most severely affected. Activity value fell 30.4% in 2009, from \$279.9 billion in 2008 to \$194.7 billion, while the number of deals fell 8.9% from 3,572 to 3,254.

According to Larsen, while many strategic buyers picked up financially troubled companies in 2009, the number of deals decreased. Bank financing prior to the financial crisis was at four to five times cash flow (EBITDA). Financing now is roughly only three times cash flow. Larsen notes that low levels of activity have persisted into the early months of 2010. The year began with the lowest number of deals he has seen since 1984.

Larsen indicates that earnouts were more common in middle market transactions in 2009, than they were in prior years. An earnout is an arrangement where the seller gets a portion of future earnings. Thus, the seller receives additional purchase price contingent on future earnings. Currently a high proportion of middle market deals include earnouts to complete negotiation.

⁶ Ibid

Uncertainty Returns

There is certainly more M&A activity in the pipeline today, yet it is unlikely that a significant number of deals will close before the end of 2010. While companies are positioning themselves for possible deals, exploring options by conducting due diligence and valuation estimates, and identifying possible buyers and sellers, many deal makers are still reluctant to complete the deal given the slow recovery of the global economy. According to Terry Bressler, managing director of investment banking at Stout Risius Ross Advisors, LLC, the economy continues to be characterized by less consumer spending and more savings. Deal makers are likely waiting and expect a more predictable market in mid-2011.

Sources of Financing

There is hope for the growth of M&A. Additionally, certain sources of financing are becoming more available. While it is still difficult for companies to obtain bank financing for M&A activity, matters have improved since the first half of 2009. But even with the 47.3% increase of issuance in the first half of 2010 over the same period of 2009,⁷ companies look to many alternate sources of capital to make M&A transactions.

It seems that mezzanine capital will be an important source of M&A capital in the near future, especially for small companies.⁸ Mezzanine capital is capital on the balance sheet between senior debt and equity. Mezzanine investors can expect a return between 18-22% on their outlay. Equity typically earns a return of around 30%. Mezzanine capital is frequently debt

⁷ Ibid

⁸ Ibid

with interest of approximately 12% plus equity warrants. Some professional capital funds focus on mezzanine capital. A cash flow advantage of mezzanine capital is that it is debt, but unlike more traditional bank loans, usually has no principal amortization for the first five years.

Private placements increased by 46.3% over the first half of 2009, while high yield bond issuance almost doubled in volume for a year to date total of \$106.2 billion. In contrast, investment grade bonds decreased in year to date volume by 16.9% from the same period of 2009.⁹

Another source of financing is offering stock to the public. While initial public offerings (IPOs) are slow, there is evidence of some increase in activity during the first half of 2010. The number of IPOs in the first half of 2010 more than tripled compared to those in the first half of 2009, and proceeds are 278.5% of proceeds of 2009 in the same period.¹⁰

Private equity firms appear to have sufficient capital to invest, given the slow M&A activity of 2009 and the recent rise in other sources of fundraising. The number of private equity transactions during the first half of 2010 increased 13.7% to 266, up from 234 such deals in the first half of 2009. The value of private equity deals rose similarly, increasing 118% for a total of \$21.8 billion during the year's first half.¹¹ Many private equity investors have taken a long term position instead of deals with immediate returns.¹²

M&As in Developing Countries

⁹ Ibid

¹⁰ Ibid

¹¹ Ibid

¹² Consumer industry M&A deals still active despite weakening economic indicators (2010, July 27). Retrieved September 9, 2010 from <http://www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/Press-releases/Pages/press-release-Consumer-industry-MA-deals-still-active.aspx>

Developing economies have recently experienced a higher recovery rate than their more developed counterparts.¹³ Emerging markets such as China and India have exhibited large increases in the number of M&A deals completed in the first few months of 2010.¹⁴ Many of these deals are cross-border transactions, with the number of ‘emerging-to-developed’ acquisitions rising from the first half of 2009. Private equity firms in developing countries have become directly involved in the restructuring of companies going through consolidation, and working with smaller companies in an effort to direct development.¹⁵

The Outlook

M&A activity is expected to be slow during the first half of 2011, and specialists in the field expect a stronger rise in the number of deals beginning the second half of 2011, through 2013.

Deals in the commercial aircraft industry are predicted to increase in 2011 and beyond. One indicator of future activity is long-term labor contracts. Some commercial aircraft companies have recently signed long-term contracts with unions, suggesting that they are anticipating better times, as well as a desire to avoid possible labor stoppages as orders increase.

¹³ Emerging economies already back on the cross-border M&A trail (2010, March 8). Retrieved September 9, 2010 from <http://www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/Press-releases/Pages/Press-release-Emerging-economies-cross-border-MA-trail-8-March-2010.aspx>

¹⁴ Emerging economy trade buyers register 25% jump in M&A activity (2010, August 23). Retrieved September 9, 2010 from <http://www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/Press-releases/Pages/Emerging-economy-trade-buyers-register.aspx>

¹⁵ Consumer industry M&A deals still active despite weakening economic indicators (2010, July 27). Retrieved September 9, 2010 from <http://www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/Press-releases/Pages/press-release-Consumer-industry-MA-deals-still-active.aspx>

M&As may increase in some consumer industries as smaller consumer companies, such as food and drink producers in developing countries, consolidate. This consolidation is likely to be driven by a need to develop more efficient supply chains and achieve improved efficiency in other parts of the value chain.¹⁶ Consolidation deals generally have long term strategic goals in mind, rather than short term profitability goals. In the current environment, these buyers are preparing for post-recession growth and expansion.

Further consolidation is also expected in automotive, realty brokerage and mortgage industries. Increased buying is expected from the Far East, because of the economic success experienced in the region. Although buying from Europe may increase, weakness of the Euro is likely to be a chilling factor. Domestic automotive suppliers are moving overseas to ensure being able to supply worldwide manufacturing from local sources. Vertical integration is expected to continue in retail. M&A activity is expected to increase as the prices of target companies drop, and buyer and seller expectations meet.¹⁷ The recent upturn of worldwide M&A activity and the relatively stable level of US M&A activity suggest the economy is moving toward market and industry recovery.

Larsen notes that many mid-size and smaller companies that went underwater during the recession have been cleaned out, and there are fewer bankruptcy filings. However, many companies have bank facilities that cannot be renewed at the original borrowing terms. Companies that had borrowed at four times EBITDA now cannot obtain more than two and one-half times EBITDA. These companies need other solutions, which may include obtaining mezzanine capital, (2) selling the company, or (3) liquidating. As financing becomes more

¹⁶ Ibid

¹⁷ Ibid

available and economic uncertainty reduces, strong M&A activity is expected in the second half of 2011 through 2013.

Exhibit 1
US Most Active Industries in 2009 (by # of Deals) (Baird)

1. Computers & Electronics
2. Healthcare
3. Professional Services
4. Finance
5. Oil & Gas
6. Telecommunications
7. Real Estate / Property
8. Unity & Energy
9. Construction / Building
10. Publishing

Exhibit 2
US Most Active Industries in 2009 (by Dollar Value) (Baird)

1. Healthcare
2. Finance
3. Oil & Gas
4. Computers & Electronics
5. Telecommunications
6. Food & Beverage
7. Transportation
8. Auto / Truck
9. Professional Services
10. Real Estate / Property

Exhibit 3

Reasons for Buyers' Interest in Current Market

1. Good assets waited through financial crisis.
2. Acquisitions to get back on growth train.
3. Corporates well positioned with cash.
4. Better feeling now about stability.

Exhibit 4
Global M&A Activity
Years 2008 and 2009

Region	M&A Value of Deals (in billions)			M&A Number of Deals		
	2009	2008	% change	2009	2008	% change
North America	\$881.9	\$860.1	2.5%	8,985	11,124	-19.2%
<i>U.S.</i>	<i>\$764.1</i>	<i>\$777.4</i>	<i>-1.7%</i>	<i>7,826</i>	<i>9,497</i>	<i>-17.6%</i>
Central/South America	\$75.9	\$72.7	4.5%	633	861	-26.5%
Japan	\$119.3	\$111.4	7.1%	2,020	2,231	-9.5%
Asia Pacific	\$253.5	\$249.7	1.5%	4,685	5,445	-14.0%
Europe	\$489.5	\$974.5	-49.8%	9,926	11,850	-16.2%
Africa / Middle East	\$44	\$58.9	-25.2%	626	762	-17.8%
Global Total	\$1,646.1	\$2,006.7	-18.0%	25,168	29,677	-15.2%

