Mergers and Acquisitions in 2007

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The widely respected UCLA Anderson economic forecast for 2007 reports that real gross domestic product (GDP) growth in 2006 was 3.2% and forecasts 2.0% for 2007. Since business investments and M&A are sensitive to economic conditions, a question is raised about their levels for 2007. Growth rates in real GDP beginning in the third quarter of 2006 through the second quarter of 2007 are estimated at about 1.7% per quarter at annual rates. Real GDP rates for subsequent quarters are expected to rise to over 3.5% per quarter through the end of 2008. These data raise the question of whether M&A activities will decline during 2007.

Some Forecasts

The value of world M&A was over $4 trillion in 2006. Cash only deals were $3 trillion. U.S. deals were almost $1.6trillion; Europe was slightly over the U.S. total. (Economist, 1/13/07, p. 90). Private equity deals are growing and will soon top $1 trillion.

A strong basis for continued M&A growth is widely expected. Martin Lipton, the icon in the legal field of M&A and governance, has written ("M&A in 2007", 12/22/06) that the factors supporting high M&A activity will continue. He notes that the benefits of consolidation continue in a widening number of industries. A strong force has been the movement of Europe toward a common market. When the completion of the transcontinental railroad system in the US at in the 1880s created the first large common market, M&A in the U.S. during 1995-2005 as a percentage of GDP was the highest ever experienced before or after. So activity in Europe will continue strong. China has also continued to use M&A to seek to remedy inefficiency in the state owned enterprises (SOE). Japan has begun to recognize the need to use M&A to broaden the visions of entrenched managements.

Other Factors Continue Strong

Forces noted in earlier studies are still operating. Kit Lokey, Chairman of Houlihan Lokey Howard & Zukin, investment bankers, predicted M&A would continue strong. ("2006: The Perfect Storm for M&A?" UCLA Anderson, CFI Quarterly, Summer 2006) The reasons he emphasized were basic economic developments. High liquidity and low debt default rates support acquisitions by cash. More industries have used M&As. Strategic mergers have been used by firms to extend their core competencies.

James B. Freedman, Chief Executive Officer of Barrington Investment Bankers in a 9/21/06 presentation to The Anderson School UCLA merger week program commented on the continued growth of deal volume. The major force was the use of M&A as an important source of growth and strategic development for corporations. He noted that buyout funds had $125 billion of uninvested funds to support $500 billion of deals. In addition senior debt financing had grown. Average equity contributions in leveraged buyouts had dropped from 41% in 2002 to 30% in 2006.

Quality of M&A

The Consulting firm, McKinsey and Company had published a widely quoted study in 1987 that two-thirds of M&A transactions had failed to create value for the acquirers. In The McKinsey Quarterly, published online in December 2006, a sample of 1,000 global mergers from 1997 to 2006 were analyzed. The initial event returns for a 5 day window covering market reactions from two days before and after the announcement date measure the deal value added (DVA). The DVA was 6.1 percent for the full 1997 to 2006, trending upward over the years.

In earlier periods most of the value gains went to acquired firms. In the later period acquiring firms had negative event returns in most of the 57% of the transactions, but trending down over the period studied. Premiums paid have also trended downward. So acquiring firms have achieved some positive gains in almost 50% of the transactions. Obviously, room for improvement remains.

Conclusions

M&A continues to be a driving force in the world economies. The good news is that acquiring firms are improving their performance.