Mergers & Acquisitions

This newsletter from Bain & Company's Mergers & Acquisitions Group provides an overview of recent deal-making activity based on publicly available data. Our goal is to stay current with trends and forecasts in M&A activity around the world in order to help our clients set realistic expectations and benchmarks.

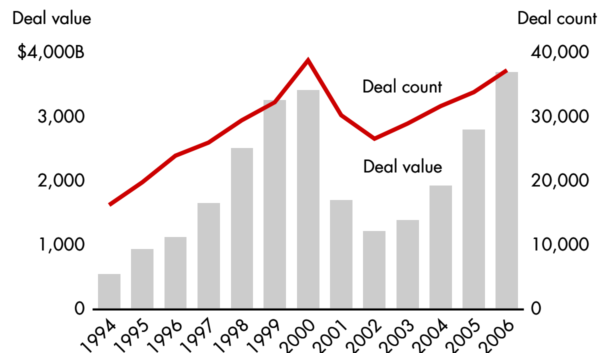
HIGHLIGHTS

- **Global M&A value reached a record $3.8 trillion in 2006, up 38% versus 2005**
- **US M&A activity rose 36%, while European activity rose 37%**
- **M&A value increased 40% in Asia but declined 36% in Japan**
- **Worldwide, mega-deals deals fueled the growth, with the combined value of deals worth more than $10 billion growing 93% and accounting for a third of total value**
- **Finance was the most active sector, followed by energy and power, and then materials**
- **Private equity deals accounted for 20% of global deal value**

Global M&A activity

The M&A market closed out 2006 with its best performance ever. According to Thomson Financial, global announced deal value reached a record $3.8 trillion in 2006, up 38% from the $2.8 trillion reached in 2005, and eclipsing the previous record of $3.4 trillion set in 2000 by more than 10%.

Figure 1: Global M&A Activity



Source: Thomson Financial

The media has trumpeted the new M&A boom – *The Economist* called it a "deal-making bonanza" while *The New York Times* declared 2006 to be "the year that made deal makers giddy." No matter what colorful idiom you use, it's clear that the M&A surge has been fueled by a number of converging factors:

- Companies are hungry for growth and finding it difficult to achieve it organically;
- Activist investors are putting pressure on companies to make wholesale changes;
- Cyclically high corporate earnings have added tons of cash to corporate balance sheets;
- Fueled by bulging coffers, private equity firms have been bidding aggressively;
- Benign debt markets have supplied plenty of low-cost financing;
- The clout of buyers has grown tremendously, while sellers have become increasingly eager to do deals too; and
- Receptive financial markets are rewarding sensible deals.

This M&A boom is different from the previous cycle in many telling ways. First, this time around deals have been happening across a broad base of industries, not concentrated in high-tech and telecom as they were in 2000. In 2006, high-tech, telecom and new-media deals accounted for 13% of global deals, compared with 38% in 2000. Second, deals have been less skewed toward America and more toward emerging markets like China and India. Third, cash reserves have swelled up, and cheap debt has become overwhelmingly available. This means that cash has become the preferred means of payment, whereas six years ago, overpriced stock was used to fund acquisitions. In 2006, 60% of deals were paid for in cash, versus 29% in 2000. Fourth, acquirers have been paying lower premiums and banking on higher identifiable synergies. Last, but not least, private equity buyers have become a major force in buying and selling companies. In 2006, 20% of acquisitions globally were backed by private equity firms compared to just 3% in 2000.

Top 10 deals

The five largest deals in 2006 included AT&T's agreement to buy rival Bell South for $102 billion; Eon's bid to buy Endesa for $66 billion; Suez's agreement to merge with Gaz de France in a $43 billion deal; Mittal Steel's $40 billion takeover of Arcelor; and Blackstone Group's $38 billion offer for Equity Office Properties – the largest buyout in history.

Figure 2: Top 10 Deals in 2006

Acquirer	Country	Target	Country	Value
AT&T	US	BellSouth	US	$102B
E.ON	Germany	Endesa	Spain	$66B
Suez	France	Gaz de France	France	$43B
Mittal Steel	Nether-lands	Arcelor	Luxem-bourg	$40B
Blackstone Group	US	Equity Office Properties	US	$38B
Banca Intesa	Italy	Sanpaolo IMI	Italy	$38B
Private equity consortium	US	HCA	US	$33B
Statoil	Norway	Norsk Hydro (oil & gas activities)	Norway	$29B
Private equity consortium	US	Harrah's Entertainment	US	$27B
Express Scripts	US	Caremark Rx	US	$27B

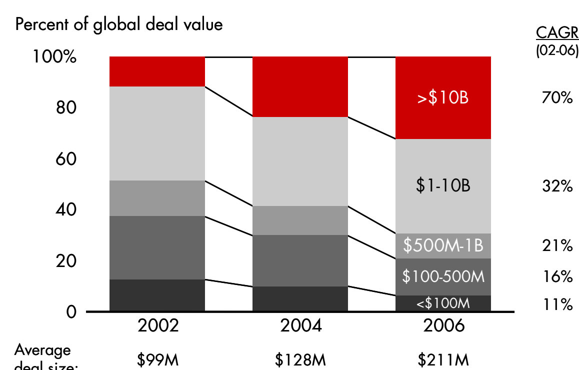
Note: Excludes withdrawn deals, spin-offs and open-market purchases; includes net debt of target company
Source: Dealogic, Thomason Financial, Literature Search

Mega-deal market vs. mid-market

It's clear from looking at the top 10 list that size rather than volume dominated the picture in 2006. While global deal value was up 38% in 2006 compared to 2005, deal count rose only 10%—to 36,958 transactions in 2006. In 2006, 545 deals worth $1 billion or more were announced globally, up from 447 in 2005. Those deals accounted for 70% of total deal value. More tellingly, the number of deals worth more than $10 billion more than doubled, to 54, accounting for a third of total deal value.

Looking at this from a historical perspective, since 2002, most of the growth in global M&A has been driven by the surge in big deals. The value of deals worth more than $10 billion grew at an annual rate of 70% from 2002 to 2006, and the value of those worth $1 billion to $10 billion grew at 32%; the deals worth less than $1 billion only increased by 16%. The average deal size more than doubled from 2002 to 2006, to $211 million.

Figure 3: Deal Size Trend



Source: Thomson Financial

Hostile bidding

Gigantic hostile bids barraged the business world in 2006. These include Eon's bid to buy Endesa for $66 billion and Mittal Steel's $40 billion takeover of Arcelor. Other notable hostile activity includes US Airways' pursuit of Delta airlines and Nasdaq's attempt to buy the London Stock Exchange.

According to Dealogic, the number of unsolicited bids reached 374 in 2006, up from 94 in 2005 and surpassing the 1999 record of

272 bids. While accounting for only 1% of the total number of announced deals, unsolicited bids represented 17% of the total deal value.

M&A experts attribute the surge to a number of factors notably:

- Corporate and private equity buyers are eager to put their vast cash reserves to work;
- The influence of impatient shareholders, especially hedge funds, is growing; and
- Executives believe they must buy their rivals or risk being bought out as their industries consolidate.

M&A activity by region

M&A activity was broad in 2006, reflecting a healthy market. Deals came from across all geographies.

Figure 4: M&A Activity by Region

	2006		2005		Change	
	Value (US$B)	Number of deals	Value (US$B)	Number of deals	Value (US$B)	Number of deals
WORLDWIDE	3,798	36,958	2,755	33,570	38%	10%
AMERICAS	1,855	13,196	1,290	11,357	44%	16%
North America	1,728	12,327	1,243	10,754	39%	15%
United States	1,565	10,433	1,153	9,235	36%	13%
Canada	162	1,894	89	1,519	82%	25%
Central America	61	555	34	384	80%	45%
Mexico	33	234	12	182	171%	29%
South America	52	201	7	114	605%	76%
Brazil	46	162	6	81	616%	100%
Caribbean	15	113	7	105	123%	8%
EUROPE	1,432	11,741	1,042	10,687	37%	10%
Western Europe	1,351	10,343	965	9,465	40%	9%
United Kingdom	349	2,579	306	2,561	14%	1%
Germany	162	1,271	107	1,131	52%	12%
France	135	1,652	109	1,392	24%	19%
Eastern Europe	81	1,398	77	1,222	4%	14%
ASIA (EX JAPAN)	226	6,311	161	6,129	40%	3%
North Asia	120	3,157	90	2,957	32%	7%
China	43	1,923	31	1,757	41%	9%
Hong Kong	28	772	21	770	34%	0%
South East Asia	66	1,911	44	2,092	50%	-9%
South Asia	36	1,197	26	1,038	41%	15%
Central Asia	4	46	1	42	255%	10%
JAPAN	103	2,525	162	2,587	-36%	-2%
AUSTRALASIA	118	2,415	69	2,243	70%	8%
Australia	108	2,002	58	1,887	87%	6%
AFRICA/ MIDDLE EAST	65	770	31	567	111%	36%

Source: Thomson Financial

US deal-making volume (involving US targets) totaled $1.6 trillion in 2006, up 36% from the previous year. The US retained its title as the largest M&A market in 2006, accounting for 41% of total deal value.

Deal count rose a more modest 13%, from 9,235 in 2005 to 10,433 in 2006. That can be explained by the ongoing strength of the mega-deals: In 2006, 5 of the top 10 global transactions involved US-based companies.

The US was the top targeted nation for cross-border M&A, with a volume of $219 billion. Such deals were up 57% versus 2005 and accounted for 14% of all 2006 US deal value. Canada was the most active acquirer of US targets, with $45 billion worth of deals, up 251% since last year. Conversely, the US was also the top cross-border acquirer, with a volume of $203 billion, up 30% versus 2005.

In **Europe**, deal making also recorded a healthy jump. The volume of deals that involved European targets rose 37% in 2006, with announced deals valued at $1.4 trillion versus $1 trillion in 2005. Europe accounted for 36% of worldwide M&A activity in 2006.

Mirroring the global trend in mega-deals, European deal count rose by only 10%, to 11,741 transactions. Like the US, Europe was home to 5 of the world's 10 largest transactions in 2006.

The UK was the most active country in Europe, with $349 billion worth of deals in 2006 – although that only represented an increase of 14% compared with an increase of 37% for Europe as a whole. Deal count in the UK was virtually flat at 2,579. The UK was the second most targeted nation for cross-border M&A, with a volume of $210 billion, up 45% compared with last year. Cross-border transactions accounted for fully 60% of all 2006 deal value involving UK targets.

Spain was the second-most-active country, with 759 deals worth $182 billion, up 70% versus 2005. Much of the credit goes to Eon's bid to buy Endesa for $66 billion – the second-largest deal in all of 2006. France came in third but recorded the largest increase in deal value versus last year. Announced deal value reached $162

billion, up 52% from 2005's volume. That increase was largely a reflection of Suez's agreement to merge with Gaz de France in a $43 billion deal – the third largest in 2006. Deal count in France increased 12%. Germany was the fourth-most-targeted country in Europe, recording $135 billion worth of deals, up 24% versus last year. Deal count in that country rose a healthy 19% to 1,652.

In **Asia** (excluding Japan), deal value increased 40% in 2006, to $226 billion, but deal count increased only 3% to 6,311 transactions.

China led the way with 1,923 transactions worth $43 billion. India was the next-most-active market, with 1,160 transactions worth $36 billion. Hong Kong was third, with 772 deals worth $28 billion.

The most notable deals in the region include Shinhan Financial's $7.5 billion for a majority interest in LG Card, Kumho Asiana's acquisition of Daewoo Engineering and Construction for $7 billion, and Synergy Drive's proposed merger with Sime Darby and seven other companies to form the world's largest palm-oil plantation company, worth $9 billion.

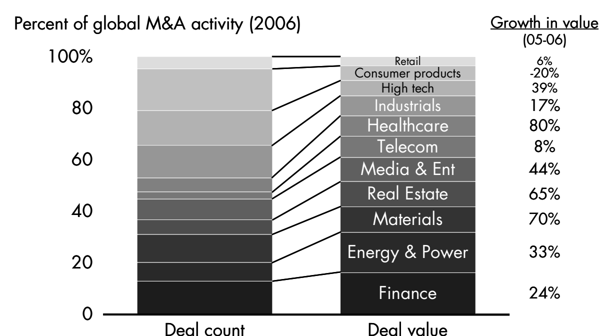
Australia's M&A market showed an 87% upsurge, to $108 billion worth of deals in 2006. Deal count increased by only 6%. The region's statistics were boosted by Cemex's $13 billion unsolicited offer for Rinker Group, the buyout of Qantas Airways for $11 billion by a consortium led by Macquarie Bank and Texas Pacific Group, and Suncorp-Metway's $6 billion acquisition of Promina Group.

In **Japan**, M&A deal value declined 36%, to $103 billion in 2006. Japanese deal count also declined, by 2% to 2,525 deals. Domestic consolidation, such as BB Mobile's $17.5 billion acquisition of Vodafone KK, dominated the M&A agenda. The largest announced cross-border transaction by a Japanese company in 2006 was the $19 billion acquisition of UK's Gallaher Group by Japan Tobacco.

M&A activity by sector

In 2006, M&A activity came from across all geographies but also spanned nearly all sectors of the world economy – both in terms of deal count and in deal value.

Figure 5: M&A Activity by Sector



Source: Thomson Financial

Finance was the most active sector by deal value, increasing 24% in value, to $592 billion. The top deals in this sector were the $38 billion merger between Italian banks Sanpaolo IMI and Intesa, and Wachovia's $26 billion acquisition of Golden West Financial.

Energy and power was the second-most-active sector, with $572 billion in 2006—an increase of 33% versus 2005. The sector accounted for 16% of the global M&A market. Among the sector's largest deals: Eon's bid to buy Endesa for $66 billion and Suez's agreement to merge with Gaz de France in a $43 billion deal – although the completion of both deals is facing regulatory and political hurdles. In the US, the sector's largest deals are the management-led investor group's buyout of Kinder Morgan for $22 billion and Anadarko's $18 billion acquisition of Kerr-McGee.

Materials was the third-most-active sector, with $362 billion worth of deals in 2006, a 70% increase over the previous year. The largest deal in this sector was Mittal Steel's $40 billion takeover of Arcelor.

Real estate was the fourth-most-active sector, increasing 65% in value in 2006, to $358 billion.

Media and entertainment was the fifth-most-active sector with deal value climbing 44%, to more than $340 billion. Notable deals include the leveraged buyouts of Harrah's Entertainment, Clear Channel, and VNU.

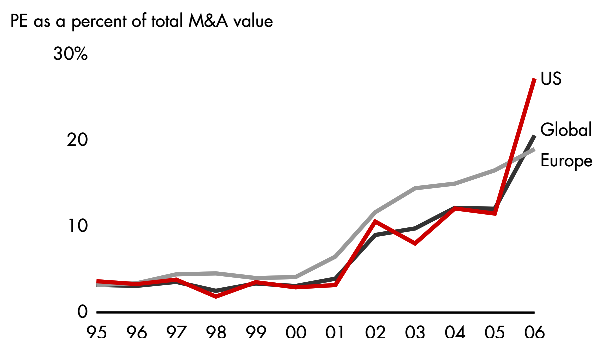
In the **US**, the most active sector was energy and power, followed by media and entertainment and then by the finance sector. In **Europe**, the most active sector was also energy and power, followed by finance and then by the materials sector.

There are pressures to do deals in virtually every sector, brought on by consolidation, globalization and technological innovation. Going forward, experts predict hot sectors for deal activity to be technology, healthcare and manufacturing.

Private equity participation

Private equity was arguably the most talked about phenomenon in the M&A world in 2006. Private equity has become a major force in buying and selling companies, and a fierce competitor to strategic buyers. In 2006, 20% of deal value was sponsored by private equity firms globally, compared with just 3% in 2000. In the US, private equity firms sponsored 27% of the deal value while in Europe they accounted for 19% – up from single-digit levels just five years ago.

Figure 6: Private Equity Share of Total M&A



Note: Based on geography of target
Source: Thomson Financial

In dollar terms, private equity firms announced a record $760 billion worth of deals in 2006, more than double the amount recorded last year. The growth was largely driven by the volume of public-to-private buyout deals. In 2006, they totaled $403 billion, more than five times the volume of $76 billion in 2005. The 10 largest buyouts in 2006 all involved publicly traded targets. Secondary buyouts recorded significantly more modest growth; they reached $97 billion in 2006, up a mere 5% since 2005.

Such growth would be practically impossible without a move up in deal sizes. Private equity firms have been on the trail of bigger prey. The 10 largest buyouts in 2006 all surpassed $10 billion in value. In fact, three of those cracked the top-10 list of M&A deals worldwide for the first time (see figure 2). The buyout of Equity Office Properties for $38 billion became the largest buyout in history. The average deal size (for deals where value is disclosed) stood at $513 million in 2006, an increase of 81% compared with $283 million in 2005.

In the **US**, the value of private equity deals (involving US targets) reached $415 billion, more than three times the amount announced in 2005. US deals accounted for 55% of global private equity activity. Nine of the 10 largest buyouts in 2006 involved US targets. Notable US private equity deals included the buyout of Equity Office Properties for a sweetened $38 billion by Blackstone (challenged by other bidders); the buyout of HCA by a group of private equity investors for $33 billion; the buyout of Harrah's by Texas Pacific Group and Apollo Management; the bid by Bain Capital and Thomas H Lee to acquire Clear Channel for $26 billion; the management-led investor group's buyout of Kinder Morgan for $22 billion; and the buyout of Freescale Semiconductor (formerly known as Motorola Semiconductor) by a consortium of private equity investors for $18 billion.

In **Europe**, the value of private equity deals involving European targets reached $263 billion, up 53% from the amount announced in 2005 and accounting for 35% of global private equity activity. The UK was the largest European private equity market in 2006, accounting for 30% of PE activity. The largest European private equity deal was the buyout of VNU by a consortium of private equity investors for $11 billion. Other notable deals include the buyout

of UK utility AWG and NXT (Philips's semiconductor business).

In other regions, **Asia** (excluding Japan) saw $17 billion worth of private equity deals, up 52% versus 2005; **Australasia** saw $28 billion worth of deals, more than seven times the amount recorded last year – driven by the buyout of Qantas and a number of real estate and infrastructure deals; **Japan's** buyout value reached $7 billion in 2006.

Private equity firms' voracious appetite and audacious bidding is driven by a number of factors:

- Billions of dollars in firepower, following another year of record fund raising;
- Aggressive use of cheap debt (and attractive lending terms) to fund acquisitions;
- Ability and desire to compete for larger deals as consortiums of PE firms continue to form or PE firms even team up with strategic buyers;
- A push into less charted territory – less mature geographies such as China and India, and new sectors such as real estate and technology;
- Public companies' desire to get out of the crosshairs of onerous regulators and activist shareholders to go private; and
- Increased ability to rein in costs and gain synergies from add-on deals.

What to expect going forward?

On the heels of strong M&A activity in 2006, nearly half of the 1,230 investment bankers, private equity professionals, and corporate executives surveyed in December 2006 by the US Association for Corporate Growth, in collaboration with Thomson Financial, expect M&A activity will increase in the next six months. Forty-one percent expect M&A activity to remain about the same, while only 9% say the pace will slow moderately.

Other survey findings:

- Forty-seven percent of respondents said acquirers' heavy capital reserves will be the main driver of M&A activity for the next six months;
- The sectors that will experience the most M&A activity in the next six months are technology (22%), health care and life sciences (17%), manufacturing and distribution (16%);
- Seventy-five percent of respondents believe the M&A market is now a sellers' market;
- Forty-nine percent of respondents expect to be involved in a cross-border deal in the next six months, and 43% said cross-border deals are becoming more important to their firm;
- Eighty-seven percent of respondents believe that the current amount of private equity capital available for investment is much too high or a little higher than it should be;
- The two greatest threats to private equity firms today are lower returns (31% of respondents identified it as the greatest threat) and competition with other private equity firms (cited by 25% of respondents);
- Fifty-six percent of respondents said that they are more focused on growing the top line of their portfolio companies than they were last year;
- The sectors that will experience the most private equity activity in the next six months are manufacturing and distribution (27%), technology (16%), business services (16%), and health care and life sciences (15%); and
- Only 19% of respondents expect the debt markets to be more favorable one year from now; 35% expect them to remain the same, while 46% expect them to be worse.

Many signs point to sustained levels of M&A activity by corporate and financial buyers in 2007 – motivated buyers with massive amounts of cash to deploy, benign credit markets, strong stock prices, pressures to grow, and so on. But no one believes that this boom can last forever. History has shown that the M&A market is cyclical, and this boom, like others before, will

come to an end. The tricky part is knowing when it will happen.

Those same factors—a slowdown in the economy, a major geopolitical upset, an unstable stock market, a contraction in the lending markets, an overleveraged deal gone bad, and so on – could be the catalyst to a setback in the M&A market.

While it would be reckless to pursue bigger targets, pay more for deals, take on more debt and go into riskier areas, it would be equally unwise to sit on the sidelines and wait for the downturn. For corporate and private equity buyers, it will be a balancing act. We at Bain believe the answer is to continue to bring rigor and discipline to the deal-making process.

As we wrote in the *Wall Street Journal* in mid-January, the most successful opportunists share a set of characteristics that they have consciously developed over time. They tend to make M&A central to their strategies; they study and learn from their mistakes; they nurture M&A as a core competency; and they build a team to preserve institutional knowledge. Winners tend to focus mostly on small and medium deals, not blockbusters. And when they do pursue mega-deals, they do so only when it is both strategically and organizationally appropriate.

Those acquirers succeed because they tend to be expert acquirers. They prepare carefully to create opportunities. The deal team—and there typically is a permanent, well-supported team of experts – works from an established playbook built on years of deal learning, so the company can efficiently recognize deals that fit strategically, evaluate them, seal the contract, and then successfully integrate the acquired business. Winners also tend to have a series of checks and balances in place to kill deal fever and maintain a rational, dispassionate approach.