commentary

The July 2015 Surge in M&A Activity

James B. Edwards

Mergers and acquisitions (M&As) have finally reached levels that existed during 2007, proceeding the recession that began in 2008. A stampede of M&A transactions took place during July 2015. Whether this means growth ahead or irrationality remains to be seen.

THE REAL BOTTOM LINE

From the owners of capital perspective, Warren Buffett values companies based on their ability to generate consistent earnings and cash. He focuses on *intrinsic value*, which he defines in each annual report of Berkshire Hathaway as follows:

> Intrinsic value is an all-important concept that offers the only logical approach to evaluating the relative attractiveness of investments and businesses. Intrinsic value can be defined simply: It is the discounted value of the cash that can be taken out of a business during its remaining life.

Mr. Buffett advises a sound ownership change transaction is one that provides the purchaser in any M&A transaction a reasonable price for what is acquired. In other words, it could be said that the "purchaser should get what they paid for." If too much is paid, the emerging business may not generate a healthy return on investment. This leads to actions such as downsizing which results in employee layoffs and shutdowns of other resources deployed in communities.

TURNING POINTS

Beginning with the business recession that began in 2008, we have witnessed a significant decrease in M&A activity lasting through 2013. During 2014, M&A activity increased substantially. Apparently, dealmakers began to anticipate that economic and market conditions became and will remain positive in the foreseeable future. Some felt that the business boom is back.

In a special study conducted by KPMG an impressive 82% of respondents said they were planning at least one acquisition in 2015; 19% planned to make two acquisitions.[1] Deloitte confirmed these expectations in their survey of 2,500 respondents from corporations and private equity firms where they found that 85% of corporate respondents expect 2015 to be a strong year for M&A.[2]

According to Dealogic,[3] a leading M&A activity tracking organization, the first three quarters of 2015 experienced a significant amount of M&A activity. This momentum began in 2014 and has continued through September 2015 (as of the time of the writing of this commentary on October 2, 2015).

Global M&A volume in July 2015 totaled $549.7 billion. This was 8% higher than the June 2015 total of $506.8 billion, and the second highest monthly volume on record behind the total of $559.2 billion in April 2007. However, the number of deals in July 2015 totaled 3,112 deals, which is 222 below the last 12-month average of 3,334 deals. This indicates that the average dollar amount of the deals during July was higher. Global deal value increased at a much higher rate than deal volume, largely caused by a high number of mega-deals. It appears that dealmakers were willing

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to pay a significant amount for targets that meet their strategic and growth objectives.

Eight deals in excess of $10 billion were announced in July 2015 for a total of $216.8 billion, representing the third highest monthly activity on record. This is by far the highest level of activity since nine such deals announced in both April 2007 ($278.3 billion) and July 2007 ($178.3 billion).

Year-to-date (YTD) global volume reached $2.9 trillion during July 2015, the second highest YTD volume on record behind $3.2 trillion in 2007. U.S. targeted YTD volume of $1.43 trillion through July was the highest on record.

Global M&A volume reached $3 trillion on August 11, 223 days into 2015, the second fastest to the $3 trillion level on record. In 2007, just before the financial crisis of 2008, the $3 trillion level was reached on July 23, 204 days into 2007 and ahead of November 10 in 2014, 314 days into that year.

U.S. targeted acquisitions during July 2015 was the highest monthly volume on record. U.S. deals totaled $350.6 billion, up 37% from $255.1 billion during June 2015. U.S. domestic deals totaling $264.4 billion accounted for 75% of global domestic M&A volume of $355.3 billion, while $86.3 billion in U.S. targeted cross-border M&A took a 44% share of global cross-border M&A volume totaling $195.2 billion.

The pace and magnitude of growth in M&A deals in the United States during 2014 and the early part of 2015 was thought to be an indicator that the U.S. economy is poised to climb out of the doldrums that followed the financial crisis of 2008, which held the level of M&A deals relatively low during the years of 2008–2013.

IS THERE A NEW TURNING POINT?

The prevailing question is whether or not this surge will continue given the sudden decline in the market capitalization level during September 2015. Usually, some M&A commentators would see this condition as an opportunity for those firms with surplus cash positions to take advantage of lower market prices of common stock. However, there is an obvious silence so far as one surfing the Internet in search of the usual comments from these prognosticators. These M&A pundits have not spoken in public as of October 2, 2015.

Some feel that company valuations have readjusted to favorable levels for purchasers. However, if the stock market is any indicator of value for many of these companies they may actually be overvalued. If a Bear market takes hold, then values may drop further and become even more attractive to acquirers.

The Bulls have one thing right: Timing the market is notoriously difficult, and is usually only done successfully by those who have their finger on the pulse and have taken the time to understand the underlying economic realities. But it is far from impossible, especially when so many signs point to an impending Bear market. Timing and shorting the market is different, it's more difficult than simply preparing for a Bear market mentally, and from an investment standpoint logically. Far worse than trying to time the market and failing is to ignore the economic realities and pretend like everything is okay and that stocks have nowhere to go but up.

Some corporate executives may think that "cheap debt capital is not going to be around forever, and I'd better start doing something today." Equity capital prices are cheap, and some think that the Federal Reserve will raise interest rates in the near future. This is an incentive for moving ahead on deals because the debt used to help finance deals could soon cost more. Cheap prices and low interest rates is an inviting condition for strategic dealmakers.

CONCLUSION

A stampede of M&A transactions has taken place during 2015. Whether this will provide satisfactory *intrinsic value* returns in the future remains to be seen. In the meantime, some of the dealmakers have made some big deals during July 2015 and investment bankers have enhanced their bank accounts.

What hasn't changed is that the true gauge of M&A activities will always be measured by the resulting economic growth. The game of "musical chairs" serves best when it leads to increased productivity and new jobs with reasonable *intrinsic value*. When it creates some degree of monopoly and restraint on the consumer it's bad news for our economic well-being.

NOTES

1. KPMG. (2014). 2015 M&A outlook survey report. Retrieved from
2. Deloitte. (2015). M&A trends report 2015. Retrieved from
3. Dealogic. (2015). Dealogic—M&A statShot. Retrieved from http://www.dealogic.com/media/market.insights/mapstatshor/

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