Box 4

RECENT TRENDS IN MERGER AND ACQUISITION ACTIVITY IN THE EURO AREA

In 2005 and the first part of 2006, the value of mergers and acquisitions (M&As) in which euro area firms acted as acquirers surged to levels relatively close to those seen during the stock market-driven M&A boom in the late 1990s and early 2000s. It is important, for monetary policy purposes, to understand the reasons behind such a development and its potential implications for corporate profitability and the balance sheet situation of the euro area corporate sector, in particular in conjunction with ample global liquidity and strong equity markets for most of this period. Against this background, this box discusses the characteristics of the current wave of M&As in the euro area.

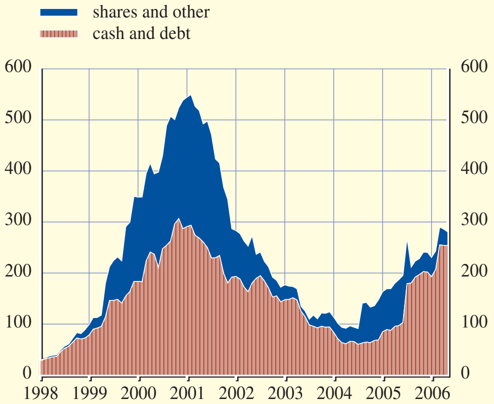
In May 2006 the value of M&A transactions conducted during the preceding 12 months in which euro area corporations acted as acquirer reached €466 billion, of which the value of deals conducted by euro area non-financial corporations and by euro area financial corporations amounted to €280 billion and €186 billion respectively. By comparison, at the peak of the previous boom in M&A activity in early 2001 the corresponding annual sum of the value of acquisitions by euro area corporations had reached €782 billion, with non-financial corporate deals accounting for €550 billion and financial corporate deals for €232 billion. As in previous periods, the current value of M&A transactions conducted by euro area corporations was lower than the value of deals in which US corporations acted as acquirer. The latter thus reached an accumulated annual sum of €904 billion in May 2006.

Non-financial corporate sector

The strong growth in euro area M&A transactions observed in the last two years seems mainly to have been driven by very favourable financing conditions, reflected in low debt financing

Chart A Value of M&A transactions in which euro area non-financial corporations act as acquirer, broken down by method of payment

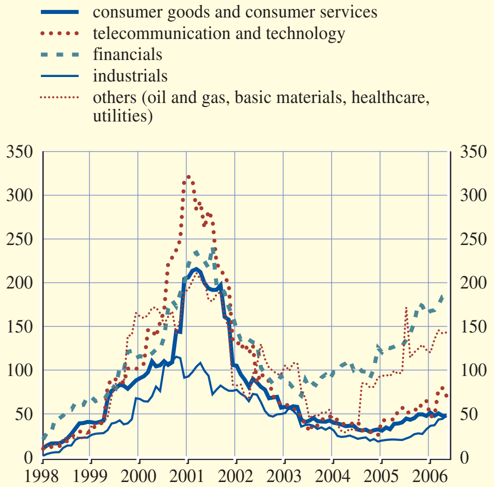
(EUR billions; 12-month moving sums)



Source: Bureau van Dijk (Zephyr database).
Note: Figures refer to completed deals.

Chart B Value of euro area M&A transactions broken down by acquiring sector

(EUR billions; 12-month moving sums)



Source: Bureau van Dijk (Zephyr database).
Note: Figures refer to completed deals.

costs and an abundant supply of credit, and strong profit developments at a time when business investment had remained relatively subdued.[1] In particular, following a period of balance sheet restructuring and continued strong profit growth, cash holdings of euro area non-financial corporations have surged in recent quarters. At the same time, non-financial corporate loan annual growth increased to more than 10% in the first quarter, while the growth rate of fixed capital investment, which has traditionally been the main driver of total loan developments, stood at around 6% in annual nominal terms in the same period. These developments may suggest that the combination of substantial cash holdings and the rise in loan growth have increasingly been used to finance M&As. This is supported by the predominance of cash-based transactions characterising the current surge in M&As, which, in the first quarter of 2006, reached a level close to the high of 2000 in terms of value (see Chart A). It may, in part, also be a reflection of the fact that the cost of equity remains significantly above the cost of debt financing, implying that stock-based deals are still relatively costly as compared with cash-based deals.

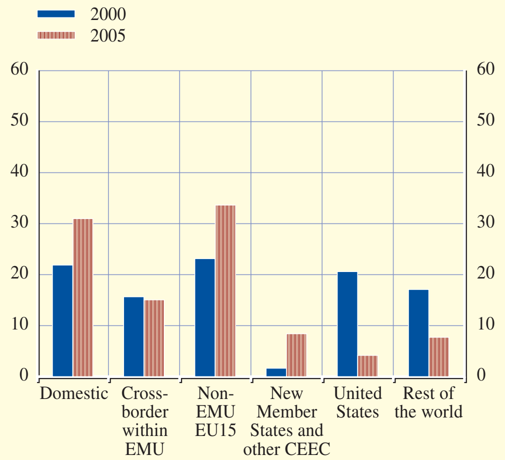
In terms of sectoral composition, current M&A activity contrasts with the wave of M&As in the late 1990s and early 2000s, which was to a large extent driven by the boom in information technology-related business and the consolidation of the telecommunication sectors (see Chart B). Thus, compared with the 1999-2001 period, the telecommunications, media and technology sector has so far played only a minor role in the deal-making of the past two years.

Looking at the direction of deals, M&A transactions between domestic firms continue to be the most common form of transaction, while cross-border transactions are more limited in number (though often substantially larger in size).[2] In particular, the importance of cross-border

1 For details on recent profit developments in the euro area non-financial corporate sector, see also Box 5 entitled "Profitability and leverage developments of listed non-financial corporations in the euro area" in the June 2006 Monthly Bulletin.
2 For example, domestic M&As constituted 63% of the total number of deals in 2005.

Chart C Geographical breakdown of the value of M&A transactions in which euro area non-financial corporations act as acquirer

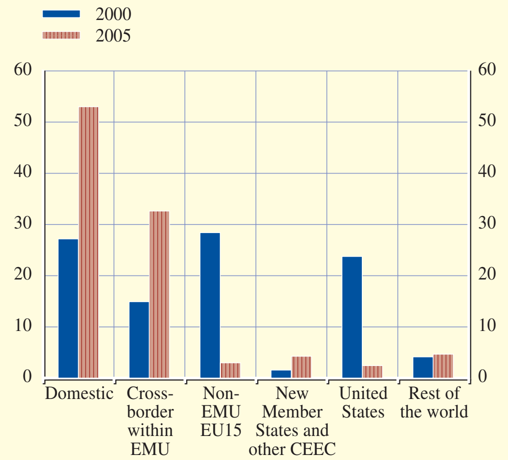
(percentages of annual sums)



Source: Bureau van Dijk (Zephyr database).
Note: Figures refer to completed deals in value terms. "Non-EMU EU15" consists of Denmark, Sweden and the United Kingdom. "New Member States and other CEEC" consists of the ten new EU Member States and other Central and Eastern European Countries (Bulgaria, Romania, Moldavia, Ukraine, Russia and the countries of the former Yugoslavia).

Chart D Geographical breakdown of the value of M&A transactions in which euro area financial corporations act as acquirer

(percentages of annual sums)



Source: Bureau van Dijk (Zephyr database).
Note: Figures refer to completed deals in value terms. "Non-EMU EU15" consists of Denmark, Sweden and the United Kingdom. "New Member States and other CEEC" consists of the ten new EU Member States and other Central and Eastern European Countries (Bulgaria, Romania, Moldavia, Ukraine, Russia and the countries of the former Yugoslavia).

deals within the euro area remains subdued (amounting to 14% of the total number of deals in 2005), which may suggest that the benefits of the Single Market and the euro have not yet been exploited to their full potential. With regard to the direction of cross-border acquisitions by euro area non-financial corporations, acquisitions of US firms are currently less important in terms of value than they were during the previous wave of M&As, while acquisitions of UK firms and of firms located in the new Member States and other Central and Eastern European countries have grown in importance (see Chart C).

Financial corporate sector

The financial sector continues to play a dominant role in overall M&A activity (see Chart B). This might indicate that the consolidation of the European banking sector is still ongoing, thereby continuing the trend observed over the past two decades. In addition, it may also reflect the growing importance of the private equity industry in the euro area.[3]

Similarly to what has been observed in the non-financial corporate sector, the recent surge in the M&A activity in which euro area financial corporations acted as acquirer is characterised by the high proportion of cash-based transactions which, over the last couple of years, represented between 70% and 90% of the overall value of M&As.

Looking at the direction of M&A transactions conducted by euro area financial corporations, domestic deals were predominant in 2005, both in terms of numbers and in terms of value

3 See also Box 2 entitled "The development in private equity and venture capital in Europe" in the October 2005 issue of the Monthly Bulletin.

(Chart D). This most probably reflects the continuing consolidation process in the national banking sectors. At the same time, in 2005 a marked increase was observed in the share of cross-border M&As in the euro area financial sector as compared with 2000. Likewise, the value of M&A transactions targeting financial institutions in the new Member States was, in relative terms, higher in 2005 than in 2000, while the opposite was true for transactions targeting financial institutions in the United States.

To sum up, the surge in M&A transactions involving euro area non-financial corporations in recent years has taken place against a background of improved balance sheet positions and very favourable financing conditions, which has fuelled a strong increase in cash-based deals, in particular. Moreover, as compared with the M&A boom of the late 1990s and early 2000s, the role of the telecommunications, media and technology sector plays a far smaller role in current M&A activity. Furthermore, a significant share of merger activity continues to take place within national borders. At the same time, while the United States was the dominant target destination for cross-border M&A transactions during the late 1990s and early 2000s, in recent years the companies targeted by euro area non-financial corporations have to a larger extent been located in the new Member States and in the United Kingdom. Finally, with respect to M&A transactions conducted by euro area financial corporations, cross-border mergers within the euro area have grown in importance in recent years.