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BUREAU VAN DIJK

M&A Report

Global Mergers and Acquisitions Reports and Analyses

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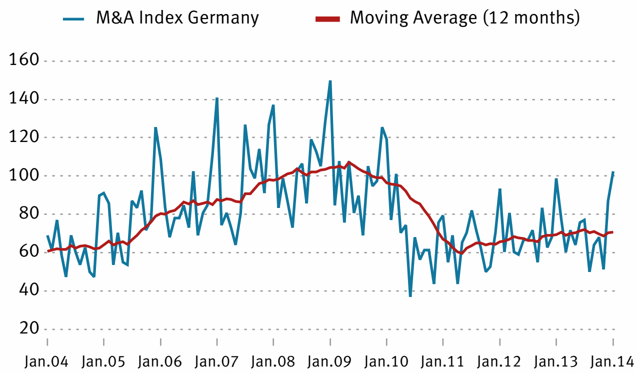
ZEW-ZEPHYR M&A Index Germany: Moderate Increase in Number of M&A Transactions

In the past six months Germany's mergers and acquisitions market (M&A) has experienced a moderate upward trend. In August 2013 the ZEW-ZEPHYR M&A Index sunk to 50 points, its lowest level since October 2011; by January 2014 it exceeded the 100-point barrier, a level it had not reached since January 2010. In the moving 12-month average of the ZEW-ZEPHYR M&A Index, however, this uptick has yet to be felt (see chart). In 2013

ZEW-ZEPHYR M&A INDEX GERMANY



Source: Zephyr database, Bureau van Dijk; calculations by ZEW

it fluctuated between 69 and 72 points. As of January 2014 it totalled 71 points. The five-point increase in the current 12-month moving average places the index slightly above the level witnessed in January of 2013.

While the number of M&A transactions increased only moderately last year, the aggregate volume of deals with publicized values is considerably higher. At 26.5 billion euros, this figure is now at its highest level since 2009. One mega deal last year stands out in particular. In a transaction worth 8.2 billion euros, the British communications giant Vodafone acquired Kabel Deutschland in October 2013, expanding its presence on the Germany market.

Photo: iStockphoto

The last time a larger transaction volume was reached was in December 2007, when Continental AG paid 11.4 billion euros for the automobile electronics supplier Siemens VDE Automotive AG.

A good indicator for the future development of M&A markets is the number of rumoured transactions together with the estimated transaction values. Based on the data available, the German M&A market is likely to pick up in the near future. The number of rumoured mergers and acquisitions is 23 per cent higher than last year's. If one includes the estimated transaction values as well, the likelihood of an uptick is even greater. The aggregated estimated transaction value of all rumoured transactions doubled between 2012 and 2013, increasing from 24 to 48 billion euros.

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The **ZEW-ZEPHYR M&A** Index measures the number of M&A transactions completed in Germany each month. It considers only mergers and acquisitions by and with German companies. It does not differentiate between the country of origin of the buyer or partner. This means that both domestic as well as international buyer companies are considered, provided the target companies are active in Germany.

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The **M&A Report** is a biyearly publication issued by the Centre for European Economic Research (ZEW) and Bureau van Dijk (BvD). It uses the Zephyr database to report on current topics and developments in global mergers and acquisitions. The Zephyr database, which is updated daily, contains detailed information on over one million M&A, IPO, and private equity transactions across the world.

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Influence of the New AIFMD Directive on Company Valuation

The European Union's Alternative Investment Fund Managers Directive (AIFMD) entered into force in 2013. In Germany, the crucial part of the act implementing AIFMD is the German Capital Investment Code (Kapitalanlagegesetzbuch, or KAGB). The new law not only covers funds already regulated by the German Investment Act (Investmentgesetz, or InvG), such as open-ended public funds. It also regulates areas that in the past were almost impossible to regulate, such as closed-end funds(e.g. private equity and venture capital funds).


Photo: iStockphoto

The KAGB determines certain requirements regarding the valuation of the assets of the investment fund, the selection of evaluators and valuation frequency (sec. 168, 216, and 217), and necessitates a comprehensive valuation process. Closed-end private equity funds in Germany, for instance, may only acquire shares in companies that have been valued by an external evaluator who satisfies the requirements of sec. 216 of the KAGB. For investments over 50 million euros, two independent evaluators must be consulted (sec. 261). In addition, at least once a year assets must be valued, the net asset value per share must be calculated and it must be disclosed to the shareholders (sec. 272).

No Specific Valuation Method Stipulated

However, the new directive is vague when it comes to the valuation method. According to sec. 168, para. 3, "a current market value is to be set that is appropriate based on careful assessment using suitable valuation models given the current market conditions" for shares that are not listed on a stock exchange or on other organized markets. Though sec. 169 of KAGB stipulates that criteria for proper valuation and for the calculation of net asset value must be determined in accordance with the Commission Delegated Regulation (EU) No 231/2013, this directive describes only the process of the calculation, not its method. Even the Capital Investment Fund Accounting and Valuation Directive (Kapitalanlage-Rechnungslegungs- und -Bewertungsverordnung, or KARBV, for short) gives no specific information about the valuation method.

Greater Requirements on the Valuation Process

The new directives do not influence the valuation methodology and the calculation of the enterprise value. Rather, they make greater requirements on the valuation process, documentation and validation tests of the models and stipulate more frequent valuations, in particular ones carried out by external evaluators. Though the new regulations have positive effects, they cause additional costs for the AIFMD which can ultimately be offset by adjusting the purchase and sale price of transactions. For instance, a private equity fund that acquires a company is likely to pay the former shareholders a lower price in order to compensate the costs that have already arisen as well as the impending costs for the extensive valuation process.

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Facebook Acquires WhatsApp

On 19 February 2014, Facebook, the operator of the world's largest online social network, announced the acquisition of the instant messaging service WhatsApp. The deal will cost Facebook nearly 14 billion euros – an extraordinary sum for a company thought to employ no more than 50 people. It is by far the largest amount Facebook has paid for a company – and one of the most expensive acquisitions in the tech sector. Since 2007, Facebook has bought a total of 43 companies, but the recent deal dwarfs them all. By comparison, its 2012 acquisition of Instagram cost the company 500 million euros, though at the time it was considered very high. The purchase of the app developer Onavo, in October 2013, cost even less, with an estimated price of 150 million euros.

Little is known about Facebook's acquisitions; details of such deals and particularly deal values are usually not made public. Concrete numbers exist for only 12 of the company's purchases, though none of these could have exceeded the double-digit million range. Based on the prices in the Zephyr database, the total volume of Facebook's acquisitions (including Instagram and Onavo) comes to around one billion euros, around seven per cent of what it paid for WhatsApp.

These impressive figures underscore the significance of the acquisition of WhatsApp among Facebook's transactions, and show that Facebook is ready to pay high purchase prices for companies with many active users. (Instagram and WhatsApp have over 100 million each.) The relatively small amounts it paid in past deals were mostly for companies owning a technology which is of interest to Facebook but having only few users.

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Shakeout in Mobile Phone Market

Ever since EU-wide deregulation in the mid-1990s, the mobile phone industry has been extraordinarily dynamic in terms of innovation and market structure. Yet after a longish period of market expansion, the market has undergone increasing consolidation over the past few years, especially in mergers and acquisitions. The chart below shows past, present and pending M&A transactions involving wireless carriers in the 27 EU member states. As we can clearly see, both transaction volumes and transaction numbers increased markedly between 2003 and 2013.

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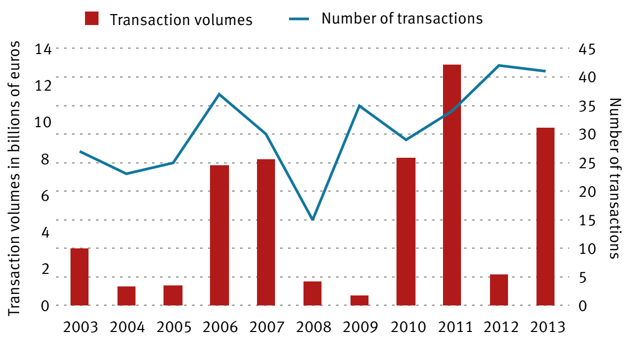
Photo: iStockphoto

Competing for Traditional Mobile Phone Services

From the beginning of market deregulation through the early 2000s, the margins on the mobile phone market were considerably larger than today. Back then, infrastructure competition accompanying the emergence of new companies, along with sector-specific regulatory obligations on the wholesale level, brought sinking price levels for end consumers.

But as competition and regulation increased, profit margins decreased, and consolidation on mobile phone markets – already burdened by high fixed costs – surged. Making matters worse, traditional mobile phone services such as telephony, SMS or mobile internet are confronted today with increased competition inside and outside the market from messaging services such as WhatsApp or Facebook Chat, leading to massive revenue declines for some companies.

PAST, PRESENT AND PENDING TRANSACTIONS INVOLVING WIRELESS COMPANIES IN EU-27



Source. Zephyr database, Bureau van Dijk; calculations by ZEW

Trilateral Oligopoly Feared

Mobile phone markets in Germany are also experiencing consolidation, and the trend is likely to continue. In the summer of 2013 a billion-euro merger was announced between E-Plus (a subsidiary of the Dutch operator KPN) and O2 (the trade name of Telefónica Europe). Given the narrow oligopolistic structure of mobile phone markets already in place today, the planned merger has raised worries. Both Germany's Federal Cartel Office and Monopoly Commission have officially expressed their concerns about the adverse effects on future competition. The Monopoly Commission's 2013 Special Report (66, para. 24) notes that the merger would create a trilateral oligopoly consisting of Deutsche Telekom, Vodafone and O2/E-Plus, each with around the same market share. The EU Commission, which has taken a similar view on the merger, registered its concerns in December of 2013. The results of the review by competition regulators can be expected soon. Judging by the analogous situation in Austria, where the EU Commission recently permitted a three-provider mobile phone market, it is likely that European competition regulators will condition any approval of the E-Plus/O2 merger on specific restrictions.

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Cartel Breakdowns and Merger Activity

Cartel agreements between competitors typically aim to reduce competition and increase company profits. Because such agreements often cause great economic harm by increasing prices or reducing innovation, they represent a serious violation of antitrust laws. But a breakdown of a cartel may motivate former members to seek out multiple mergers and acquisitions in an effort to regain lost market power. Mergers between former cartel members and acquisitions of smaller and mid-size companies are seen as a way to improve a company's market position in the post-cartel period. The discovery of a cartel, moreover, can act as a kind of exogenous shock, leading to structural upheavals and an increased number of transactions within the affected sector. To test whether cartel breakdowns do indeed affect M&A activity, ZEW researchers used the Zephyr database to investigate transactions in 24 sectors.

Number of Mergers Increases

Their findings show that the number of global mergers in a given sector increased by 51 per cent after a cartel breakdown. In the three years before cartel breakdowns occurred, there were 696 company mergers globally in the sectors under investigation. In the three years after the cartel breakdowns, there were 1,052 mergers (see the table below). When one considers only horizontal mergers – that is, mergers between companies at the same production level – the number of mergers increases from 196 to 359.

Researchers also looked at the data for mergers involving one European company and those involving only European companies. Here the increases were also clearly evident, although not as strong as for global mergers.

The results of the ZEW study suggest that competition authorities should take into consideration that the companies involved possibly consider mergers to be a "second-best" alternative to the recently collapsed cartel. Former cartel members might try to systematically regain the market power they have lost by increasing merger activities. Accordingly, competition regulators should keep an eye on former cartel members after cartel breakdown to prevent mergers from creating cartel-like market structures in the long run. Furthermore, the ZEW study indicates the need to re-allocate or expand resources in competition authorities, law offices and consulting firms to be able to efficiently deal with the increased number of mergers.

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Photo: iStockphoto

AVERAGE NUMBER OF MERGER TRANSACTIONS AND PERCENTAGE CHANGES THREE YEARS BEFORE AND AFTER THE CARTEL BREAKDOWNS

	Average number of transactions					
	All mergers			Horizontal mergers		
Geographic scope	3 years before cartel break-down	3 years after cartel break-down	%-change	3 years before cartel break-down	3 years after cartel break-down	%-change
Worldwide	696	1.052	51,2%	196	359	83,2%
At least one merging firm stems from EEA	414	522	25,1%	129	188	45,7%
Both merging firm stem from EEA	275	351	27,6%	76	126	65,8%