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M&A Report

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Steady Level of Private Equity Involvement in the M&A Market

In spite of the global economic and financial crisis, the proportion of transactions with private equity involvement has remained at a stable level both in terms of number and value. Admittedly, in the last six months the proportion of transactions with private equity involvement has fallen by around 4 percent, however the proportion of the overall transaction value has grown slightly. Therefore private equity continues to make a substantial contribution to global M&A activity. Nevertheless, it should be taken into account that in recent months the level of M&A activity has declined overall and the involvement of private equity firms has also fallen sharply. Hence, private equity firms have participated in around 50 percent fewer transactions based on value since the second half of 2007. Likewise, the number of transactions has decreased, albeit only by around 20 percent.

The most remarkable investments made by private equity firms in recent months have taken place predominantly in the automotive sector. One current case is Qatar Investment Authority's (QIA) investment in Volkswagen (see also page 3) a further strategic investment aimed at complementing Qatar's huge wealth in natural resources by diversifying in new asset classes. Furthermore, as recently as March of this year Daimler AG announced a new major shareholder. Aabar Investments, an investment firm based in Abu Dhabi, acquired all of the new shares in a 10 percent capital increase and now holds 9.1 percent of the German car manufacturer. After Kuwait Investment Authority, which has been a significant shareholder since 1976 and currently holds a 6.9 percent stake, Aabar Investments is already the second significant shareholder from the Arabian peninsula. The investment firm plans, in a similar way to QIA, to serve as a strategic investor and remain loyal to the company in the long term. The cooperation foresees, amongst other things, the joint development of new electric cars and new composite materials.

A few weeks later the Stuttgart-based car manufacturer announced the final separation from its loss-generating partner Chrysler. The merger, which was described as a match made in heaven, of the former Daimler-Benz AG and Chrysler Corporation, had already been declared over in 2007, when DaimlerChrysler sold the majority of its American division to the financial investor Cerberus. The latter secured an 80.1 percent stake in Chrysler Group for 5.5 billion euro. Daimler AG sold its remaining stake in April.

Financial investors have also attracted attention within the supply sector, through the acquisitions of Tower Automotive, Allison Transmission, Thule or Stabilus amongst others. It remains to be seen to what extent car manufacturers and their suppliers have to call upon the support of financial investors in times of crisis in the coming months.

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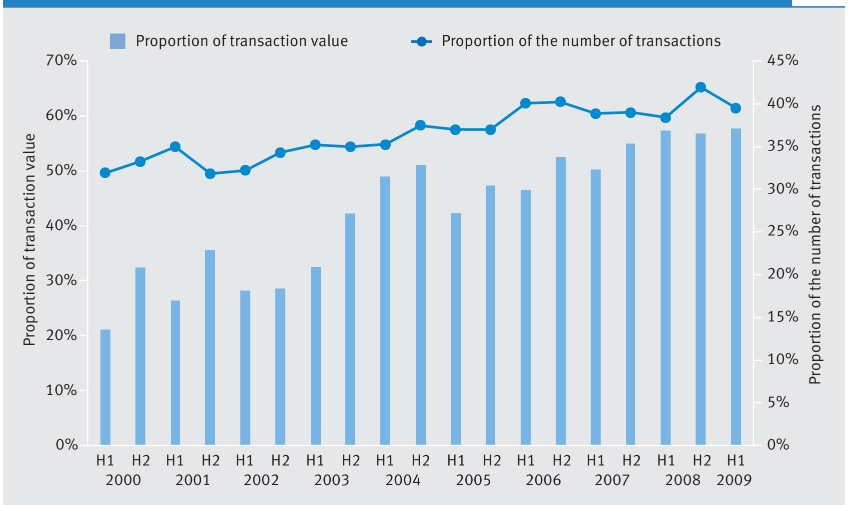
Development of Worldwide M&A Activities with Private Equity Involvement



Source: Zephyr database, Bureau van Dijk Electronic Publishing

Remunicipalisation: A New Trend Among Suppliers

The remunicipalisation of electricity companies is a topic that has gained particular significance in local and regional politics. Accordingly, there have been demands from the ranks of regional politicians for public investment in energy companies to be expanded further in order to be able to guarantee both environmentally-friendly provision of energy and security of supply at favourable prices. Another reason for the attractivity of a market (re-)entry is the profitability of an investment in local electricity distribution networks. In general local authorities pay lower interest for the capital borrowed to finance such investments than they get as return on equity. The recent acquisition of E.ON's subsidiary Thüga, which itself holds around 90 stakes in energy suppliers, by other municipal suppliers or Hamburg's re-entry into the energy market confirm the trend towards remunicipalisation. Local authority districts and government organisations already have stakes in around 89 per cent of all primary energy suppliers and hold majority stakes of an average of 73 per cent in almost 640 primary energy suppliers. Public owners, therefore, have a central influence on the provision of households with electricity.

Furthermore, if we consider upstream value-added steps in energy provision, the picture becomes clearer. With regard to expiring franchise agreements, several public providers have already signalled interest in (re-) entering the energy market. Whilst security of supply is guaranteed by law and this should not have any influence on consumers' choice of supplier, there is the question of whether public investment in energy companies can guarantee a more favourably-priced energy provision than private firms. This central aspect could not be confirmed in the course of a current ZEW study. In fact, it was shown that the relationship between public and private investment in the primary energy supplier, which supplies the majority of consumers in a region, has no significant influence on the price of the basic energy supply contract or the general tariff. However the size of the holder's share, independent from the type of the holder, affects the strategic pricing of the general tariff. The long-term effects of remunicipalisation on the already scarce competition in regional electricity markets, therefore, remain to be seen.

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Once Again a Significant Decline in Transaction Values

Despite the considerable recovery on the global stock markets in the last six months, the global financial and economic crisis has once again led to a sharp decline in the activity of investment banks and private equity firms. Consequently, the number of transactions carried out by investment banks has decreased from 2,667 to 2,090. Private equity investors only carried out 2,002 (2,640) deals. If we consider the value of these transactions, the decline is even more dramatic. In both sectors, the transaction value has more than halved. These figures indicate that not only were a smaller number of transactions undertaken, but the transactions that were carried out, on average, amounted to significantly less than six months previously. In the ranking of investment banks, a new name – Greenhill & Co. Inc – climbs to the eighth place. Only new entries can be found amongst the private equity firms. In eight out of ten cases these new entries are based on a single comparatively large transaction.

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Ranking of Investment Banks 2009

Position H1 2009	(H2 2008)	Investment Bank	Transaction Value	Transaction Volume (bn euro)
1	(5)	Morgan Stanley	65	139.5
2	(2)	Goldman Sachs	41	90.9
3	(10)	Deutsche Bank	40	59.6
4	(6)	Citigroup Inc.	62	56.2
5	(9)	Lazard	61	45.6
6	(3)	UBS	78	43.4
7	(8)	Rothschild	84	42.0
8	(-)	Greenhill & Co. Inc.	9	39.9
9	(4)	Merrill Lynch	20	39.2
10	(1)	JP Morgan	43	32.3
		Others	1,698	61.3
		Total*	2,090	396.2

Quelle: Zephyr database, Bureau van Dijk Electronic Publishing
* Consolidated aggregate amount, since single transactions can be carried out by several investment banks or private equity firms.

Ranking of Private Equity Firms 2009

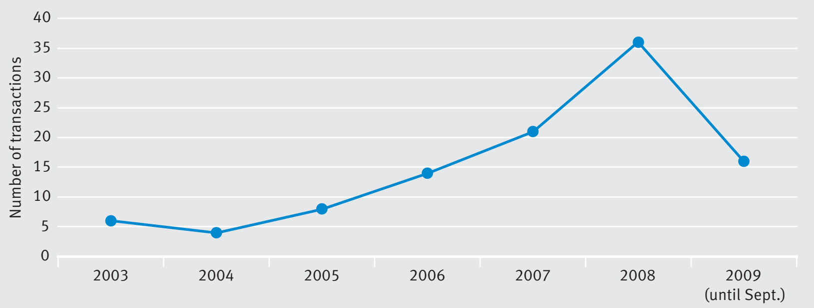
Position H1 2009	(H2 2008)	Private Equity Firms	Transaction Value	Transaction Volume (bn euro)
1	(-)	Paulson & Company Inc.	2	11.2
2	(-)	Stone Point Capital LLC	1	10.2
3	(-)	Dune Capital Management LP	1	10.2
4	(-)	MSD Capital LP	1	10.2
5	(-)	JC Flowers & Company LLC	1	10.2
6	(-)	Soros Fund Management LLC	1	10.2
7	(-)	Temasek Holdings (Pte) Ltd	1	5.4
8	(-)	Hopu Investment Management Company	1	5.4
9	(-)	Ahorro Corporación Financiera SV SA	2	3.5
10	(-)	Advanced Technology Investment Compa.	1	3.4
		Others	1,996	23.9
		Total*	2,002	47.3

Quelle: Zephyr database, Bureau van Dijk Electronic Publishing
* Consolidated aggregate amount, since single transactions can be carried out by several investment banks or private equity firms.

Qatar Enters German Sports Car Manufacturer Porsche

In mid August 2009 the Emirate of Qatar acquired ten percent of the ordinary shares of Porsche via Qatar Holding LLC, an investment vehicle of the sovereign wealth fund Qatar Investment Authority. Consequently, for the first time in the corporate history of Porsche an external investor is acquiring a stake in the ordinary shares, which up until now have been in the possession of the Porsche and Piëch family shareholders. At the same time, the emirate is acquiring a significant share of Porsche's options on Volkswagen ordinary shares and consequently is making a considerable contribution to improving Porsche's difficult liquidity situation. Meanwhile, Qatar also holds almost seven percent of Volkswagen. Indeed, whilst the owners of Porsche do not want to divest any further parcels of their ordinary shares, the investment in Volkswagen is to be increased to up to 19 percent.

Investment Activities of the Emirate of Qatar



Source: Zephyr database, Bureau van Dijk Electronic Publishing

The Qatar investors' fondness for German sports cars was already apparent at the end of 2007. Qatar-based Nasser Bin Khaled Holding acquired a 25 percent stake in the German sports and racing car manufacturer HWA. HWA was founded in 1998 as a spin-off from AMG, the customisation specialist for the Mercedes-Benz brand. HWA develops and builds racing vehicles and engines as well as small series premium sports cars.

The increased investment activity of investors from the Emirate of Qatar in recent years is particularly noticeable since the beginning of the financial crisis. Whilst in 2003, six acquisitions were carried out, the number of transactions rose to 36 in 2008.

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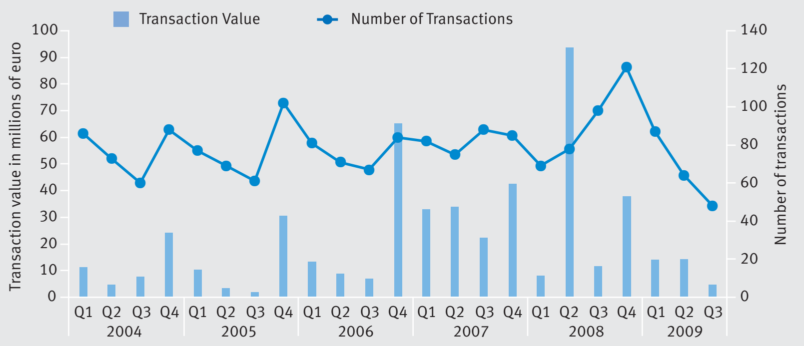
Declining M&A Activity in the Euro-Zone's Financial Sector

Acquisition activity in the financial sector of the 16 countries in the euro-zone has declined considerably in the course of the global financial crisis. This is also evident in the value of transactions. Whilst the value of transactions in the financial sector of the euro-zone stood at an average of around 830 million euro in 2007, it has decreased to an average of 783 million euro since the outbreak of the financial crisis in 2008. The statistic is distorted by the acquisition of Dutch ABN Amro in the second quarter of the previous year by a consortium consisting of British Royal Bank of Scotland, Spanish Banco Santander and Dutch-Belgian financial group Fortis. With a transaction value of more than 70 billion euro, it is the largest acquisition in the global financial sector. The largest acquisition of a financial institution in the euro-zone this year, as measured by transaction value, is the acquisition of Dresdner Bank by Commerzbank. The latter paid around 6.5 billion euro to acquire its competitor. The other large transactions this year can be attributed predominantly to the global financial crisis. Thus, French BNP Paribas acquired the majority of troubled Fortis Bank in Belgium from the government in spring for more than four billion euro.

M&A Activity in the Financial Sector of the Euro-Zone



Source: Zephyr database, Bureau van Dijk Electronic Publishing

In Ireland, the government nationalised Anglo Irish Bank at a cost of around three billion euro. The nationalisation of HSH-Nordbank and Hypo Real Estate also cost the German government around three billion euro. If the governments in Germany and other countries resell their shares, a reorganisation of the banking landscape in Europe could be triggered as a result. Consequently the consolidation of the financial sector, which many experts are calling for, could also regain momentum.

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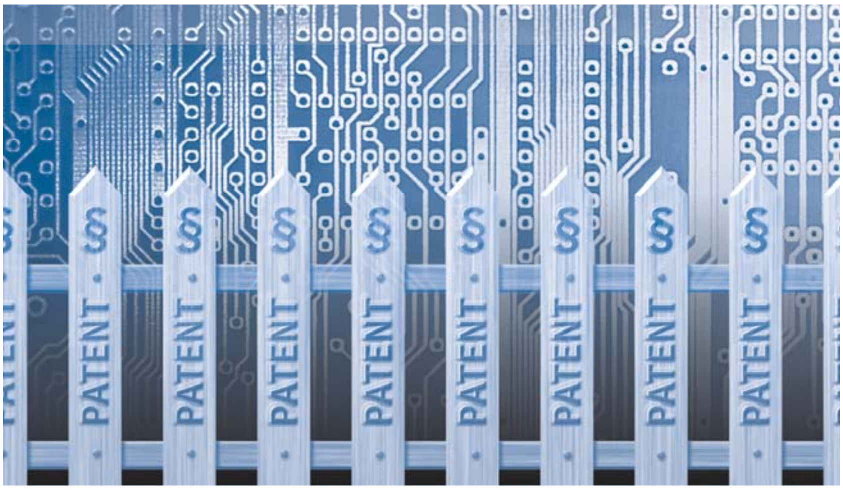
Acquisitions Lead to a Concentration of Blocking Patents

An important aim of mergers and acquisitions is to gain access to technologies and in particular to patent rights in the process. On one hand, patents principally serve to expand the technology portfolio of the acquiring company. With the aid of externally-available technology buyers seek to develop innovative products and services, which in turn increase the value of the company. On the other hand patents can, however, also be utilised strategically. A strategic use of this type can comprise so-called “patent fences”, which block the innovation activity of competitors. Patents which companies apply for in order to erect a patent fence do not necessarily have a high technical quality. Rather, they are consciously designed in such a way that the innovations of a company are protected by further patents, which results in making it significantly more difficult for competitors to patent “around a particular technology”. These “two faces” of the acquisition of patents in the course of M&A activity are studied in a ZEW research project (see also ZEW Discussion Paper No 08-042). Patents serve firstly to expand the patent portfolio, but secondly also to block or trigger patent fences in technology markets. Consequently, both aspects can be expected to have an influence on the acquiring company’s willingness to pay for the target company. The aim of the study is, therefore, to gain a better understanding of the motivation of the acquiring companies with regard to technology and patents.

In an initial step, the study uses information from the patent examination procedure of the European Patent Office to classify the patents of the target company on the basis of their function. In the process, the study develops new methods of representing on one hand the technological value and on the other hand the blocking potential of the patent portfolio of the target company. In the empirical analysis this data is used to account for the consideration paid by the buyer.



Photoillustration: ZEW

On the basis of a random sample of 479 European M&A transactions in the period from 1999 to 2003, it is shown that the technologies acquired have a positive effect on the consideration. Furthermore, the study shows that buyers are in a position to estimate and evaluate patent quality as well as the blocking potential of technologies. In doing so, buyers are particularly interested in those technologies which exhibit a high blocking potential as well as a close relationship to technologies already utilised by the buyer.

Hence, M&A transactions evidently lead to a reduction of competition in technology markets. It is therefore necessary for the management of companies to closely observe M&A activity in order to prevent the emergence of patent fences as early as possible. But merger control authorities, too, at European and national level, which up until now have only taken into account the position of companies in product markets for their decision, should also keep an eye on developments in technology markets in order to prevent a single company from gaining a dominant position in a technological field.

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IMPRESSUM

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