M&A REPORT

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The **M&A Report** is a biannual publication issued by the ZEW – Leibniz Centre for European Economic Research und Bureau van Dijk. It uses the Zephyr database to report on current topics and developments in global mergers and acquisitions. The Zephyr database, which is updated on a daily basis, contains detailed information on over one million M&As, IPOs and private equity transactions around the world.

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M&A REPORT

ZEW-ZEPHYR M&A Index Shows First Signs of Recovery Since August 2019

The number of mergers and acquisitions (M&A) involving German firms has started to stabilise and shows early signs of recovery after months of decline. In 2020, the ZEW-ZEPHYER M&A Index – established in 2005 to measure M&A transactions involving German companies – recorded its lowest levels since its establishment. Since August 2019, the index has started to show first indications of recovery.

M&A activity involving German firms appears to not have been substantially affected by the COVID-19 pandemic so far. One potential explanation is that the German government has implemented an array of measures, such as the suspension of the insolvency rule, which have helped companies throughout the crisis. However, these economic policy measures may in turn delay takeovers of distressed firms.

There were two major M&A deals in the ZEW-ZEPHYER M&A Index involving German companies. One of the biggest German M&A deals of the year so far took place in April in the semiconductor industry. Germany-based Infineon Technologies took over US-based Cypress Semiconductor Corporation for just over 9.2 billion euros. The M&A deal, which was announced in June 2019, transforms Infineon Technologies into the world's largest producer of automotive chips.

Another notable M&A deal is the takeover of US-based Wabco by German car parts maker ZF Friedrichshafen at a sum of 6.3 billion euros. ZF Friedrichshafen – Germany's third largest auto parts supplier – announced the takeover of American brakes manufacturer Wabco back in spring 2019. The completion of the takeover happens, however, at an unfavourable time for the auto parts supplier ZF Friedrichshafen. The German company plans to adjust its capacities worldwide and cut around 15,000 jobs by 2025 – half of them at German manufacturing sites.

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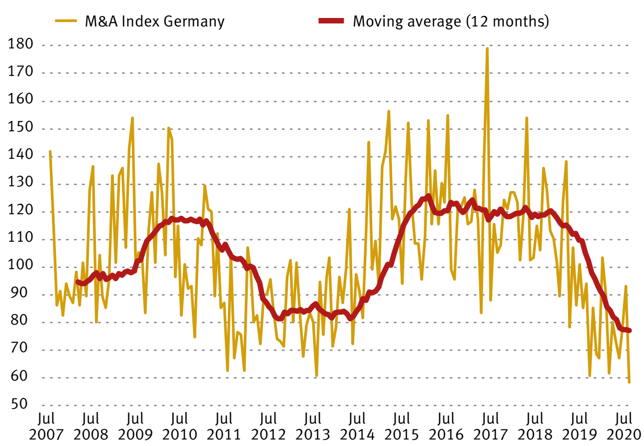
ZEW-ZEPHYR M&A-INDEX GERMANY



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

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 and international buyer companies are considered, provided that the target companies are active in Germany. The M&A Report is a biannual publication issued by ZEW and Bureau van Dijk. It uses the Zephyr database to report current topics and developments in global mergers and acquisitions. The Zephyr database, which is updated on a daily basis, contains detailed information on over 1.9 million mergers and acquisitions, IPOs, and private equity transactions around the world.

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Changes in the Pharmaceutical Industry Lead to Record Levels of M&A Activity

The COVID-19 pandemic has put the spotlight on the pharmaceutical industry as it races towards finding a vaccine. As things stand, the industry appears to be in good shape to rise to this challenge. In recent years, the pharmaceutical industry has seen a boom in merger and acquisition (M&A) activity with numbers hitting a record high in 2019 with just over 3,800 recorded deals. M&A activity in the industry is rising not only in terms of its volume but also its value. The aggregated value of deals with known values was, for example, worth over 300 million euros in 2019.

The pharmaceutical industry is currently undergoing major changes. New and innovative technologies such as artificial intelligence and gene manipulation are emerging and the demand for healthcare is soaring. At the same time, governments and insurance firms are putting more and more pressure on the pharmaceutical companies to reduce drug prices. These changes might explain the upward consolidation trend in the industry.

It is probably not a coincidence that US-based firms are leading this trend, as the US government and insurance companies based in the US have introduced reforms and new payment schemes to increase drug pricing transparency, and in turn a downward pressure on prices, in the last few years.

Notably, Chinese pharmaceutical companies are also bucking the trend and in 2017 they accounted for the highest share of M&A activity in the industry for the first time. In contrast to China and the United States, there has not been a significant change to merger and acquisition activity in Europe throughout the past decade.

To what extent the COVID-19 pandemic will affect M&A activity remains unknown, as the coronavirus crisis presents both great opportunities and risks to the pharmaceutical industry.

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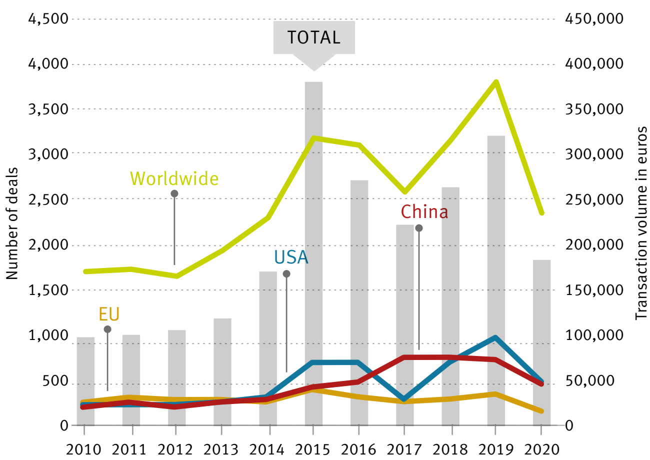
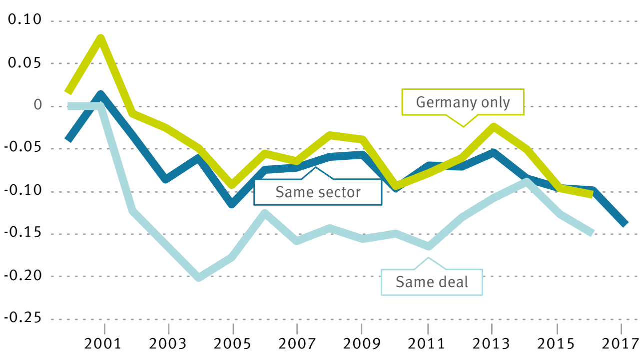
M&A ACTIVITIES IN THE PHARMACEUTICAL INDUSTRY



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

Buyers or Targets – Who Has More Pricing Power in M&A Transactions?

TARGETS EXHIBIT HIGHER PRICING POWER
(PRICE MARKUP DIFFERENCES ACQUIRERS–TARGETS)



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

In recent years, policy and academic circles on both sides of the Atlantic and beyond have been engaging in a lively discussion on the causes and consequences of increased industry concentration. Higher industry concentration is said to be linked to higher price-cost margins (price markups) and these are most often associated with increased market and pricing power by firms. This association is of great interest for competition policymakers, particularly in light of the ongoing debate on the extent to which lax merger control has contributed to these developments. If policymakers pay attention to these developments, then practitioners ought to do the same.

By relying on estimates for German firms produced elsewhere, the analysis examines the average price-cost margins of parties involved in M&A transactions which took place between 2000 and 2017. Selecting the data this way makes it possible to document the relative market power of acquirers and targets in M&A transactions as well as answer the fundamental question: which company is acquired by whom? The findings show that targets in M&A transactions exhibit, on average, higher price markups, which is depicted as a negative difference between acquirers and targets in the figure on the bottom of page 6. If markups are indeed associated with profitability, then firms with higher price markups make for more attractive targets in M&A transactions.

The findings also uncover a widening gap in the early 2000s and a relatively stable pattern from 2005 onwards. For all three graphs in the figure, the size of the firm was held constant to account for the fact that, in the sample, smaller firms on average exhibit higher price-cost margins. The observed patterns are most pronounced when looking at the data deal by deal. The light blue line depicts average differences within a deal (when both parties to a transaction are German firms). Both the dark blue line and the green line depict the numbers at a more aggregate level: the dark blue line illustrates the difference between the average price markups of all acquirers and that of all targets of firms in the same sector and the green line shows a sample of deals with both acquirer and targets in Germany.

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No Sign of a Rise in Distressed Acquisitions

To mitigate the extent of corporate insolvencies as a consequence of the economic fallout from the current coronavirus pandemic, Germany adopted changes to its insolvency law in March earlier this year. This enabled excessively indebted companies to hold off from filing for insolvency in the first three quarters of 2020.

This initiative, although criticised by some economists, has generally been welcomed by the industry. The numbers speak for themselves, as it has since become evident that these changes have prevented a sharp decline in the number of German companies filing for insolvency in the first half of 2020 compared to 2019 (-6,2 per cent year-on-year).

A company under financial distress may choose to sell off its assets in order to temporarily improve its financial situation or engage in M&A transactions as part of the bankruptcy proceedings. This may also explain why there was an increase in deal activity and volume in the aftermath of the global financial crisis 2007–2008, consistent with the data on bankruptcies in general. The figure below shows the insolvency numbers and deal activities broken down by industry sectors in a year-on-year comparison. In the first half of the year, the figure of M&A deals fell in line with the levels of insolvencies in most industry sectors. The most striking development is the ongoing rise in deal activity in the construction and real estate sectors. The increased number of insolvencies in the manufacturing sector has not yet been accompanied by an increase in M&A deals. From the data presented, we can observe a certain correlation between both data records, while of course not being able to demonstrate a causal relationship.

Financial analysts cited increased uncertainty and macro challenges as possible causes for the decline in the number of deals closed. Due to the COVID-19 travel restrictions, cross-border deals between businesses may have been hampered. Despite this, the appetite for mergers and acquisitions appears to be on the rise and an increasing volume of ‘distressed’ M&A deals in 2021 seems plausible, especially following the expiry of the exemption from the insolvency reporting obligation.

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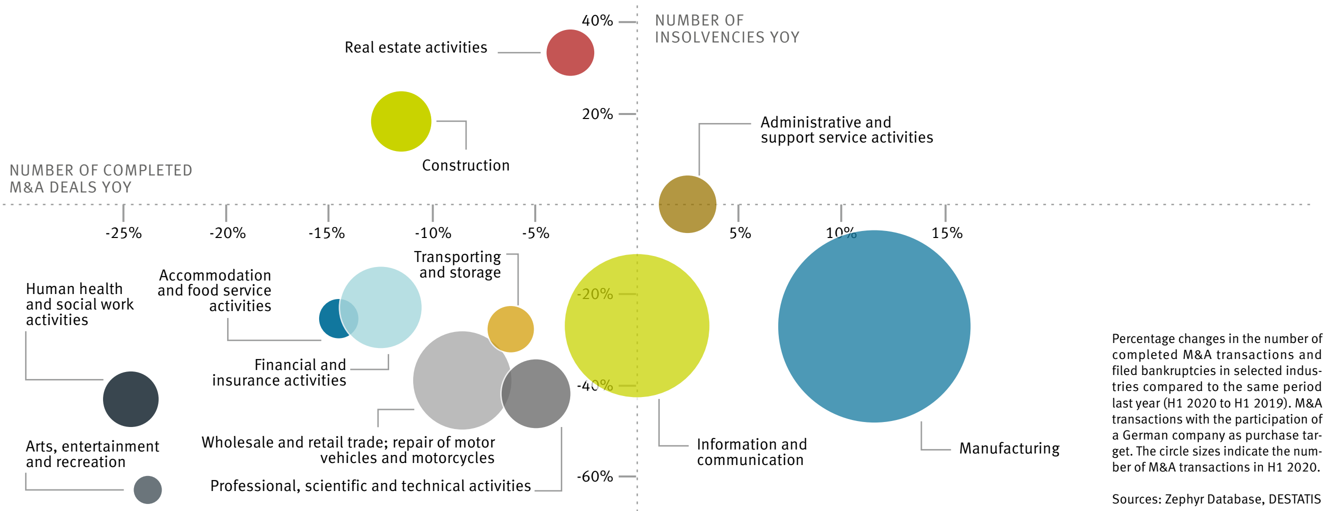
YEAR-ON-YEAR CHANGE IN INSOLVENCY AND M&A FIGURES (H1 2020 VS H1 2019)



Percentage changes in the number of completed M&A transactions and filed bankruptcies in selected industries compared to the same period last year (H1 2020 to H1 2019). M&A transactions with the participation of a German company as purchase target. The circle sizes indicate the number of M&A transactions in H1 2020.

Sources: Zephyr Database, DESTATIS