M&A MARKETS—GONE AWRY OR ANEW?

by Robert W. Wood • San Francisco

At the end of last year, it was difficult not to be down in the mouth (and down in just about every other area) about the status of M&A markets. Apart from the beating the U.S. has taken, other spots in the world were also not doing so well, either because they were influenced by U.S. activity, or because of independent factors. The value of mergers and acquisitions worldwide in 2000 set a record: $3.5 trillion, up from $3.3 trillion in 1999. See "The Great Merger Wave Breaks," *The Economist*, (Jan. 27, 2001), p. 59.

But if 2000 was an "up" year again, it must be noted that the lion's share of 2000's deals came in the first *half*

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of 2000, indeed, especially in the first *quarter* of year 2000. The last part of the year was not so rosy. (Good time for a vacation.) This has to be influenced by declining share values, but also seems to be effected by a more general pessimism permeating our now global economy. Sure, these statistics can be manipulated, but the downward trend seems manifest.

European Influence

Some advisors are looking to Europe to reverse the downtrend, despite European deals being hugely affected by the downturn in the American market. A number of investment bankers expect the European merger downturn to be temporary for several reasons, including the pending radical reform to the capital gain tax in Germany. Regarding this topic, see Wood, "Massive German Tax Overhaul," Vol. 9, No. 1, *M&A Tax Report,* (Aug. 2000), p. 1; and Wood, "More on German Tax Reform," Vol. 9, No. 3, *M&A Tax Report,* (Nov. 2000), p. 8.

Soon, this German law will allow firms to sell their stakes in other companies tax-free, rather than being compelled to face a whopping 50% capital gain tax (that is *still* the law in Germany until the January 1, 2002). Thus, the general effective date of this enormous change is still the future, causing cautious taxpayers to hold back. As we noted in these pages recently, this delayed effective date may actually have contributed to a good deal of the slowdown in merger activity. Understandably, people want to wait for a significant rate cut (indeed, rate elimination!) to kick in. It is hard to ignore the prospective change when planning deals today.

Uniformity Flops, Antitrust, etc.

Then there are nontax effects and impetuses as well. Antitrust enforcement has become problematic and less predictable. Take the blockage of WorldCom's planned $115 billion takeover of Sprint in mid-2000. That deal was blocked by antitrust enforcement in Europe. In contrast, American antitrust enforcement—to the extent we yet know about the new Bush administration's policies—is likely to take a typically Republican (and therefore, considerably lighter and nimbler) stance.

Accounting Rules, Too

The accounting treatment of mergers also has some effect on this mix. There was a great deal of talk (actually, veritable volumes of it) about the Draconian elimination of pooling of interest treatment. [See Wood, "Amortizing Goodwill: FASB Still at It After All These Years," Vol. 7, No. 12, *M&A Tax Report,* (July 1999), p. 6; and Muntean, "FASB Recommends Amortization Period for Intangible Acquired in a Merger or Acquisition," Vol. 7, No. 8, *M&A Tax Report,* (March 1999), p. 1.]

Indeed, until quite recently, the banishment of pooling of interest accounting was supposed to discourage mergers. Yet, it does not appear that these dire predictions will prove true. See Sarti, "FASB and Merger Goodwill Amortization: A Reversal of Fortune," Vol. 9, No. 7, *M&A Tax Report,* (Feb. 2001), p. 1.

More About Europe

Even before the end of 2000, there were hitches in the proposed uniform takeover code for Europe. The European Parliament in December approved changes that would give local governments more latitude in allowing companies to adopt takeover defenses, without prior approval from shareholders. See Shishkin, "Europe Hits Rough Spot on Takeovers," *Wall Street Journal,* (Dec. 14, 2000), p. A22.

Unfortunately, the European parliamentary activity on which we reported in January—then we were hoping fervently that the patchwork of European takeover legislation would get better, not worse—did not pan out. See Wood, "European Deals Stagnant," Vol. 9, No. 6, *M&A Tax Report,* (Jan. 2001), p. 6.

Japan and China

Clearly, there is hardly one market internationally. Indeed, it is interesting and undeniable that M&A activity in non-Japan Asia is breaking records. Throughout Asia (*except* Japan), deal makers, lawyers and accountants are working overtime to get deals done. The number of deals announced (but still not yet completed) is truly promising. Not surprisingly, in 2000, Hong Kong was the leader, with 772 deals valued at US$57 billion. Second place went to China, with 448 transactions valued at US$44 billion. See Leahy, "M&A Activity in Non-Japan Asia Surges to Record High," *Financial Times,* (Jan. 17, 2001), p. 21.

The pace of development in China is being characterized as a veritable boom, including not only local and intra-Asia transactions, but also bold moves to acquire pieces of U.S. companies. I think that will continue. Take the case of Beijing Sanyuan Food's offer of $9.3 million for the Beijing dairy operations of New York-based Kraft Food International.

A good deal of this kind of buying is to expand customer base, including Tsingtao (the huge Chinese brewer) buying up eight breweries around the country. Among these purchases was a 75% purchase of Carlsberg Shanghai Brewery (Carlsberg is based in Denmark), plus a 63% stake in Beijing's

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Five Star Brewery. For details, see "Buying Binge: An M&A Wave Breaks Over China," *BusinessWeek*, (Jan. 29, 2001), p. 48.

What Goes Around...

There are many other examples. The good news is that while bread-and-butter transactions in the U.S. may be way down, there are various other bright spots in the world. Still, if you want to be truly depressed, consider this statistic: overall, U.S. deal activity, including cross-border transactions, sunk to its lowest level since September 1998. The statistical publication, *Mergerstat*, reported in December 2000 that as of October 2000 there was a drop of 30.2%. See "M&A News and Trends," *Mergerstat*, (Dec. 2000), p. 1.

Perhaps not so depressing is the fact that in dollar volume, as opposed to raw numbers of transactions, the drop has only been to its lowest level since February 1999. So it all depends on how you look at things...