THE REBOUND OF EUROPEAN M&A: WHY IT IS SUSTAINABLE

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The year 2014 was a game-changer for European M&A. It registered its highest levels of deal activity since the financial crisis. Overall European M&A activity climbed 40.5 per cent to $901.4 billion (the highest value since 2008). It should be noted that sources regarding statistical deal activity presented in this article are mostly based on data published by mergermarket (*M&A Monthly Insider*, December 2014 and April 2015; and *Global and Regional M&A: 2014*) and Dealogic (*Global M&A Review*, Full Year 2014 and First Quarter 2015) as well as a variety of major news publications. Such sources may adopt different criteria or assumptions to collect or present their data, and some of them may not derive the underlying data from definitive year-end reports.

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Inbound M&A, at $320.6 billion in 2014, reached a record high by both deal value and deal count unmatched since 2001, mostly driven by US-based acquirers (which represented 60.7 per cent of the total) and Asian acquirers (with Chinese buyers alone representing 76.2 per cent of all of emerging Asia's investment into Europe). Underlining the strength of European companies, outbound M&A in 2014 surged to its highest level since 2007 (at $365.8 billion, it shot up 190 per cent from the previous year), most of it directed toward the US (71 per cent of the total, the highest value since 2001). Intra-European cross-border M&A was also extremely strong at $264.5 billion (ie, more than double the 2013 figure of $131.3 billion). On average, M&A transactions were larger in 2014 (deal volume was up only 4.8 per cent year-on-year) and 10 deals exceeded the $10 billion mark compared to only six in 2013.

So far, 2015 looks promising. Compared with the first quarter of 2014, deal value in the first quarter of 2015 exceeds, at $185.1 billion, Q1 2014's $177 billion by 4.6 percent. Inbound M&A almost doubled at $94.2 billion, with M&A activity from Asia increasing by 312 per cent. Outbound M&A decreased by 38 per cent to $40.6 billion (with a reduced investment in American and Asian companies) but appears to be picking up again. Large M&A deals are becoming bigger: if only two transactions exceeded the $10 billion mark in the first quarter of 2015, compared to three in Q1 2014, such transactions were actually closer to the $20 billion mark. This trend was confirmed since the end of the first quarter of 2015 by Nokia's $16.6 billion proposed combination with Alcatel-Lucent and Shell's $70 billion proposed acquisition of BG Group.

The general trend was observed in most of Europe's main markets in 2014, including France, the most active European country for M&A ($204.7 billion, the highest value since 2007 and up 327.5 per cent over 2013), the United Kingdom ($154.5 billion, up 28.7 per cent) and Germany ($73.9 billion). These three countries together represented 45 per cent of total European activity in 2014. In Q1 2015, the United Kingdom had a strong start with $75 billion of deal value, representing alone 40.5 per cent of Europe's total M&A value, with two major deals representing almost half of the value (the $19 billion acquisition of EE by BT Group and the $15.3 billion acquisition of Telefónica UK by Hutchison).

DEEP-SEATED REASONS FOR EUROPE'S M&A REBOUND

On a macroeconomic level, the gradual (albeit selective) recovery of European economies and financial markets, after five years of financial, credit, sovereign-debt and monetary crises, spurred increased confidence in the continent's prospects. Stronger M&A activity resumed in Europe under the combined effect of improved financing conditions, high levels of cash reserves on corporate balance sheets and, in private equity and investment funds, rising levels of investment returns, and strong equity market performance that allowed listed corporate buyers to pay all or part of their public takeovers in stock. In addition, the volume of capital available to US corporations, one of the most significant groups of investors in Europe, increased substantially, and their willingness to deploy such capital grew in large part as a result of an improved US economy.

The study of some of the major announced or completed transactions, and the motives underlying them, reveals a mix of opportunistic and deeper-seated reasons for the renewed vitality of European M&A since 2014.

KEY DIFFERENTIATING FACTORS DRIVING EUROPEAN M&A

High-quality assets

During the financial crisis, European companies were forced to reorganise their structures, clean up their balance sheets, streamline their activities and focus on their core businesses. As a result, many companies emerged with better asset quality, which made them more attractive to potential buyers, or with increased cash and/or share performance, which facilitated their acquisition strategy. Buyers were prepared to pay the price for such assets: At $365.4 million in 2014, the average price paid for European targets was the highest in seven years, and even jumped to $424 million in Q1 2015. Combined with other factors, this helps explain the robust health of European M&A, as well as a wave of industry consolidations. For example, the pharmaceutical, medical and biotech industry reached an aggregate deal value of $114.9 billion in 2014, including inbound transactions, such as Eli Lilly's purchase of Novartis' animal health business through an asset swap worth $5.4 billion; outbound transactions, such as Merck's $17 billion acquisition of Sigma-Aldrich Corporation; and intra-European transactions, such as Novartis' announced acquisition of GlaxoSmithKline's vaccines and oncology drug developing division for $14.5 billion.

Fiscal attractiveness and general political stability

One of the main drivers of cross-border M&A activity into Europe in 2014 was the increase of so-called "tax inversions", ie, in a European context, a combination transaction between a US and a non-US company resulting in the surviving company relocating its corporate headquarters in a European jurisdiction (where it generally enjoys a lower effective tax rate). Twelve inversion transactions were announced globally in the first nine months of 2014 alone, eight of which involved a European target, for a total value of $309 billion (over four times the value for the same period of 2013), including Medtronics' $45.9 billion acquisition of Ireland-based Covidien. Although inversion transactions from the United States have slowed down as a result of the measures adopted by the US government in September 2014, most European jurisdictions enjoy other advantages, such as their general political stability, the existence of an independent judicial system and general openness to foreign investment. Even the newly introduced French regime on foreign investments, which drew much criticism in connection with General Electric's announced $12.3 billion purchase of Alstom's Thermal and Renewable Power and Grid assets, generally remains relatively mild compared to the protectionist measures adopted in numerous other markets.

Access to talent and technology

Beyond the classic motives underlying strategic growth transactions, such as the desire to expand into new markets, increase revenue, increase market share and/or achieve economies of scale (eg, the planned merger of French Lafarge with former Swiss rival Holcim worth $39.6 billion, creating a European behemoth in the cement industry), European M&A in 2014 and 2015 also has been characterised by a search for talent and new technologies. This has been particularly evident in the technology, media and telecommunications industry (TMT), which underwent important global consolidation and took the top spot in Europe with $120.2 billion of M&A deal value in 2014, and $42.6 billion in Q1 2015. Relevant examples include Luxembourg-based Altice's $23 billion acquisition of SFR (and $9.2 billion proposed acquisition of Portugal Telecom assets) and Vodafone's $10.1 billion acquisition of Kabel Deutschland, all of which aim to combine a mobile company with a cable or fiber assets operator, allowing the combined entity to compete with operators that are taking a competitive edge by offering quadruple-play (ie, fixed phone, wireless phone, TV and internet) solutions to their clients. More recently, four major deals were announced in Europe with the $70 billion proposed acquisition of BG Group by Shell, the $19 billion acquisition of EE by BT Group, the $16.6 billion proposed combination of Nokia and Alcatel-Lucent, and the $15.3 billion acquisition of Telefónica UK by Hutchison.

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EUROPEAN M&A WILL REMAIN ROBUST IN 2015

Those who predicted a sustainable growth of European M&A in 2015 seem to be vindicated for the time being – and that prediction should remain valid for the rest of 2015.

On the one hand, economic recovery remains fragile in a number of European countries, and national governments may continue to protect their sensitive (and, in certain cases, less sensitive) industries from foreign buyers. Geopolitical tensions in certain regions may take their toll on economic and M&A activity if they continue or worsen. On the other hand, the overall attractiveness of European companies should remain strong in 2015, as observed in the first quarter, with deal values on record since 2008 and inbound activity doubling compared to Q1 2014. Global factors, such as the strength and search for external growth of US and Asian players, a prolonged weakness of the euro, or the recent pressure on oil prices, will continue to provide M&A opportunities. Industry consolidations, fuelled in part by regulatory efforts to increase convergence, are likely to continue, in particular in the TMT, pharmaceutical, medical and biotech, and industrials sectors (which have led the EMEA marketplace with 583 deals totaling a combined $37.1 billion in the first quarter of 2015). Unsolicited transactions may again become more frequent, and certain shelved transactions (including pan-European relocations) may resume if political conditions evolve favourably.

In addition, M&A activity may increase as a result of the rise of shareholder activism in Europe, which increasingly focuses on break-ups, divestments, spin-offs, takeovers, acquisitions and other types of M&A transactions. M&A related activism represented approximately 20 per cent of total activism campaigns in Europe in 2014, and 14 per cent in 2015 to date, coming second after board-related activism (according to Activist Insight). Since the beginning of 2015, the most high profile campaigns in this area have targeted such companies as Vivendi, Essenden, UBS or Banco BPI.

For all these reasons, economic operators should be able to build on 2014's momentum to continue the positive trend well into 2015.

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