The M&A Market is Poised for Continued Growth in 2015

2015 outlook and expected trends

J.P.Morgan

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A quick recap of 2014

A rise in the number of transformational deals of $10 billion-plus in value and an increase in cross-border transactions drove a 27% year over year increase in global M&A activity in 2014.

Hernan Cristerna and Chris Ventresca, J.P. Morgan Global Co-Heads of M&A, say that a boost in CEO and boardroom confidence was a critical supporting factor in 2014. As the economic recovery continued, global equities rallied and debt markets remained favorable, our clients became more proactive in using M&A to drive shareholder value.

Equity investors rewarded acquirers for sound synergistic acquisitions that generated incremental growth -- the average price reaction to an acquirer's shares was a gain of 3%[1]. Target companies with limited upside from their current stock prices were more willing to entertain takeover proposals at a reasonable premium.

This virtuous circle of growth drivers fueled the positive M&A story in 2014.

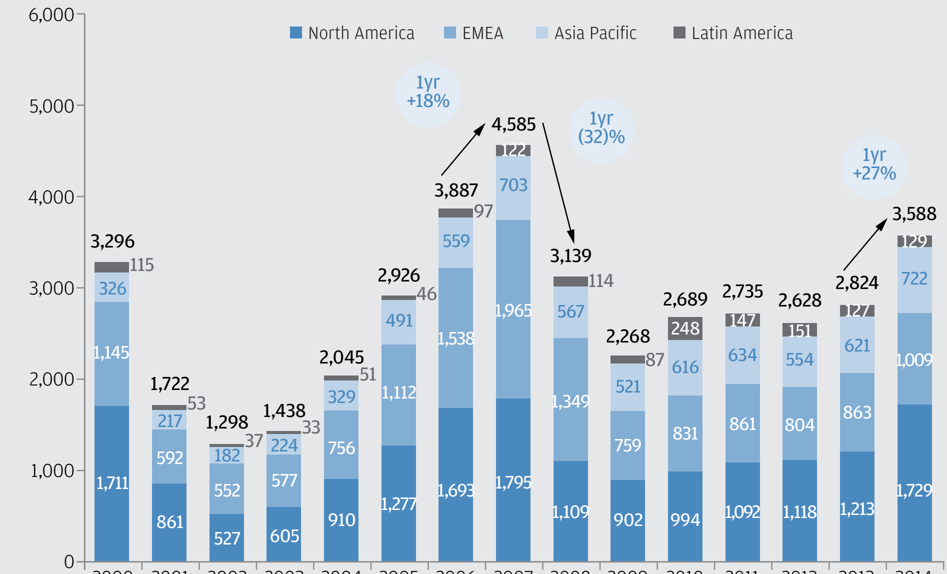
2014 fast facts

- Global deals of $3.6 trillion, up from $2.8 trillion in 2013, were supported by favorable financing markets (both in availability of capital and historically low cost of capital), improved economic fundamentals, CEO and boardroom confidence and investor support for M&A.
- 2014 global M&A by deal value saw 35 deals of more than $10 billion amounting to $818 billion, up from 20 totaling $462 billion in 2013. (See Chart 1 for an overview).
- U.S. targets accounted for 43% of all inbound transactions last year, up from 28% in 2013.
- Global cross-border deals, valued at $625 billion, were at the highest levels since 2007. (See cross-border section on page 12).
- As equity markets increased, the use of stock to facilitate M&A transactions rose in 2014 to 33% from 19% in 2013.
- There were $686 billion in failed deals, the highest level since 2008, due to increased regulatory considerations, interlopers and activist shareholders. It is important to note that a high level of failed deals is consistent with previous M&A upswings.

[1] Based on the average one month price following the announcement of a transaction. The price reaction is rebased against the local index the stock is listed so any market volatility is factored in.

Chart 1

The rise of transformational M&A -- global M&A deals by value



	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
North America	1,711	861	527	605	910	1,277	1,693	1,795	1,109	902	994	1,092	1,118	1,213	1,729
EMEA	1,145	592	552	577	756	1,112	1,538	1,965	1,349	759	831	861	804	863	1,009
Asia Pacific	326	217	182	224	329	491	559	703	567	521	616	634	554	621	722
Latin America	115	53	37	33	51	46	97	122	114	87	248	147	151	127	129
Total	3,296	1,722	1,298	1,438	2,045	2,926	3,887	4,585	3,139	2,268	2,689	2,735	2,628	2,824	3,588
# of deals	**9,699**	**6,963**	**6,541**	**6,843**	**8,366**	**10,090**	**11,651**	**13,864**	**12,007**	**8,947**	**10,894**	**11,218**	**10,811**	**9,932**	**10,565**
# of deals >$10bn	39	19	9	9	15	33	48	46	34	23	16	20	18	20	35

Source: Dealogic as of Jan. 14, 2015
Deal value greater than $10 million

What's ahead

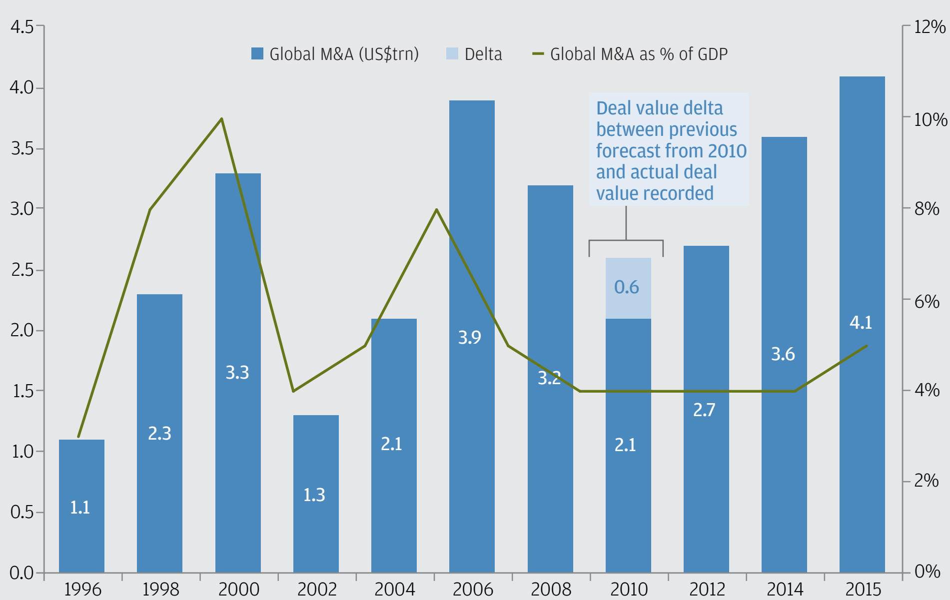
The factors that supported deal-making in 2014 are likely to be sustained in 2015, propelling a fresh round of robust activity around the world.

In 2015, it is estimated to amount to at least $4.1 trillion of total volume based on economic and market criteria. (See Chart 2 for detailed forecast.) The strength of CEO and board confidence, regulatory pressures and economic patterns -- GDP growth, equity market stability and cost of capital -- will be the key factors to support or derail projected growth. In this respect the recent full value of major equity market indices, which is in line with the 2009 high, should be followed closely for signs of excess valuations.

U.S. inbound activity will also likely mirror activity that was seen in 2014, which rose 92% compared to 2013 with transaction value of $274 billion -- a level not seen since 2005.

Chart 2

Global M&A forecast



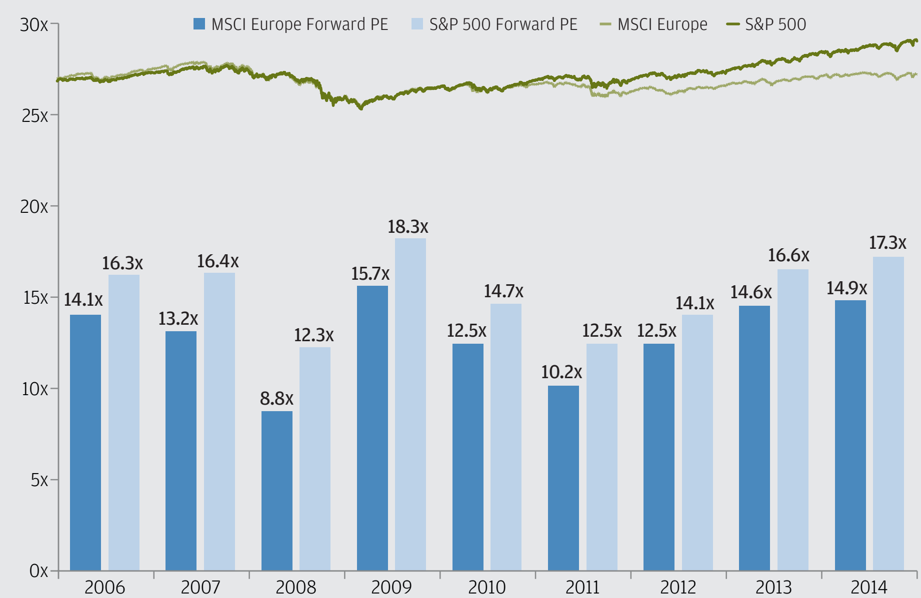
Based on our M&A forecast in July 2014, we commented in earlier reports that global M&A deal value for 2014 could reach U.S.$3 trillion. Full year actual for 2014 recorded U.S.$3.6 trillion. Based on the hypothesis that the M&A/GDP pattern could repeat itself, global activity as a % of GDP could reach 3%, 3.1% & 4% in 2014, 2015 and 2016 respectively, mirroring the actual GDP growth rates of 2002, 2003 and 2004. When matched with the IMF GDP forecast for the same years, this means that activity could eventually reach U.S.$4.1 trillion by 2016.

Source: Dealogic, IMF

Shareholder activism will continue to rise globally, encouraging companies to proactively optimize their portfolios and business mix. We expect this to increase deal activity for spin-offs and corporate divestures in 2015. Based on the valuations of major European and U.S. indices (See Chart 3 below), we can expect companies to feel pressure to deliver on growth expectations in their stock price and price/earnings multiples.

Chart 3

M&A valuations for Europe and U.S.



Source: Factset

EXECUTIVE TAKEAWAYS

- Investor support for M&A and strategic investment will continue.
- The withdrawal of some recent deals highlights the need for companies to proactively prepare for twists on the road to a successful closing and allow more time prior to announcing a deal to assess risks, such as regulatory concerns, shareholder approval and potential interlopers.
- Companies should proactively anticipate activist portfolio demands.
- Acquirers need to prepare for market volatility and take a longer term view on value creation. They should remain flexible on use of cash and stock as acquisition currencies and be willing to trade off between the two to maximize value.

1. Positive acquirer price reactions underline support for growth through M&A activity

CEOs embarking on transformational M&A during 2014 have on the whole benefited from share price appreciation, a critical measure of investors' confidence in the strategy and merits of M&A relative to other forms of growth or redeployment of excess cash to shareholders. We expect this trend to continue in 2015.

The upward trend in acquirers' share prices over recent years, which was especially evident in 2014, demonstrates that markets are highly receptive to strategic acquisitions where a clear plan for growth has been identified and investors have confidence in the execution and integration capabilities of senior management.

The top 10 positive market reactions seen in Table 1 highlight this point. For example, Altice expanded into Portugal to complement its cable TV business with mobile, a model adopted by many peers in the telecommunications industry. As a result, Altice saw its share price gain 20% over a 30-day period from the first public announcement of the deal.

Table 1

Selected key deals in 2014 with positive price reactions

Ann. date	Deal value ($ billion)	Target	Acquirer	Target nationality	Acquirer nationality	30-day price reaction[1]
13-Jan-14	61.9	Time Warner Cable	Charter Communications	U.S.	U.S.	2.1%
11-Mar-14	23.6	SFR	Altice	France	France	36.2%
22-Apr-14	16.0	GlaxoSmithKline[2]	Novartis	U.S.	Switzerland	3.1%
24-Apr-14	13.1	Biomet	Zimmer Holdings	U.S.	U.S.	10.0%
15-Jun-14	45.9	Covidien	Medtronic	Ireland	U.S.	3.7%
10-Aug-14	46.1	Kinder Morgan Energy	Kinder Morgan	U.S.	U.S.	6.4%
18-Aug-14	9.7	Family Dollar Stores	Dollar General	U.S.	U.S.	10.4%
22-Sep-14	16.9	Sigma-Aldrich	Merck KGaA	U.S.	Germany	8.6%
02-Nov-14	9.3	PT Portugal SGPS[3]	Altice	Portugal	France	19.7%
30-Nov-14	10.6	Gagfah	Deutsche Annington Immobilien	Germany	Germany	3.7%

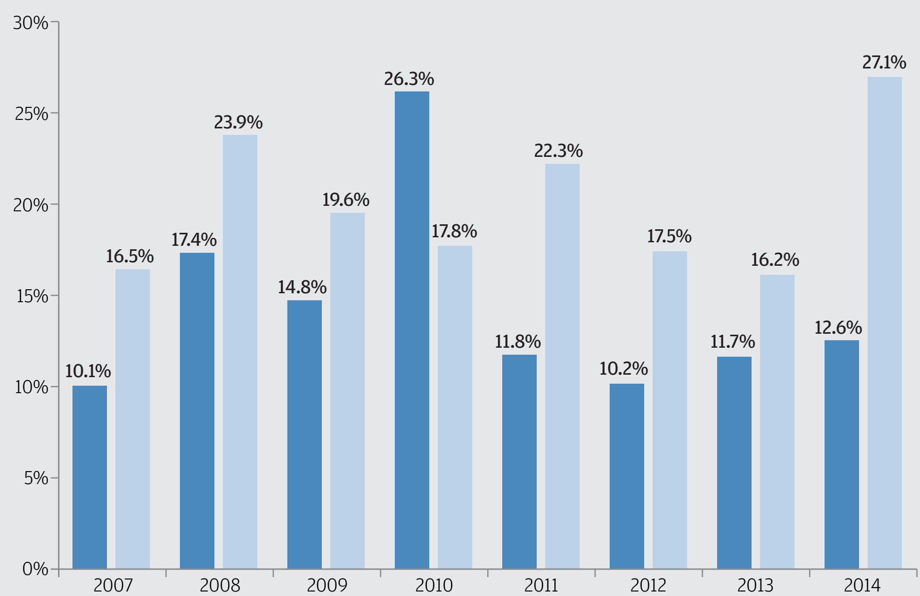
Source: FactSet, Dealogic
Note: only deals involving EMEA/US acquirers are included
[1] Excess return over S&P 500 returns times acquirer's beta from unaffected date prior to announcement
[2] Oncology portfolio, R&D activities and AKT inhibitor rights
[3] Telecommunication Assets in Portugal

Fast facts

- Approximately 27% of transactions by U.S. acquirers and 13% by EMEA acquirers profited from capital appreciation of more than 10% following the announcement of a deal (see Chart 4).
- The use of stock to facilitate M&A transactions rose in 2014 to 33% of total consideration, up from 19% in 2013.
- Transactions involving a capital increase also benefited from positive market reactions by an average of 1%. Numericable, which is majority owned by Altice, launched a US$5.9bn capital increase to partly fund its takeover of Vivendi's SFR mobile business.

Chart 4

Percentage of acquisitions with market reaction >10%[1]



Source: FactSet, Dealogic
Only deals involving EMEA/US acquirers are included. Light blue bars for U.S. and dark blue bars for EMEA.

EXECUTIVE TAKEAWAYS

- Investors are supporting companies that make a strong case for external growth.
- A continued strategy of returning cash to shareholders can raise questions about senior management's corporate ambitions and confidence to execute.
- The markets remain poised to reward financially-savvy transactions in 2015.

2. Continued activism growth requires careful consideration to avoid time-consuming public campaigns

Activists gained momentum in 2014, targeting larger corporations and entering new geographies. Both the number of activist funds and campaigns reached new highs in 2014. There were also unexpected sources of activism among traditionally long-only investors. As a means of generating alpha, 2015 is likely to see an increase, not a pullback, in this type of activity and proactive shareholder engagement will be a crucial requirement for corporate leaders.

The increased size and successful track record of activist funds has allowed hedge funds to more effectively leverage their ownership to drive change, even while holding a relatively small percentage stake.

Activist fund inflows continue to increase and, as activists seem to put this additional capital to work, a rise in overseas activism is a likely natural result. 2014 saw a number of U.S.-based hedge fund activists target companies in Europe and Asia -- a trend that will likely accelerate going forward. As in the U.S., companies and boards that have lost touch with shareholder expectations will be most susceptible. The experience in the U.S. should prompt overseas boards to realize that they must proactively take action to address shareholder concerns.

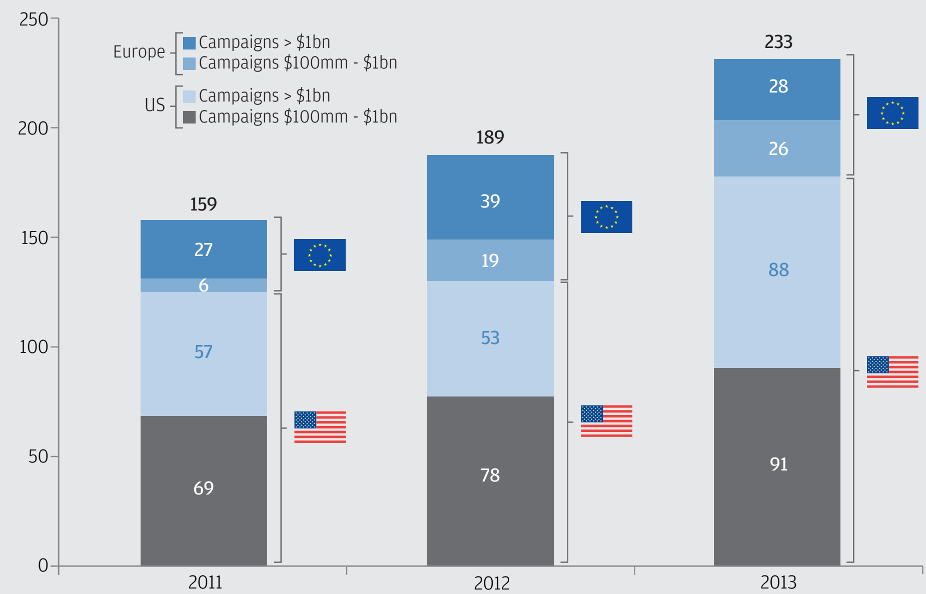
Fast facts

- Shareholder activism continues at a level well above the 2010-13 average of 138 campaigns in the U.S. and 42 in Europe.
- While investor types of all kinds are turning to activism, hedge funds continue to drive the majority of meaningful shareholder activism.
- From 2003 to Q3 2014, assets under management for activist hedge funds increased from $11.8 billion to $112.1 billion.
- More than 10 activist hedge funds today manage over $10 billion, or about as much as the entire asset class 10 years ago for each fund.

Source: Activist Insight

Chart 5

Campaigns against companies over $100 million market capitalization



Source: Activist Insight

EXECUTIVE TAKEAWAYS

- Proactively engagement in constructive dialogue with your shareholders is crucial to understanding and addressing any fundamental concerns.
- Management should assess its strategy through the lens of an activist to evaluate the company's strengths and weaknesses in relation to typical themes (see Chart 6 overleaf).
- Companies should continually monitor their shareholder base for activist investors as well as activist supporters.
- Best practices require a high level of preparedness, including a comprehensive response team of internal and external experts who can assist in identifying areas of vulnerability and prepare your team for potential "attack themes".

Chart 6

Common themes targeted by Activists

Attack themes	Typical tactics
1 **Operational performance**	• Highlight stock price underperformance • Identify valuation (multiple) gap relative to peers • Compare operating metrics to peers • Suggest alternative strategies
2 **Recapitalization/ capital structure**	• Benchmark capital distribution strategies to peers • Use existing cash on balance sheet or leverage capacity • Proceeds used to fund dividend or share repurchase • Highlight unsuccessful and/or other poor uses of capital M&A
3 **Management/ governance**	• Propose a new management team/board with a different vision/execution plan • Highlight governance issues or lack of shareholder rights • Separate CEO and Chairman roles • Focus on executive compensation issues
4 **Portfolio realignment/ corporate clarity/ asset sales**	• Propose sale/spin-off of selected assets to increase value • Separate/monetize real estate • Valuation/multiple disparity among operational segments • May involve publicly identifying underperforming assets
5 **Strategic alternatives/ sale**	• Evaluation of strategic combinations, including sale/merger • May publicly name potential suitors • May make an offer themselves to encourage a process or emergence of competing offers

3. Rise of portfolio separations as a value-enhancement opportunity

The second half of 2014 saw a wave of spin-offs, with investors proving highly receptive to companies reorganizing core businesses and activists providing a further prompt for action. Recent high-profile separations, such as eBay's separation of PayPal, Bayer splitting its plastics business to focus on healthcare, or Philips shedding its lighting business, all resulted in the stock price of the parent gaining more than 3% after the news.

Today's investors are less swayed by the safety net of size and scale, and instead, are focused on companies that are trading at a premium stemming from superior operating performance. With this trend set to continue, we are likely to see a continued flow of spin-off activity in 2015.

Corporations are concerned that if they do not assess the logic of separating some of these non-core or "less-core" businesses they could be more susceptible to the distractions of an activist campaign. This should provide companies with renewed vigour to separate these businesses and pre-empt any public actions by activists.

Fast facts

- Spin-offs have been well-received by the investor community in 2014; of the top 11 most visible spin-offs last year, the median share price gain of the parent was 4%.
- Spin-offs are typically value creative; median value creation was approximately 8% and, in 14% of cases analysed, value creation[1] was greater than 50% (see Chart 7).
- Spin-offs in the healthcare sector generated an impressive 19% of value creation since 2007, with large-scale separations such as AbbVie and Abbott Laboratories generating 21% returns.

[1] Value creation is measured as the delta between pre-spin and combined market capitalization post-spin

Chart 7

Number of spin-offs sorted by value creation/destruction post completion

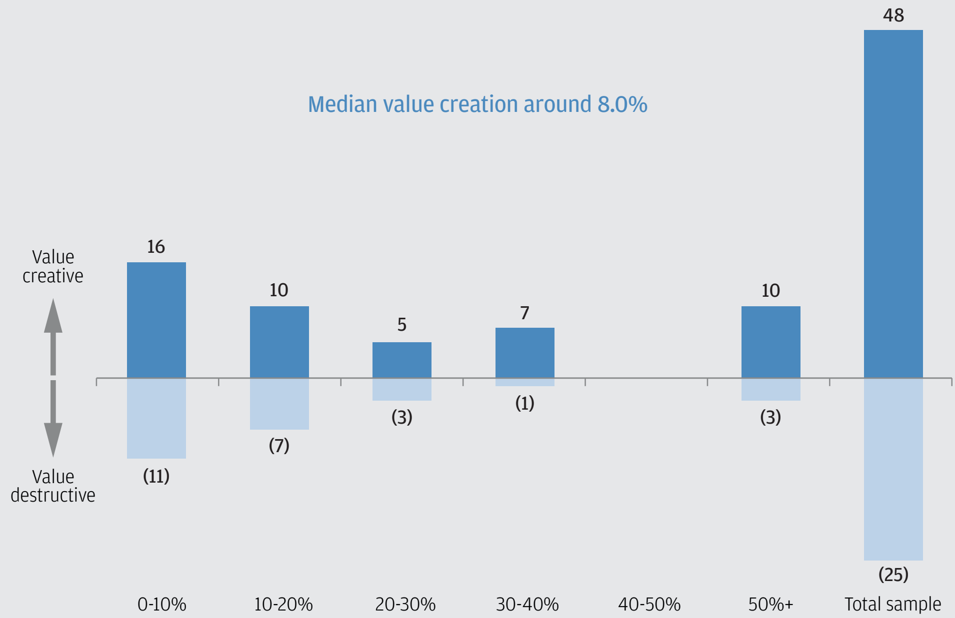


Chart shows the number of spin-offs where the combined post spin-off value of the two separate entities is either calculated positive/negative. Each spin-off has been grouped on the y axis depending on the level of value creation/destruction.

EXECUTIVE TAKEAWAYS

- There is renewed investor scrutiny on portfolio composition.
- Effective portfolio management typically results in improved growth and profitability metrics, leading to a superior valuation.
- Separated businesses often thrive as a result of a streamlined and dedicated strategy relative to not being prioritized by a diversified parent.

4. Cross-border transactions provide a significant source of value creation

International corporations are considering how best to pursue external growth strategies in today's complex global economy. North American companies have proven to be an attractive target. This should continue to be the case, given the region's relatively superior economic recovery compared with the uncertainty in the rest of the world.

Given investor support for external growth, companies are evaluating targets in regions most exposed to fundamental earnings growth. European, Asian and Latin American companies looked for transaction opportunities in North America based on the continued growth of the U.S economy and the U.S dollar, relative to stagnant conditions in most other parts of the globe.

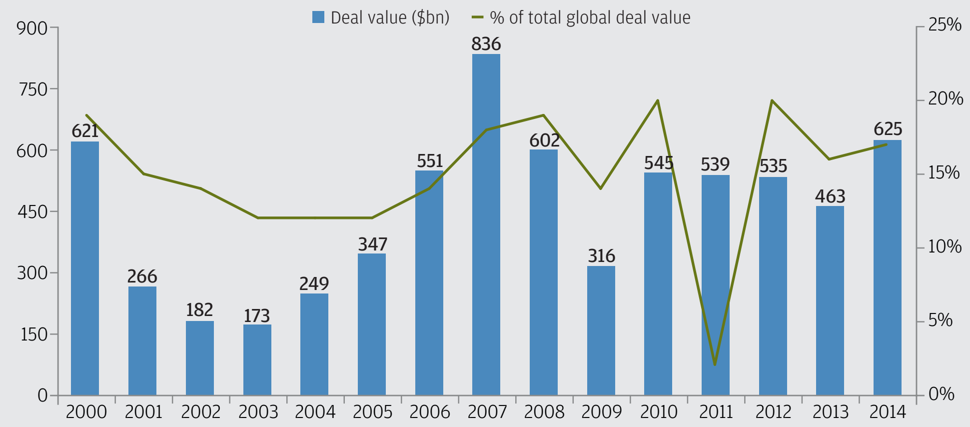
As evidence of an economic recovery in Europe rises, flows into the region will continue to increase. At present, Europe, Middle East and Africa (EMEA) cross-border activity is driven by deep value or highly synergistic combinations.

Fast facts

- Global cross-border deals rose to $625 billion in 2014, up from $463 billion in 2013 (see Chart 9 overleaf).
- Global buy-side transaction activity in North America drove the increase, accounting for almost half of all cross-border M&A in 2014.
- U.S. acquirers targeted capital structuring benefits, while European acquirers have invested in U.S. technology-driven businesses.
- Investor reaction to cross-border deals involving foreign stock consideration should be assessed relative to flowback (a sell-off of stock back to the country of issuance).
- The stock component of transatlantic deals accounted for approximately 23% of all considerations in 2014, the highest since 2010. In most cases, the strategic merits of a cross-border deal outweigh short-term flowback technical factors.

Chart 8

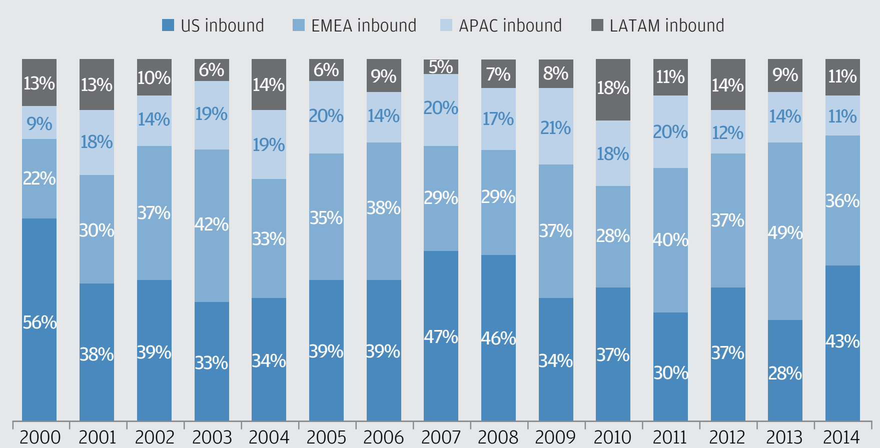
Cross-border[1] M&A was at its highest levels since 2007



Source: Dealogic as of Jan. 14, 2015.
Only deals with value greater than $10 million are included.
[1] Cross-border deals refer to acquirer and target belonging to different countries

Chart 9

Inbound M&A activity in $ billion (2004–2014)



Source: Dealogic, only deals above U.S. $10 million are included

EXECUTIVE TAKEAWAYS

- Opportunities to pursue acquisitions in the U.S. will continue to lead cross-border flows in 2015.
- Perceived strong interest from overseas buyers is likely to result in U.S. boards pursuing competitive processes when approached, driving up the value of takeover transactions.
- Buyouts from Asia appear the most long-term and strategic in their approach. When combined with the support of state-owned financial institutions, these deals are capable of justifying higher valuations than Western counterparts.
- Industrial policy considerations will continue to provide an obstacle in specific cross-border situations, requiring thoughtful preparation.

5. Unprecedented sources of finance provide substantial low-cost liquidity to facilitate transformational M&A

Significant liquidity in the financial markets, coupled with investor search for yield, is facilitating funding for transformational corporate deal activity. Furthermore, increasingly proactive sovereign wealth funds, pension funds and high-net-worth private investors are providing additional sources of financing and flexibility to facilitate large and complex transactions.

This has come at a cost to private equity, notwithstanding its significant funds available for investment, which is struggling to identify opportunities commensurate with restrictive high-return criteria. In turn, this is leading private equity to pursue ever-increasing sources of funding from public investors to gain flexibility in their returns.

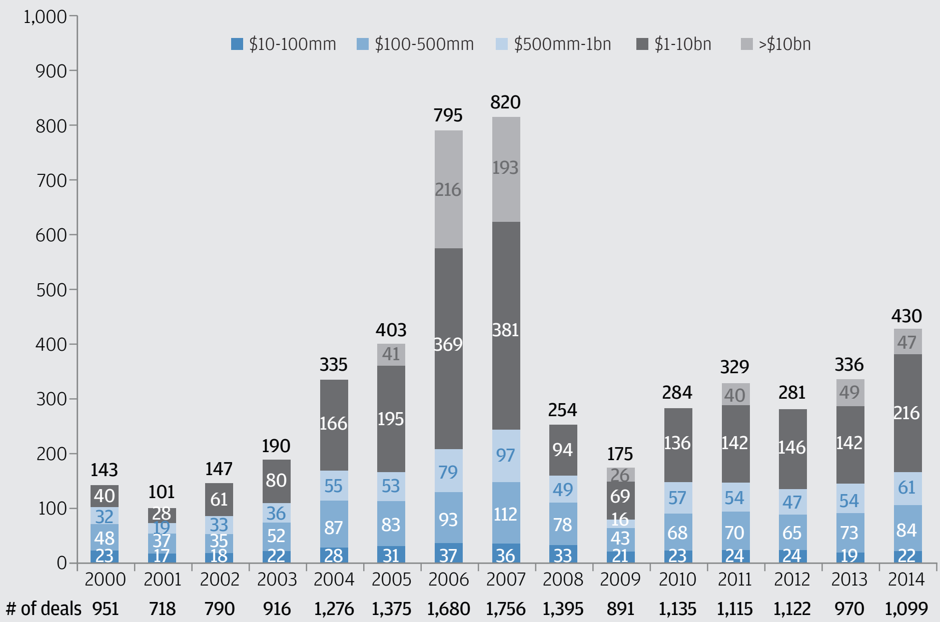
Fast facts

- There is ample financial liquidity available for transformational deals. Verizon's acquisition of Verizon Wireless, which was financed by a $60 billion bond offering, is an example. This debt transaction had a weighted average maturity of more than 15 years, but was priced at a weighted average cost of only 5%.
- Sovereign wealth funds provide a significant opportunity to partner in M&A, having been involved in the acquisition of $20 billion worth of deals last year.
- Significant take-private transactions are being facilitated by high-net-worth investors ready to commit sizeable pools of long-term equity. Warren Buffett's Berkshire Hathaway acquisition of Duracell International for $4.7 billion last year is one example.

There is nearly $500 billion of private equity buyout firepower and a degree of pressure exists to deploy these funds before the next capital-raising cycle. Recent private equity IPOs searching for sustainable sources of funding include Carlyle Group, Apollo Global Management, Vesta Capital and Blackstone.

Chart 10

Financial sponsor buy-side by deal value ($ billion)



Source: Dealogic as of Jan. 14, 2015
Deal value greater than $10 million

EXECUTIVE TAKEAWAYS

- Companies motivated to pursue significant M&A transactions should take advantage of unprecedented liquidity and low-cost sources of funding.
- There is a range of different types of partners to facilitate complex transactions by identifying alternatives for non-core assets, regulatory issues, or investment policy considerations.
- Sellers face a wide range of investor options, consistent with extracting top valuations in competitive processes.

About J.P. Morgan M&A advisory solutions

We advise corporations and institutions of all sizes on their most complex strategic needs, in their home markets and around the world.

Clients benefit from bespoke solutions combining:

- In-depth knowledge of sector and market dynamics with M&A bankers based locally in most major markets globally.
- Innovative advice on valuation, transaction structures and deal tactics/negotiations.
- Rigorous execution delivered with responsive and agile service.
- Ability to partner with product experts across our full range of competencies including, comprehensive financing through our debt and equity issuance platforms, as well as derivatives and treasury services including, escrow services and others.

J.P. Morgan provides M&A advisory solutions across the full strategic lifecycle of our clients:

Strategic expansion

- Acquisitions including cross border opportunities
- Mergers and joint ventures

Enhancing business value

- Corporate combinations
- Divestures
- Capital restructuring projects
- Spin-offs and other restructurings

Shareholder strategy

- Defense preparedness for publicly announced and non-public approaches
- Dedicated shareholder activism advice

Select highlights from 2014:

Pending
$69.8bn
Advisor to Comcast on its acquisition of Time Warner Cable

Pending
$65.7bn
Advisor to Actavis on its acquisition of Allergan

2014
$28.4bn
Advisor to Forest Laboratories on its sale to Actavis

Pending
$27.6bn
Advisor to Reynolds American on its acquisition of Lorillard

2014
$23.6bn
Advisor to Altice SA on its acquisition of Societe Francaise du Radiotelephone from Vivendi

Pending
$17.4bn
Advisor to Harvest Fund Management and other on acquisition of 30% stake of Sinopec Marketing

Pending
$16.9bn
Advisor to Merck on its acquisition of Sigma-Aldrich

2014
$14.2bn
Advisor to Merck on its sale of Consumer Care business to Bayer

Pending
$13.3bn
Advisor to Burger King Worldwide on its combination with Tim Hortons

Pending
$13.3bn
Advisor to Repsol on its acquisition of Talisman Energy

2014
$10.9bn
Advisor to Ziggo on its sale to Liberty Global

Pending
$10.7bn
Advisor to Deutsche Annington Immobilien on its offer to acquire Gagfah

Pending
$10.6bn
Advisor to D.E Master Blenders 1753 on its merger with Mondelez Coffee

2014
$10.0bn
Advisor to Grupo Corporativo Ono on its sale to Vodafone

Pending
$9.9bn
Advisor to Telefonica for the acquisition of GVT from Vivendi SA

2014
$9.5bn
Advisor to Merck for acquiring Cubist Pharmaceuticals

Pending
$9.3bn
Advisor to Altice on its acquisition of Portugal Telecommunication Assets from PT Portugal SGPS

Pending
$9.2bn
Advisor to Dollar Tree on its $9.2 billion acquisition of Family Dollar

Pending
$8.8bn
Advisor to Petsmart on its sale to investor group

Pending
$8.7bn
Advisor to Aviva on its acquisition of Friends Life Group

2014
$7.3bn
Advisor to Compania General de Electricidad SA on the sale of the company to Gas Natural SDG SA

2014
$4.0bn
Advisor to Johnson & Johnson on the sale of it's Ortho-Clincal Diagnostics unit to Carlyle Group

Pending
$3.7bn
Advisor to Standard Life plc on the disposal of Standard Life and Investments in Canada

2014
$3.2bn
Advisor to Blackstone Group and PAI Partners on the disposal of United Biscuits to Yildiz Holding

2014
$1.5bn
Advisor to Hony Capital on the acquisition of Pizza Express

To find out more about the trends discussed or for a tailored scenario analysis, please contact your J.P. Morgan representative.

Notes

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