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The seventh M&A wave

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The history of mergers and acquisitions is probably as long as commerce itself, and it is difficult to determine a date for the first case of a merger or acquisition between companies in history. However, we can identify a few "waves" of mergers and acquisitions that have occurred since the late nineteenth century.

The waves of M&A caused major changes in the structure of global capitalism, causing a transition from a business atmosphere composed of agglomerations of small and medium-sized local businesses to the current form, with the market dominated by multinational corporations.

The waves of mergers and acquisitions are usually caused by a combination of economic, regulatory or technological changes, which are called "shocks“.

An economic shock occurs when there is an expansion of the economy that motivates companies to increase production to meet the rapid growth of aggregate demand, and M&A processes are an efficient way to increase production as an alternative to organic growth. Regulatory shocks occur by eliminating legislative barriers that prevent associations between companies, such as changes in U.S. banking laws that occurred in 1994, which repealed the Bank Holding Company Act of 1956, which prevented U.S. banks from operating in other states or acquiring interests in companies in other market sectors. Technology shocks can occur in various forms, since new technology can dramatically change the structure of an industry or even create a new market segment.

It is important to emphasize that such waves of M&A are also highly influenced by the dynamics of capital markets. Factors such as capital liquidity in the market, the cost of capital, or even the movement of the stock market (number of IPOs, for example), are important influences on the number of M&A transactions.

First wave of mergers and acquisitions 1890 - 1905

The first wave of mergers and acquisitions occurred in the period between the 1890s and early 1900s when. U.S. companies tried to build monopolies in their respective industries, forming so-called "Trusts", an extreme form of horizontal integration (when a company acquires another that produces the same type of product, i.e., a competitor that is at the same stage of production). Examples include the creation of Standard Oil Company of New Jersey, in 1899, United States Steel Corporation in 1901, and International Harvester Corporation in 1902.

The U.S. Congress responded to the wave of mergers with the creation in 1890 of the Sherman Antitrust Law or the Sherman Act), which aimed to protect the interests of consumers by combating monopolies, to prevent prices in certain sectors from being controlled by conglomerates. However, the Sherman Act did not have the desired effect in its first years in effect, because during the period of major consolidation, the U.S. Justice Department, which was responsible for enforcing the law, did not have enough staff to fully enforce it.

So, for example, the Sherman Act in 1911 put an end to Standard Oil Co., a John D. Rockefeller company and largest oil group in the United States (at the time it refined 84% of U.S. oil).

In this first wave, more than 1,800 companies merged or were acquired in the period from 1890-1905. Most mergers that were conceived during the first wave ended in failure because they failed to achieve the desired level of efficiency. The failure was also extended by a slowing U.S. economy in 1903, followed by the stock market collapse of 1904, and, as mentioned, the actual application of the Sherman Act made the legal environment more hostile for more mergers and acquisitions and in fact boosted other anti-trust laws, such as Clayton Antitrust Act of 1914, which complemented the terms of the first law.

Second wave of mergers and acquisitions of 1926-1929

With a stricter antitrust environment, the creation of monopolies was hindered by the U.S. government, and what was seen during the second wave of mergers was the creation of oligopolies and vertical integration between different companies (when a merger occurs between supplier and customer).

The main factors that led to this new wave was a large availability of capital for investment in the United States, with the development caused by the post-World War I economic boom , and the technological shock caused by industrial innovations, such as in transportation, with the commodification of motor vehicles and the development of passenger airlines.

This was the first large scale formation of conglomerates and American investment banks actively participated in the processes, performing a key role in facilitating the transactions. Some examples of conglomerates created at the time are IBM, General Motors, John Deere and Union Carbide.

Although the availability of capital caused by favorable economic conditions has motivated a large number of M&A processes, it also paved the way for the crash of the U.S. stock market in 1929, which ended the wave and brought the arrival of the Great Depression.

Third wave of mergers and acquisitions of 1965-1969

The third wave of mergers and acquisitions has been characterized by a trend towards diversification among companies. Also caused by an economic boom, which once again flooded the market with cheap capital, this wave of M&As became known as the Conglomerate Merger Period (conglomerate merger period). At this time, there were significant changes in M&A, with transactions that were up to then unusual, such as the acquisition of big companies by smaller companies and financing of transactions through IPOs or equity swaps.

The conglomerates formed during this period were extremely diverse in terms of product lines, in accordance with the trend at the time, and many of them acquired companies totally outside their original business area. We can cite the example of ITT telephone (International Telephone & Telegraph) acquiring Avis Rent a Car (car rental company) and Sheraton Hotels.

One reason for the trend of diversification observed at this time was the antitrust atmosphere that arose in the United States. Clayton Act of 1914 made it illegal to purchase shares from other companies when such a merger resulted in a large reduction in the degree of competition within an industry. However, the Clayton Act had an important gap, it did not preclude the acquisition of a company's assets, only shares. With this, the U.S. Congress passed in 1950 the Celler-Kefauver Act, which strengthened the provisions of the Clayton Act closing that gap. Armed with tougher laws, the U.S. government adopted a stronger antitrust posture, and the alternative was to form conglomerates in different business areas.

The third wave ended in mid-1969 due to efforts by the U.S. government to fragment conglomerates and prevent further mergers and acquisitions that were considered harmful to competition. Moreover, the conglomerates formed at the time showed poor financial performance.

Fourth wave of mergers and acquisitions 1981-1989

The downward trend in M&A processes that characterized the years from 1970-1980 was sharply reversed in 1981. When the fourth wave began, characterized by a large number of hostile takeovers, which became a common alternative for enterprise growth through acquisitions. What defines whether an acquisition is hostile or friendly is the reaction of the board of directors of the target company. If the board approves the acquisition, it is amicable; if the board is opposed, the acquisition is considered hostile.

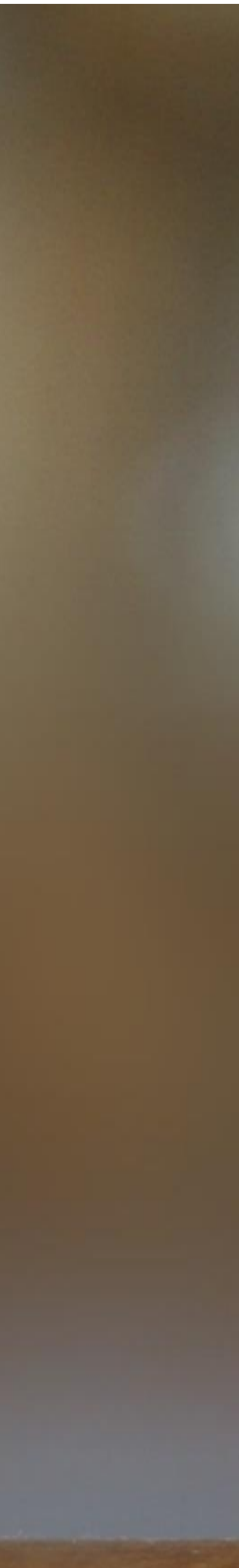
Such offers are usually fully or partially financed by debt or even Private Equity funds, which enter as partners in the business. These funds gained great importance in the financial market at the time, especially the fund Kohlberg Kravis Roberts, which acquired RJR Nabisco businesses (processed food and tobacco company) and Beatrice (processed food company), which are valued as two of the largest transactions in the period.

The fourth wave of M&A can also be distinguished from the other three by size and prominence of the target companies, which characterized it as the "mega-mergers" wave. Some of the largest companies in the United States became acquisition targets in the 1980s, such as Gulf Oil, RJR Nabisco and Kraft. The most prominent sectors were the processed foods, oil and gas and pharmaceutical industries.

The end of the fourth wave occurred in 1989, with the end of the great economic boom of the 80s and beginning of a brief recession in 1990, which caused the collapse of several mergers completed during this period. Another important factor that caused the end of the wave of transactions was the collapse of the speculative bonds market, which financed a good part of the acquisition.

Fifth wave of mergers and acquisitions 1992-2000

Driven by globalization, the stock market boom and the high level of market deregulation, the fifth wave of M&A began in 1992. It was also a period of large transactions, but the negative history of many highly levered deals of the fourth wave was quite evident, and therefore, the transactions of that period had a more strategic nature and were focused on long-term results, and did not have a high degree of leverage, with most transactions being financed



by a more reasonable combination of debt and equity.

The fifth wave of M&A was actually the first truly international wave. There was big business volume in Europe (mainly from 1998), Asia and, to a lesser extent, South America; and prominent sectors were banking and telecommunications. The fifth wave of mergers ended with the bursting of the stock market bubble in 2000.

Sixth wave of mergers and acquisitions of 2001-2008

The sixth wave of mergers and acquisitions started after the 2001 recession, when economic growth resurfaced and there was a flood of dollars into the market, thanks to the stimulus from the U.S. Federal Reserve, which kept interest rates low to stimulate the economy.

Low interest rates also boosted the rise of Private Equity funds, as levered acquisitions became cheaper and, in addition, the stock market was booming, which led to large amounts of available capital and an extremely favorable environment for the number of M&A transactions.

M&A transactions multiplied in a market environment with high liquidity and cheap capital, but also generated distortions, especially in the prices of target companies, which ended up being overvalued due to enormous speculation and lack of perceived risks, directing a large volume of resources at "rotten" assets. The result was the outbreak of the Subprime crisis in 2007, which dried up credit and plunged the world into recession, also ending this wave of transactions.

The seventh wave:

In the context of finance, there is little interest in the history of M&A, and it is likely that many errors that occurred in earlier periods will reoccur.

Understanding history can help us identify the proximity to a new wave of M&A.

In 2014, optimism seems to be returning to the market, and the value of mergers and acquisitions globally reached 1.75 trillion U.S. dollars in the first six months of the year, an increase of 75% over the same period last year and the largest volume of transactions since 2007. What is observed is that the business environment after the 2008 crisis, characterized by risk aversion and a focus on organic growth by firms, is dissipating.

It is true that we are living in a more volatile era in terms of market growth, but companies are beginning to understand that this volatile world is the new standard, after all, there will always be wars and countries with difficulty to honor their sovereign debt payments. In such an environment, it may not be possible to rely only on organic growth and cost cutting to deliver consistent financial results. Managers seem to once again be believing that it is easier to buy growth than build it.