Merger momentum to continue in 2015, EY says

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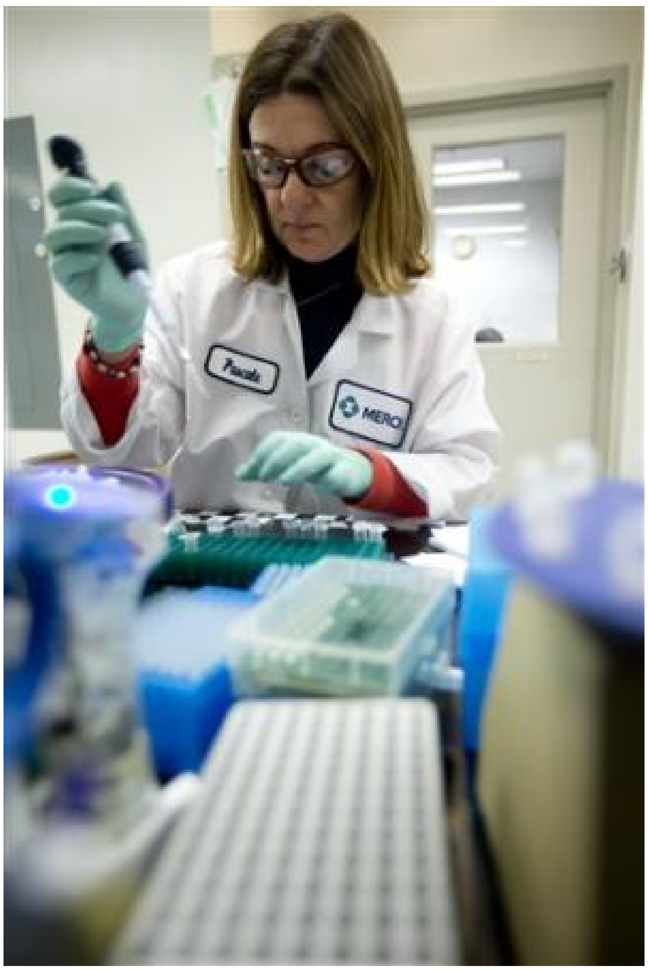

In this Thursday, Feb. 28, 2013 file photo, Merck scientist Pascale Nantermet conducts research to discover new HIV drugs in West Point, Pa. Merck's acquisition of Cubist Pharmaceuticals, announced Monday, Dec. 8, 2014, helped boost the total value of global deals this year to $3.4 trillion, the best year since a total of $4.6 trillion of deals were struck in 2007, according to financial data provider Dealogic. (AP Photo/Matt Rourke, File)

A banner year for mergers and acquisitions will be followed by more deals next year as executives grow more confident in the strength of the U.S. economy, according to the consultancy firm EY.

On Monday, drugmaker Merck announced that it was spending $8.4 billion to buy Cubist Pharmaceuticals in another sign of the recovering confidence in the market for mergers and acquisitions.

The tie-up helped boost the total value of global deals this year so far to $3.4 trillion. Even if there aren't any more big deals announced in 2014, it would be the best year since a total of $4.6 trillion of deals were struck in 2007, according to financial data provider Dealogic.

Executives are becoming more confident about the prospects for growth as the U.S. economy continues to strengthen despite sluggishness overseas.

A more stable atmosphere in Washington is also helping to build up confidence, said Rich Jeanneret, EY Americas Vice Chair, Transaction Advisory Services. For investors, that's a welcome change from a recent pattern of spats among lawmakers in recent years that held up spending bills and threatened to bring the country close to defaulting on its debt.

"Brick by brick we're building a strong economy, and I think that's really boding well for the M&A environment," Jeanneret said. "Executives have confidence in this market."

The outlook for deals is also being helped by the huge cash piles that companies have built up in the aftermath of the financial crisis. Companies listed in the Standard & Poor's 500 index hold about $1.2 trillion in cash and cash-equivalent securities, according to S&P Capital

IQ. That's close to a record.

The increase in deals has been one of the factors that sent stock indexes up to record levels this year. Mergers are typically good for stock prices, at least for the companies being bought, because the acquiring company normally pays a premium to ensure that the deal is approved by shareholders of the company being acquired.

For example, Cubist's stock surged after Merck offered to pay $102 per share of Cubist, a 37 percent premium to its closing price on Friday.

Still, mergers aren't all good news.

If a tie-up is between two companies in the same field then job cuts often result as the companies try to seek greater efficiencies by cutting headcount.

This year, a wave of mergers was also driven by U.S. companies seeking so-called tax inversions. By acquiring an overseas company, the U.S. business can reincorporate its business overseas in a jurisdiction with lower taxes, allowing the company to lower its tax rate. The tactic drew criticism from President Barack Obama who described them as unpatriotic because they were eroding the U.S.'s tax base.

Of course, sometimes mergers just don't work out. AOL's takeover of Time Warner at the peak of the Internet bubble is a classic example. Time Warner wound up spinning off AOL in May 2009, nine years after a $166 billion dollar merger at the peak of the Internet bubble. In 2002 and 2003, Time Warner absorbed nearly $100 billion in charges to account for the rapidly diminishing value of the combined company, as AOL's subscription revenues plunged as its dial-up services were replaced by broadband connections.