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M&A *Index* Q4 2014

Mega-deals lead the resurgence in M&A markets

Key points

- So far this year, companies have announced $2.5 trillion worth of M&A deals. This makes 2014 the best year for deals by value since 2007. This year will go down as a year when mega-deals (> $10 billion) made a comeback and so far 26 such deals have been announced amounting to $672 billion.
- We forecast global deal volumes in Q4 2014 to recover and reach around 8,500, which will make a total of around 31,500 for the year. Though less pronounced, it represents an increase of 3% over last year and would make 2014 the best year for volumes since 2011.
- Looking ahead to 2015, following the end of the US quantitative easing programme, the pace of the US economic recovery is expected to continue. However other economies, including the Eurozone and many of the emerging markets are facing challenges. These diverging economic trajectories mean that the US companies could take advantage of an appreciating US dollar to pursue cross-border M&A deals.
- Globally corporates are in a position of strength, they have record levels of cash reserves, have rebuilt balance sheets, stock market rallies have lifted their share prices and M&A spend as a percentage of market capitalisation remains lower than average. However the conditions for global economic growth remain challenged and with heightened geopolitical risk and investor scrutiny following high-profile deal withdrawals, we expect companies to display patience and consideration while pursing M&A activities in 2015.

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Figure 1. The Deloitte M&A Index
Global M&A deal volumes

About the Deloitte M&A Index

The Deloitte M&A Index is a forward-looking indicator that forecasts future global M&A deal volumes and identifies the factors influencing conditions for dealmaking. The Deloitte M&A Index has an accuracy rate of over 90% dating back to Q1 2008.

Factors set to influence M&A in 2015

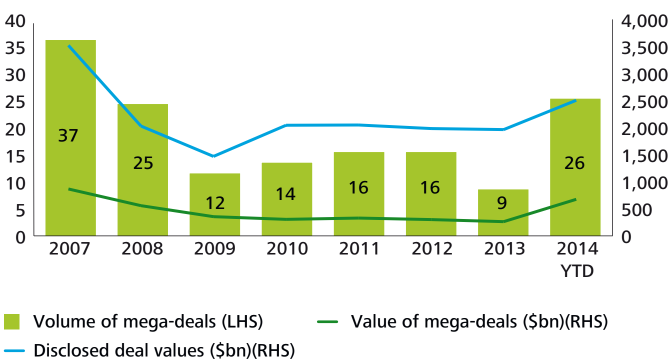
The Deloitte M&A Index has highlighted a number of factors that are likely to impact deal volumes in 2015.

The return of 'animal spirits'

A defining theme for 2014 has been the return of mega-deals over $10 billion in value. So far, 26 mega-deals have been announced during the year, amounting to $672 billion in value, the highest figure since 2007. The steady flow of mega-deals has propelled total deal values for year-to-date to $2.5 trillion, again, the highest figure since 2007.

At the start of the year, we highlighted that conditions were favourable for dealmaking, however confidence remained low. The equity rallies in the first half of the year provided a much-needed boost to confidence, which did not get undermined in spite of some high-profile deal withdrawals.

Figure 2. Global disclosed deal values and yearly volumes and values of mega-deals (2007 – YTD 2014)[1]



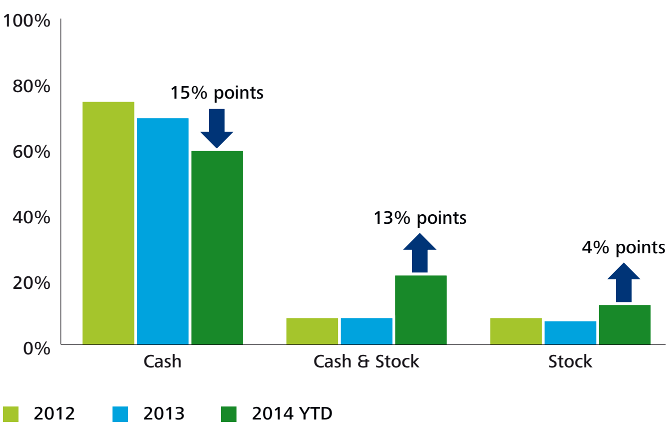
Source: Thomson One Banker; Deloitte analysis

M&A financing: Shift from cash to stock

While companies are sitting on record levels of cash reserves, they are less reluctant than in the past to use their hard preserved cash in deal financing. In 2012 all-cash deals accounted for 75 per cent of the total. However since that time, there has been a steady decline in cash only deals which has made up just 60 per cent of the total to date in 2014. Instead there has been a steady increase in deals involving stock as a means of finance, and in 2014 nearly one third of deals had stock as a component.

Many companies have been undertaking share repurchase programmes in the last few years, and with the value of equities in global market hitting a record $65.6 trillion earlier this year, stock has been an attractive currency for acquisitions. We expect this trend to continue in 2015.

Figure 3. M&A deals by type of financing as % of total value of deals (2012 – YTD 2014)



Source: Bloomberg; Deloitte analysis

1 YTD 2014 refers to 14th of November 2014.

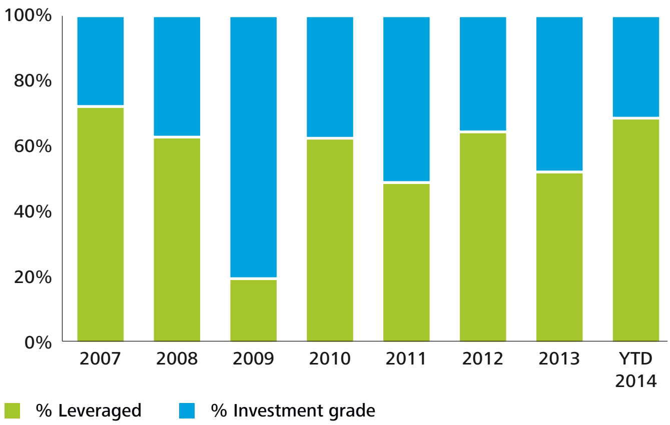
Factors set to influence M&A in 2015

Leveraged loans driving M&A

In recent years there has been a boom in the syndicated loan market. Data from Dealogic shows that leveraged loans, which make up 37 per cent of total syndicated global loans, stood at $1.35 trillion in 2014. Companies are increasingly using leveraged loans to fund M&A activities. As of October 2014, acquisition related loan volumes in the US reached $206 billion, the highest since 2007.

In addition the search for yield is driving alternative investors such as hedge funds and specialist asset managers to provide lending for mid-market companies. The Deloitte Alternative Lending Tracker estimates that in Europe a large proportion of the financing is being used for M&A or LBO purposes. We expect this trend to continue in the coming year and provide a steady rise in both main and mid-market M&A activities.

Figure 4. Acquisition-related loan volumes in the US (January to October 2007–2014)



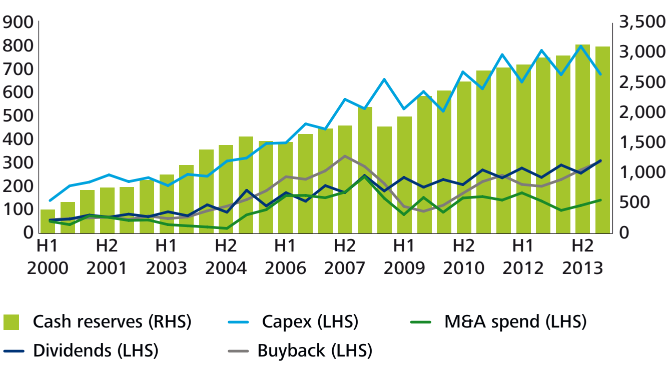
Source: Dealogic

Corporate cash still plentiful

Deloitte estimates that one thousand largest non-financial companies in the world have around $3.1 trillion in cash reserves as of H1 2014, close to record highs. These companies have been returning cash to shareholders through dividends and share buy-backs. In H1 2014, companies returned $600 billion, the highest six-monthly amount in well over a decade. Much of this has been financed through debt which grew by 21 per cent from $7 trillion in 2008 to $8.5 trillion in 2014.

The S&P Global 1200 Index reached record highs in 2014, however the annual revenue growth for these companies fell for two consecutive years. We expect investors to put the spotlight back on revenue growth and companies to start spending on M&A and capex to boost their growth prospects.

Figure 5. S&P Global 1200 corporate cash and spending patterns ($bn), 2000 to H1 2014



Source: Bloomberg; Deloitte analysis

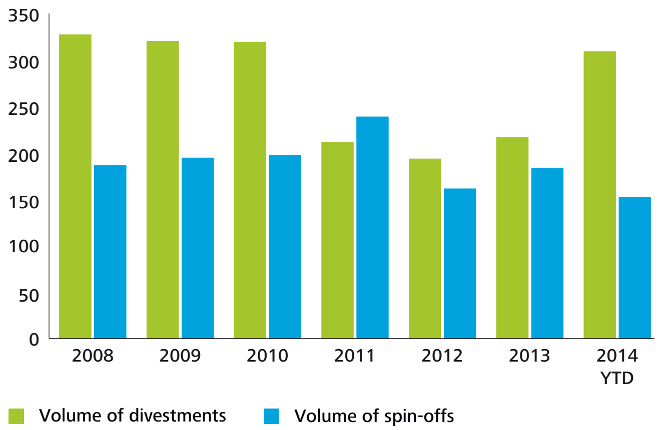
Factors set to influence M&A in 2015

Divestments and spin-offs

Divestment values have already reached $129 billion in 2014, the highest since 2011. Many companies are now actively evaluating their portfolios and disposing of non-core assets to refocus and build a platform for growth. For instance, Procter & Gamble announced a major strategic review of its portfolio and is planning to divest several high-profile brands such as Duracell. Pressure from shareholder activists is increasing, and it is estimated that 45 per cent of the activists who initiated public campaigns in 2014 made demands relating to M&A activities.

While the last couple of years have been a subdued time for spin-offs, there were many high-profile announcements in the second half of the year. HP, eBay, Symantec and Bayer are some of the companies that announced spin-off plans and these are expected to keep the markets busy in 2015.

Figure 6. Global divestment and spin-off volumes ($bn), 2008 – YTD 2014[1]



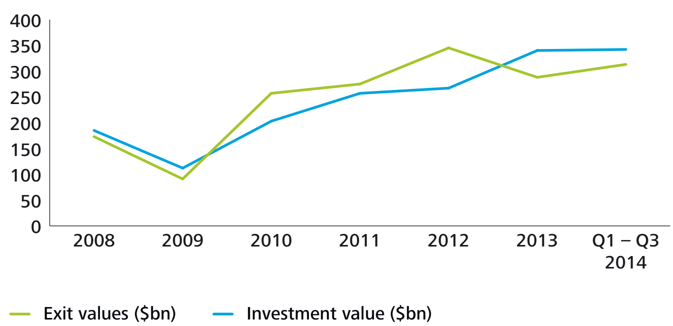
Source: Thomson One Banker; Mergermarket; Deloitte analysis

The return of private equity

Private equity (PE) firms had an active 2014. In just the first three quarters, they have made more exits than in the whole of 2013. The buoyant IPO markets during the year favoured private equity exits, and PE firms had already completed more than 200 exits through IPO by Q3 and are on course for a strong year-end performance. Since 2008, the financial sponsors have made $1.74 trillion through exits, and it was matched by $1.7 trillion in new investments.

Preqin estimates that the private equity sector have around $1.19 trillion in 'dry powder' and with a number of funds approaching their maturity, we can expect PE firms to start investing more in 2015.

Figure 7. Financial sponsor investments and exits (2008 to Q1 – Q3 2014)



Source: Thomson One Banker; Deloitte analysis

1 Divestment refers to the agreed sale of an asset or assets from one company to another, distinguished from other transactions by the fact that it is the vendor which actually initiates the transaction. Spin-off refers to the tax free distribution of shares by a company of a unit, subsidiary, division, or another company's stock, or any portion thereof, to its shareholders.

Factors set to influence M&A in 2015

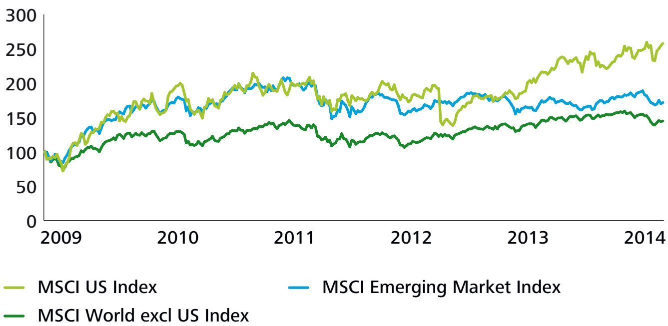
Diverging economic trajectories creates opportunities for US corporate sector

In October 2014, the US Federal Reserve finally ended its $4.5 trillion bond-buying programme that had helped steer the US economy through the financial crisis. This year the US economy is well on the way to recovery with GDP growth expected to accelerate to 3.1% in 2015. The US unemployment rate is below six per cent; US corporate after tax profits were estimated at a record $1.7 trillion for the last financial year and US equities outperformed both European and emerging market indices. A growing US economy also means a strengthening US dollar, which since 2008 has gained about 13 per cent against the euro and about 12 per cent against the British pound respectively.

Meanwhile many others are struggling to revive their economies. In the eurozone, the European Central Bank announced that it would inject a further one trillion euros into the economy to avert deflationary pressures. This could result in higher asset valuations but a weakening Euro. The Bank of Japan outlined aggressive measures to counter deflationary tendencies and they could give a competitive advantage to Japanese manufacturing. At the same time the long-term growth forecasts for the BRIC countries have been lowered.

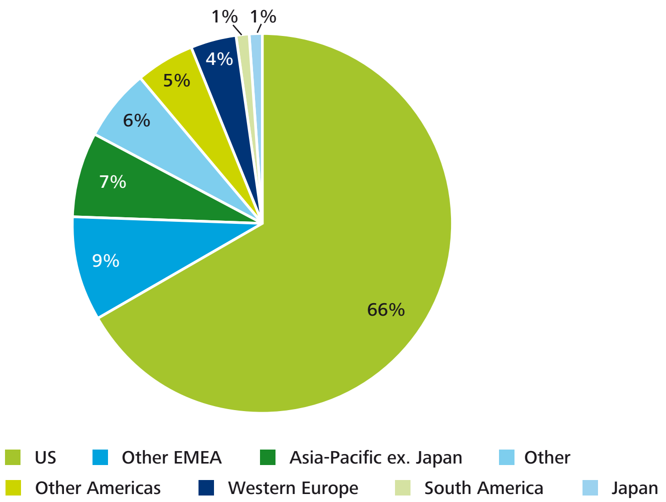
S&P 500 companies in 2012 earned around 34 per cent of their revenues from overseas. With such a significant amount of turnover coming from countries experiencing a slow recovery, US companies may come under pressure to grow their revenues elsewhere. The stronger dollar and strength of their share prices presents an opportunity for US companies to do more cross-border M&A deals. In the coming year we should expect to see an increase in cross-border transactions, particularly from the US into Europe.

Figure 8. MSCI Indices performance



Source: Bloomberg; Deloitte analysis

Figure 9. S&P 500 revenues by region (2012)



Source: Goldman Sachs Global ECS research

Corporate barometer

Analysis of the S&P Global 1200 company fundamentals yields four key insights:

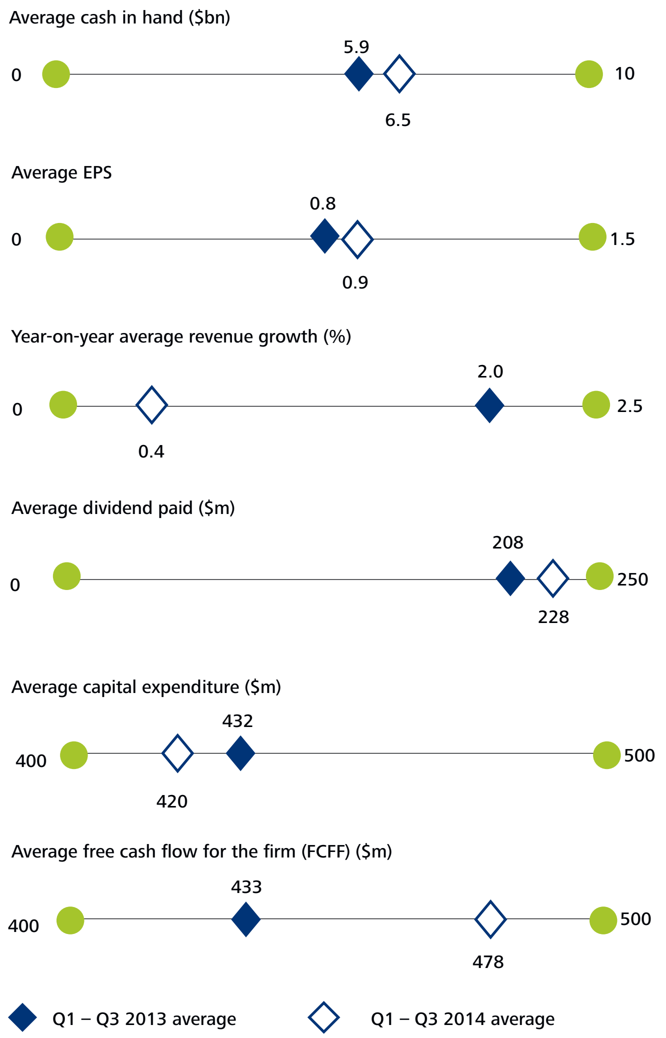
First, average revenue growth fell from 2.0% in the first three quarters of 2013 to 0.4% in the corresponding period of 2014. With corporates seemingly reaching peak operational efficiency, we anticipate they will need to look for growth outside of their current markets in 2015.

Second, average cash in hand per company increased from $5.9 billion over the first three quarters of 2013 to $6.5 billion in the same period of 2014. FCFF across the S&P Global 1200 shows a similar trend, averaging $433 million across the first three quarters of 2013 and $478 million in the same period of 2014.

Third, average dividend payments per company increased from $208 million in the first three quarters of 2013 to $228 million for the same period of 2014, continuing the trend of returning cash to shareholders. The average EPS also increased from $0.8 in 2013 to $0.9 in 2014.

Finally, average capital expenditure per company fell slightly from $432 million to $420 million.

Figure 10. Company fundamentals, S&P Global 1200: Q1 – Q3 2013 vs. Q1 – Q3 2014 average



Source: Bloomberg; Deloitte analysis

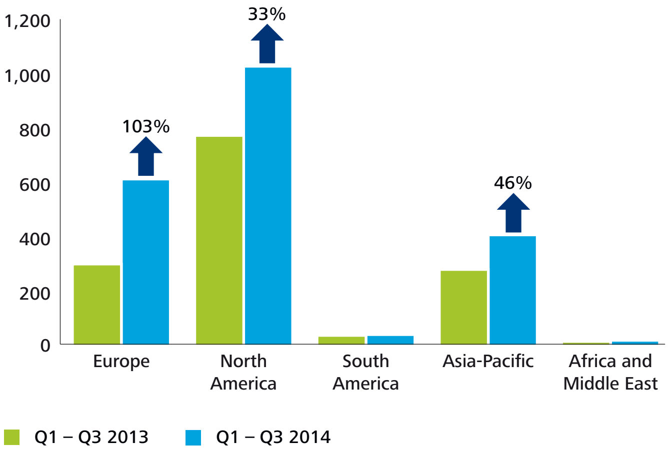
Geographies

Europe searches for growth in North America

There has been a sharp increase in European dealmaking. Europe's M&A deal values jumped from $301 billion in the first nine months of 2013 to more than $600 billion in the same period of 2014 largely due to rebound of M&A within the EU.

The EU-North America corridor has been particularly active on both sides in 2014. European companies have been making acquisitions in North America where the economic recovery has taken hold much faster. European outbound deals in North America reached nearly $150 billion, more than six times the level in 2013. On the other hand, North America's outbound M&A into Europe almost matched this amount with more than $130 billion in disclosed deals, up more than $80 billion from the previous year's level.

Figure 11. Global deal values by region of acquirer ($bn), Q1 – Q3 2013 vs. Q1 – Q3 2014



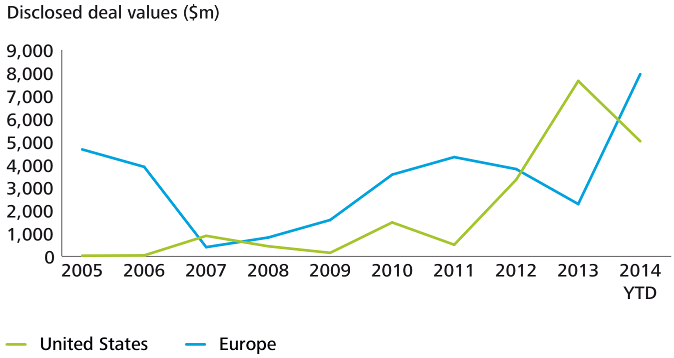
Source: Thomson One Banker; Deloitte analysis

Return of Chinese dealmaking

Earlier this year China's National Economic Development and Reform Commission (NDRC), which is the main authority for approving outward investment, raised the threshold for investments requiring approval to $1 billion. This gave a major boost to Chinese outbound M&A activity in US and Europe which reached $13.0 billion in 2014, an increase of nearly 31 per cent over 2013. In particular, outbound activities into Europe more than tripled from $2.3 billion in 2013 to $7.9 billion for the ten months of 2014.

Historically Chinese outbound M&A activities centered around manufacturing and energy & utilities. In recent months they are moving towards consumer brands and technologies. Earlier this year, Hony Capital, a Beijing based private equity firm, acquired UK based Pizza Express for $1.54 billion in what was the largest ever private equity buyout by a Chinese firm.

Figure 12. Chinese outbound M&A activity into US and Europe ($m), 2005 – YTD 2014



Source: Thomson One Banker; Deloitte analysis

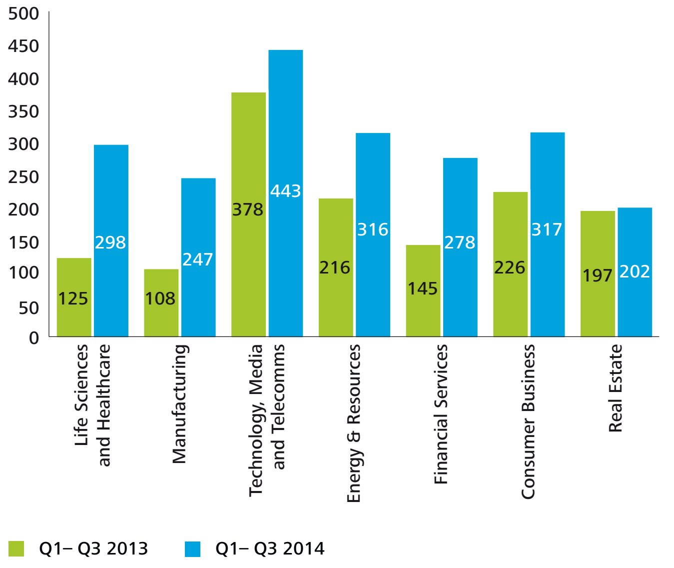
Sectors

Global deals are up across all major sectors

The first three quarters of 2014 saw an overall increase of 50 per cent in disclosed deal values compared with the same period in 2013.

Global deal values in the life science and healthcare industry were boosted by seven mega deals which totalled nearly $180 billion helping global deal values in the sector reach $298 billion, an increase of 139% over the last year's performance.

Figure 13. Global deal values by sector ($bn), Q1 – Q3 2013 vs. Q1 – Q3 2014



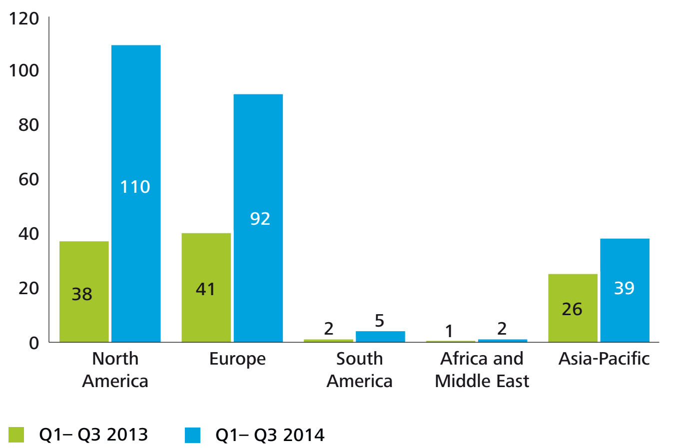
Source: Thomson One Banker; Deloitte analysis

Manufacturing sector deals increase globally

In the manufacturing sector during the first three quarters of 2014 around $247 billion of deals were announced, up from $108 billion for the same period in 2013. Four mega-deals accounted for 29 per cent of this total.

The sector has experienced consolidation deal activities particularly in North America and Europe. In North America, total deal values almost tripled from $38 billion to $110 billion year-on-year. In Europe, the rise was also significant from $41 billion in Q1 – Q3 2013 to $92 billion in the same period of 2014.

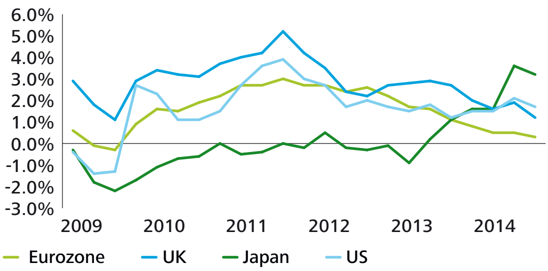
Figure 14. Manufacturing sector deal values by geography ($bn), Q1 – Q3 2013 vs. Q1 – Q3 2014



Source: Thomson One Banker; Deloitte analysis

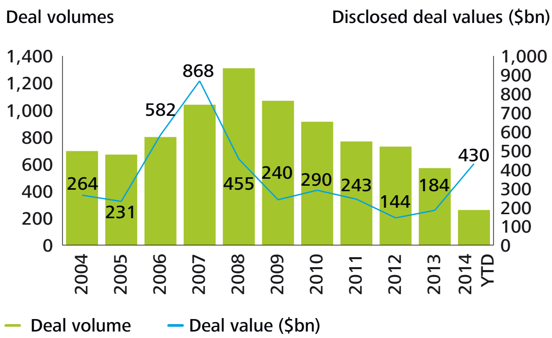
Charts we like

Figure 15. Inflation rate based on CPI change (%) 2009-2014



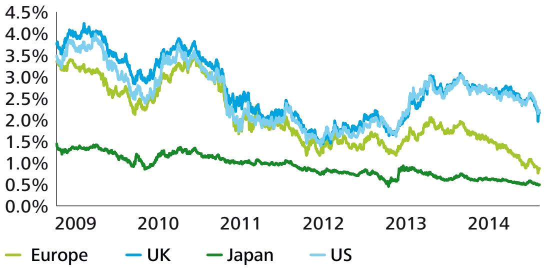
Source: Bloomberg; Deloitte analysis

Figure 18. Withdrawn deal volumes and values, 2004-YTD 2014



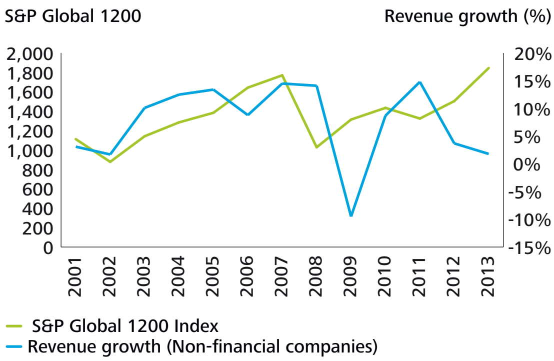
Source: Thomson One Banker; Deloitte analysis

Figure 16. 10-year government bond yields 2009-2014



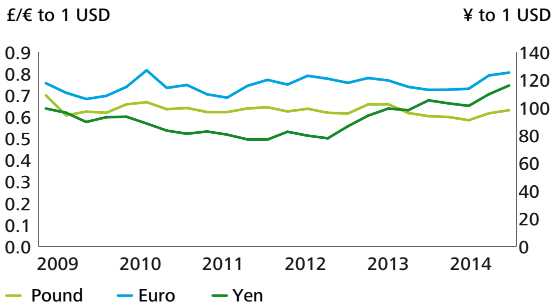
Source: Bloomberg; Deloitte analysis

Figure 19. S&P Global 1200 revenue growth v share price (2001–2013)



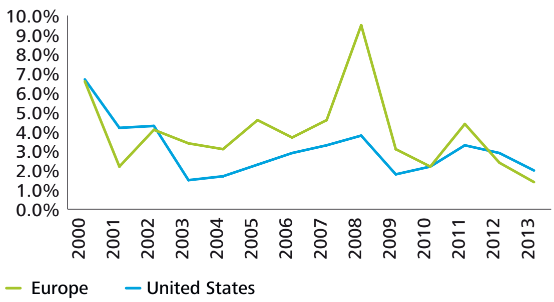
Source: Bloomberg; Deloitte analysis

Figure 17. Currency exchange rates against US dollar



Source: Bloomberg; Deloitte analysis

Figure 20. S&P Global 1200 cash proportion of M&A spend as % of market capitalisation (2000–2013)



Source: Bloomberg; Deloitte analysis

Notes: In this publication, references to Deloitte are references to Deloitte LLP, the UK member firm of DTTL.

About the Deloitte M&A Index

The Deloitte M&A Index is a forward-looking indicator that forecasts future global M&A deal volumes and identifies the factors influencing conditions for dealmaking.

The M&A Index is created from a composite of weighted market indicators from four major data sets: macroeconomic and key market indicators, funding and liquidity conditions, company fundamentals, valuations.

Each quarter, these variables are tested for their statistical significance and relative relationships to M&A volumes. As a result, we have a dynamic and evolving model which allows Deloitte to identify the factors impacting dealmaking and enable us to project future M&A deal volumes. The Deloitte M&A Index has an accuracy rate of over 90% dating back to Q1 2008.

About the authors

Sriram Prakash and Irina Bolotnikova are the UK Deloitte Insight team for M&A and New Growth, based in London. Haranath Sriyapureddy, Abhimanyu Yadav and Sukeerth Thodimaladinna are research analysts in the Business Research Center, at DTTL.

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