Deloitte.

M&A *Index* Q2 2013

Strong US recovery to push M&A volumes higher

Key points

- Deloitte LLP predicts a US-led recovery will drive up global M&A volumes in Q2 2013.
- Q2 2013 could see up to 7,500 deals globally.
- The projected growth in global deal volumes is supported by predicted stronger equity markets and attractive company valuations.

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About the Deloitte M&A Index

The Deloitte M&A Index is a forward-looking model that forecasts future global M&A deal volumes and predicts the factors influencing dealmaking.

The M&A Index is created from more than 30 weighted market indicators from four major groups:

- Macroeconomic and key market indicators (including world real GDP growth (YoY%) and the CBOE VIX Index)
- Funding and liquidity (including global investment grade and high yield corporate bond market volumes and global IPO volumes)
- Company fundamentals (including average cash in hand and average net debt/shareholder equity)
- Valuations (including trailing price/earnings multiples and deal P/E multiples).

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 enables us to project future M&A deal volumes. The Deloitte M&A Index has a 90 per cent accuracy rate dating back to Q1 2008.

Q2 M&A deal forecast: Up

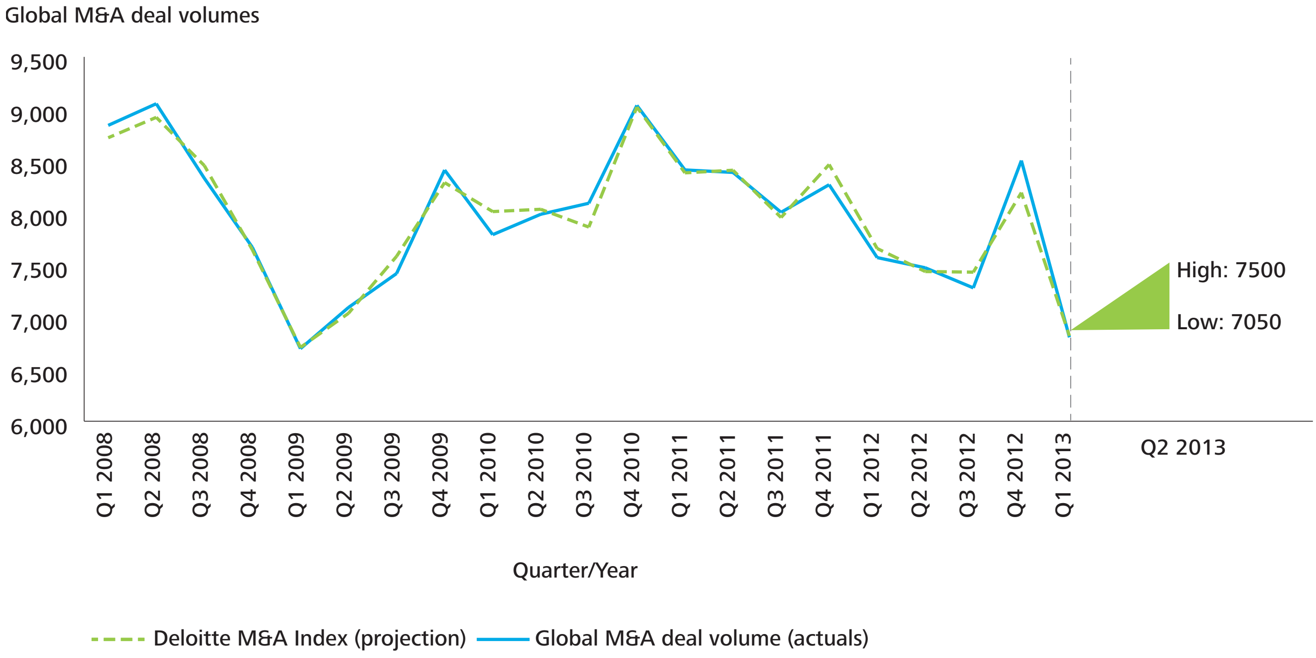
Deloitte expects a significant quarter-on-quarter increase in global M&A deal volumes for Q2 2013. Much of this increase is being driven by the steady US economic recovery and stronger company fundamentals across the US and Europe.

Despite Q1 2013 representing the lowest quarter for M&A volumes since Q1 2009, we expect dealmaking to pick up in the coming months. Investor confidence appears to have returned with global equity indices close to record highs, implying optimism about the future.

The US is the main driver behind a recovering M&A market with corporate and economic data increasingly positive. Other 'tailwinds' such as record corporate cash piles, accommodative monetary policy and attractive valuations should all to help to drive M&A. The remaining significant 'headwind' comes from Europe. Though a collapse of the eurozone seems far less likely than it did 18 months ago, uncertainty persists and continues to be a drag on M&A volumes.

Looking ahead, we expect the US-led resurgence to have a knock-on effect and for M&A volumes to improve. With companies seeking growth and returns we expect an increase in dealmaking in the coming months.

Figure 1. The Deloitte M&A Index



Source: Deloitte analysis, based on data from ThomsonONE Banker and Bloomberg

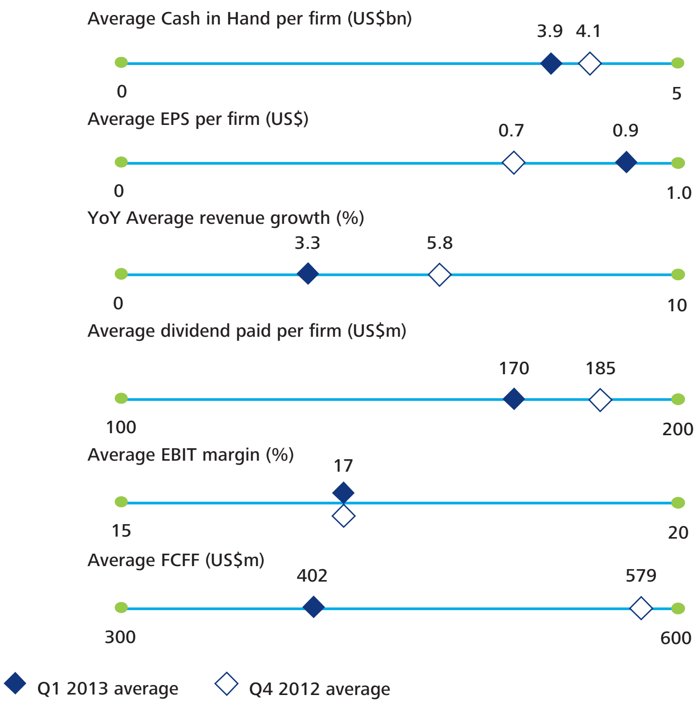
Factors influencing M&A

This quarter, the Deloitte M&A Index has highlighted a number of variables which have a significant statistical relationship and will impact M&A deal volumes:

- **Strong corporate performance** The Deloitte M&A Index indicates that the shifting company fundamentals of the S&P 500 and FTSE 100 are likely to have the most pronounced effect on M&A volumes (Figure 2). With corporate cash reserves currently at or near record highs, it is these companies that are likely to kick-start an M&A revival. Falling average cash in hand, lower dividend payments, increased earnings per share (EPS) and rising free cash flow for the firm (FCFF) are early signs that firms have more free cash and are beginning to put it to use. Much of this activity is taking place in the US, which we expect to lead the recovery in global M&A volumes.

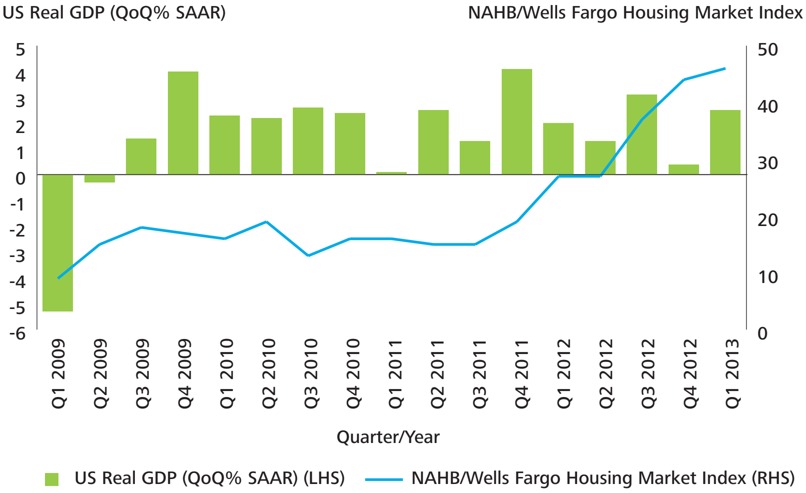
- **US-led recovery** A steady decline in jobless claims, rising consumer confidence and a rebound in house prices underpin the positive economic indicators coming from the US. Real GDP grew from just 0.4 per cent in Q4 2012 to 2.5 per cent in Q1 2013, and is expected to rise to 3 per cent by the end of the year.[1] In the corporate sector, average cash in hand for S&P 500 companies declined from US$3.0 billion in Q4 2012 to US$2.8 billion in Q1 2013, and the average dividend pay-out of S&P 500 companies declined from US$175 million in Q4 2012 to US$152 million in Q1 2013. The US economy seems to be at an inflection point and corporates there are now strategically deploying their cash for growth related initiatives.

Figure 2. Company fundamentals (FTSE100 and S&P500) (Q1 2013 v. Q4 2013)



Source: Deloitte analysis, based on data from Bloomberg

Figure 3. US real GDP v. Housing market (Q1 2009–Q1 2013)

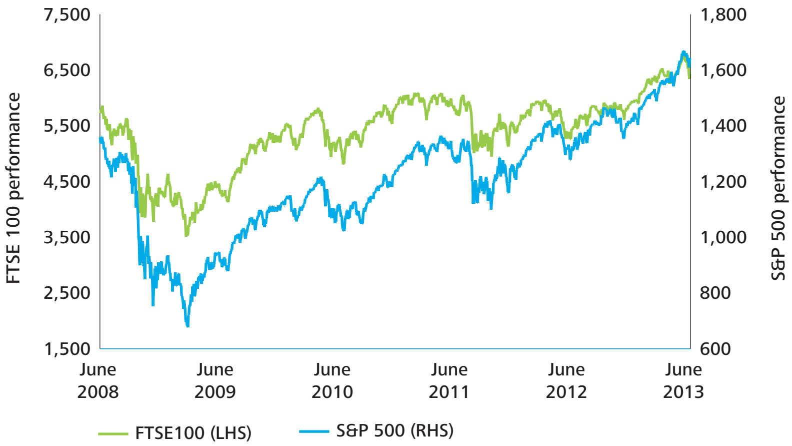


Source: Bloomberg; Deloitte analysis

- **The great rotation: From bonds to equities**
  2013 has also seen the recovery of the world's major indices with many reaching or exceeding their 2007–08 highs. This is perhaps motivated by stronger corporate earnings and investors seeking to buy stocks before, not after, earnings shoot upwards. Corporates across the FTSE 100 and S&P 500 have shown strong Q1 results with healthy growth in year-on-year average revenue and earnings per share (EPS). US corporate performance has been particularly robust. Of the S&P 500 companies that have reported earnings for Q1 2013, 70 per cent have reported earnings above the mean estimate and 47 per cent have reported revenues above the mean estimate.[2]

- **Attractive valuations, but for how long?**
  Over the last decade, the trailing price/earnings multiples of the S&P 500 and FTSE 100 indices have averaged 16.5x and 20.1x respectively. Current P/E multiples of the S&P 500 and FTSE 100 indices are 16.3x and 16.9x respectively. Given the buoyant performance of equity markets across the globe since the start of the year, the next few months might represent the last chance for companies to undertake strategic deals at attractive valuations.

Figure 4. Performance of S&P 500 and FTSE 100 (June 2008 – June 2013)



Source: Bloomberg; Deloitte analysis

Notes

1 World Economic Outlook, International Monetary Fund, April 2013.

2 Earnings Insight, Factset, May 2013.

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