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The Deloitte

M&A *Index* Q2 2014

Growth is back on the corporate agenda

Key points

- Deloitte forecasts a strong resurgence in deal volumes for Q2 2014, bolstered by strong economic figures from the US and Europe.
- We expect the global deal volumes to reach nearly 8,000 deals by the end of Q2 2014, up by 10% for the same period in 2013.
- More than $500 billion worth of deals were announced just in the first two months of 2014. It appears growth is firmly back on the corporate agenda.
- The S&P 1200 share price index currently stands close to its pre-crisis high, however revenue growth has been declining since 2012. With confidence levels recovering, M&A activity provides a compelling way to enhance revenues and profits.

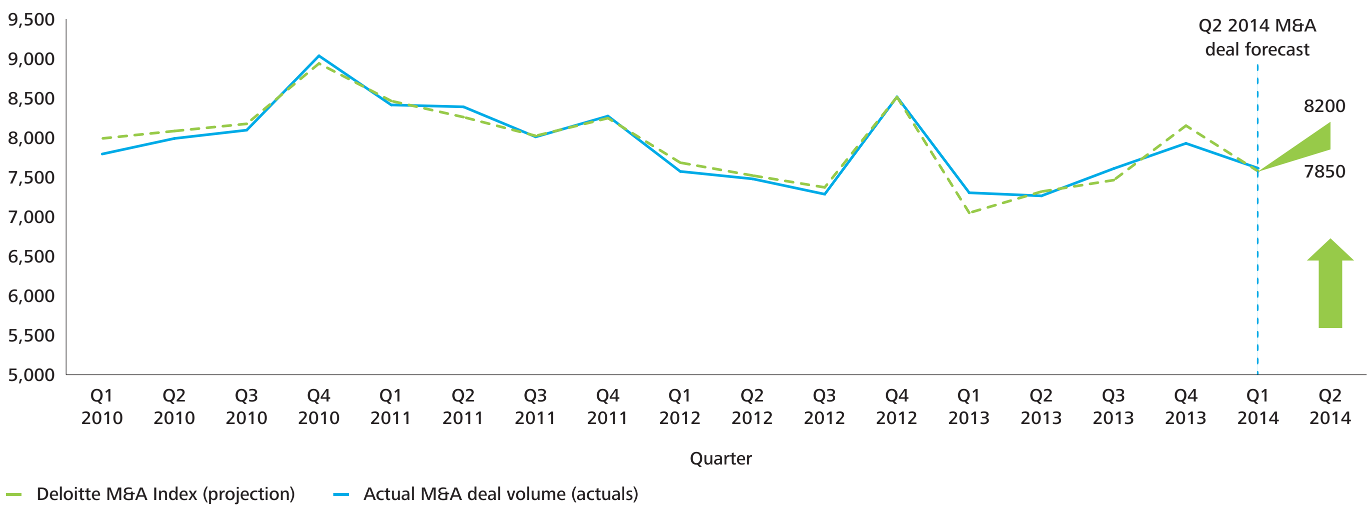
Contacts

Iain Macmillan
Head of UK M&A
020 7007 2975
imacmillan@deloitte.co.uk

Sriram Prakash
Head of M&A Insight
020 7303 3155
sprakash@deloitte.co.uk

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 per cent dating back to Q1 2008.

Factors influencing M&A

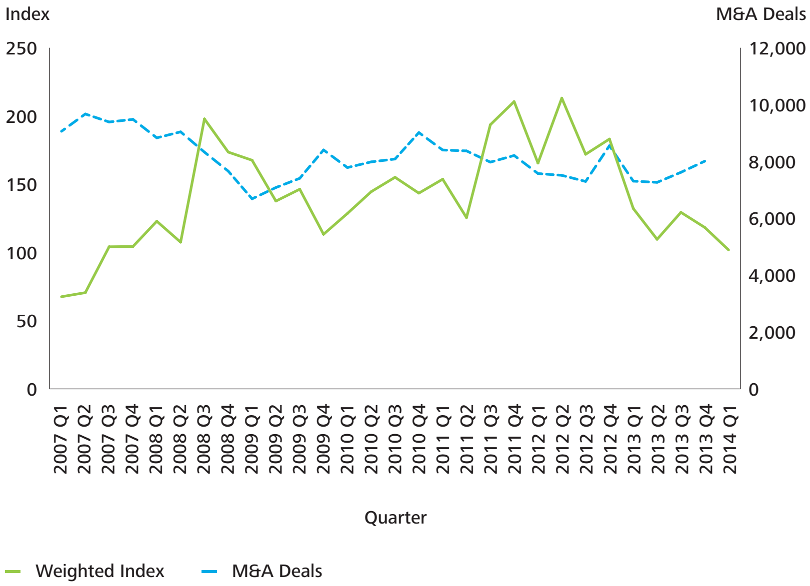
The Deloitte M&A Index has highlighted a number of variables that impact M&A deal volumes:

Policy uncertainty falls

Corporate sector fundamentals are strong, however economic uncertainty over the last few years significantly dampened corporate risk appetite. In the previous editions of the Deloitte M&A Index we argued that until market sentiment improves, companies would not take on greater risk. On the policy front, there have been a number of positive developments such as the US deal on debt ceiling, decisive actions by EU leaders to manage the Euro crisis and the UK avoiding a double dip recession.

Policy uncertainty was one of the variables that strongly featured in our Q2 2014 projection calculations. There is an inverse relationship between macroeconomic policy uncertainty and M&A volumes. In recent months, policy uncertainty has been falling steadily and if this continues, we can expect an uptick in M&A volumes in the coming quarters.

Figure 2. Global policy uncertainty (Q1 2007-Q1 2014)



Source: Policyuncertainty.com, Thomson M&A, Deloitte analysis

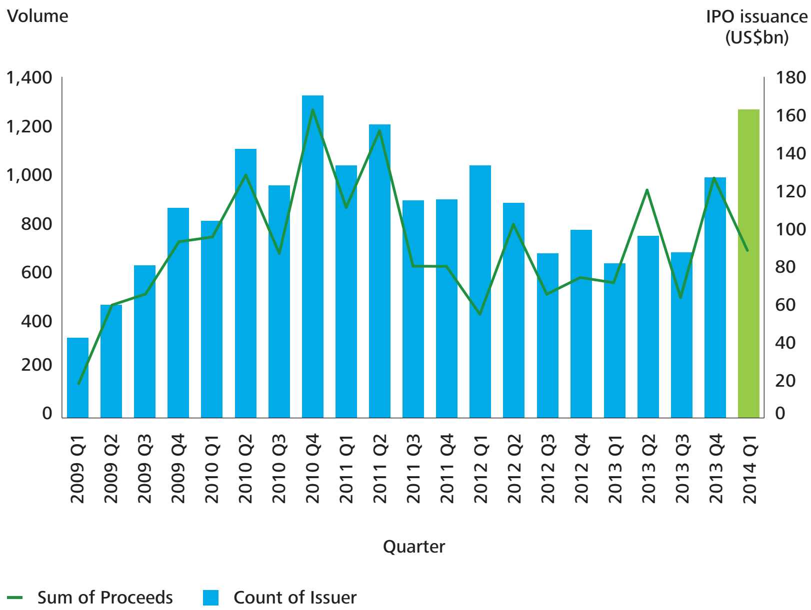
*Weighted index is a weighted score for US, Europe and Chinese uncertainty index.

IPO markets are booming

The recent boom in the global IPO market is a strong indicator of increasing market confidence. In Q1 2014 IPO levels reached 40 per cent of total for 2013. If this trend continues, we can expect a record year for IPOs. While technology IPOs have grabbed the headlines, it is encouraging that in 2013 IPO listings were spread across a number of sectors, suggesting that growth prospects are well distributed across the economy.

According to Dealogic, 2013 was the most active year in recent record for Private Equity (PE) backed IPOs. There were 182 PE backed IPOs that raised a total of $56.4 billion. With successful exits underway, we expect Private Equity to start investing some of its record levels of ‘dry powder’, which Preqin estimates currently stands at $1.067 trillion.

Figure 3. Global IPO volume and issuance (US$bn) (Q1 2009-Q1 2014)



Note: Q1 2014 data as at 18 March, 2014

Source: Thomson Reuters, Deloitte analysis

Factors influencing M&A

Pressure on revenue growth

The S&P 1200 share price index currently stands close to its pre-crisis high; however revenue growth has been declining since 2012 at a rate of 3%. Companies will be under pressure to maintain their share price performance. At the same time, S&P 1200 non-financial companies are sitting on record piles of cash and the net debt to EBITDA ratio for US and European companies is 18% and 8% below their 10-year average respectively. With confidence levels recovering, M&A activity provides a compelling way to enhance revenues.

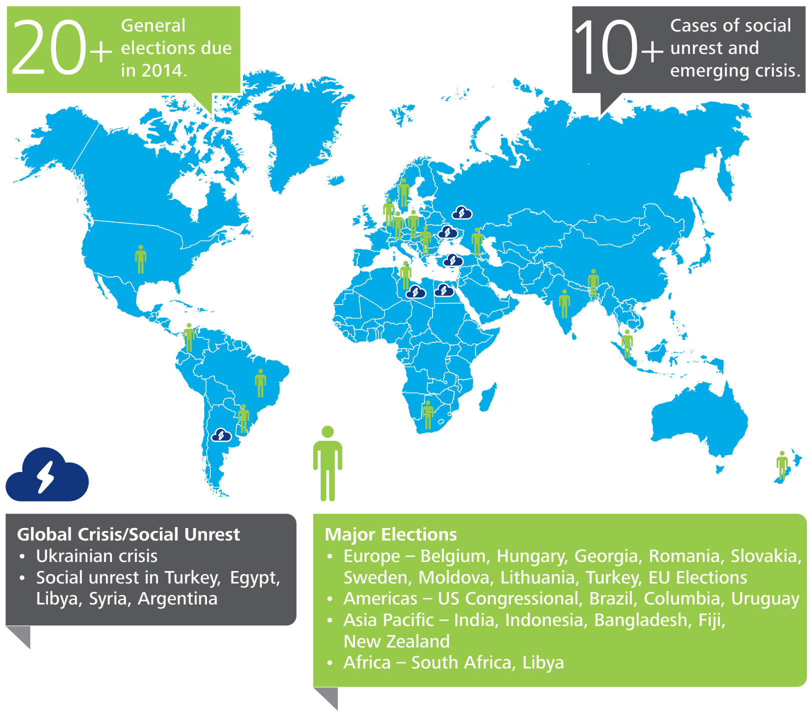
Figure 4. Corporate revenue growth rate vs. share price index (S&P 1200)

Source: Bloomberg, Deloitte analysis

Changes to the political landscape could influence corporate risk and investment appetite

With 21 general elections coming up in 2014, we expect changes to the political landscape may have an impact on corporate risk and investment appetite. Major elections include ones in the key emerging markets of India and Brazil, congressional elections in the US, parliamentary elections in EU and the Scottish referendum.

Figure 5. Global political scenario – 2014



Source: Deloitte analysis

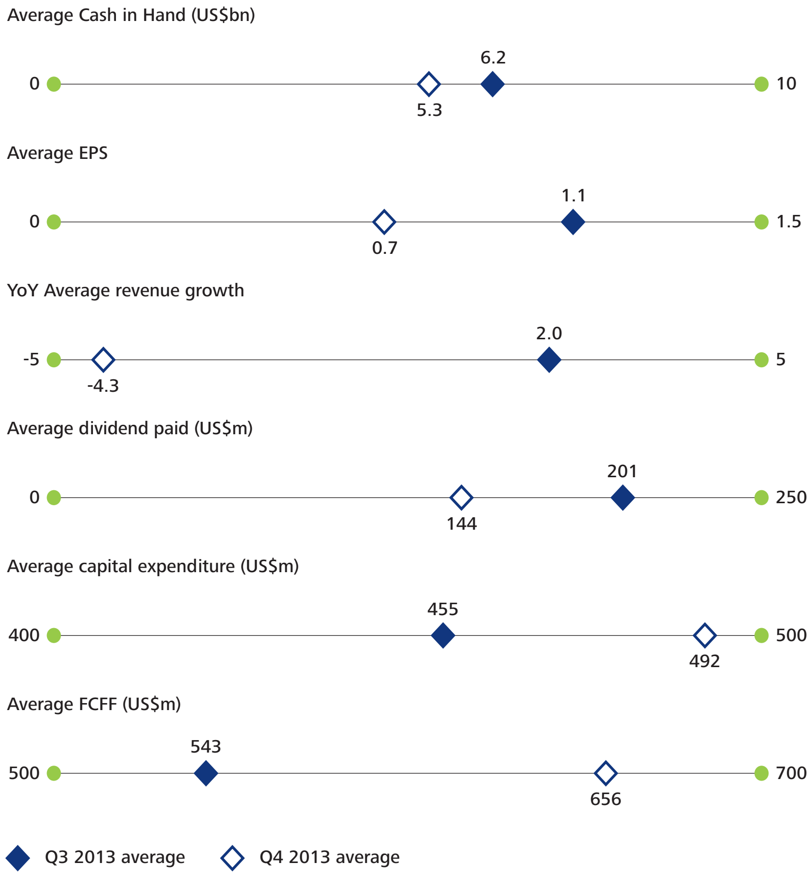
Corporate barometer

We observed two significant changes in S&P 1200 company fundamentals. First there was a sharp decline in average revenue growth, which fell by 4.3% year-on-year in Q4 2013. This was partly due to the severe weather conditions in the US which resulted in unused inventories.

Second, average cash in hand fell from $6.2 billion to $5.3 billion. Some of the cash was spent on M&A. Global deals in Q4 2013 amounted to $521 billion.

Companies also increased their average capital expenditure from $455 million to $492 million, suggesting a more positive investment outlook and confidence in their balance sheet strength.

Figure 6. Company fundamentals (S&P Global 1200)
(Q3 2013 vs. Q4 2013 average)



Source: Bloomberg, Deloitte analysis

Geographies

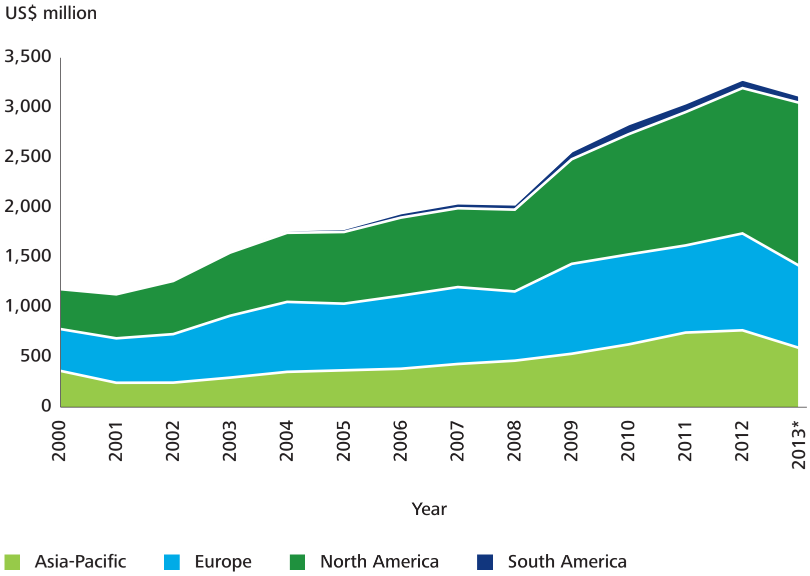
The US continues to lead the resurgence

Industrial production in February 2014 grew at the fastest rate in six months – a positive sign business investment may take off in 2014.

US companies in S&P 1200 are sitting on reserves of $1.53 trillion, which is 51% of the total cash reserves of the index constituents.

US companies have started to become more active in global M&A markets. In Q1 2014, they were involved in 38% of all global M&A transactions up from 34% in Q4 2013.

Figure 7. Global cash holding pattern as per geographies**



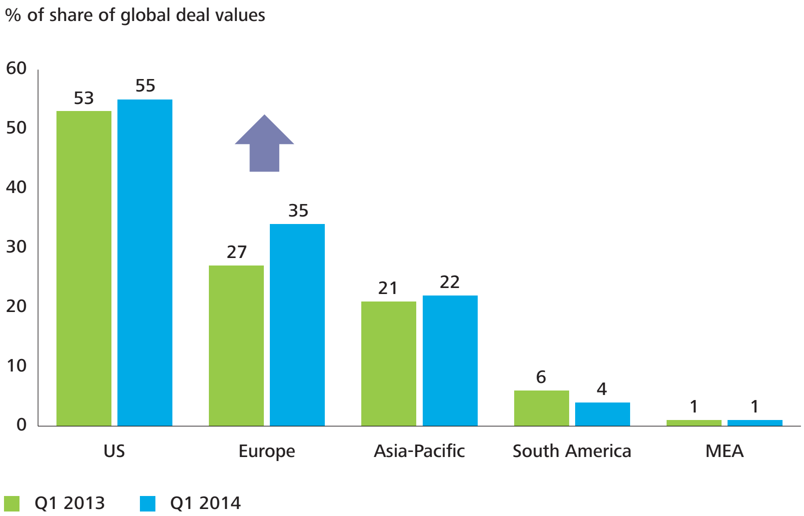
Source: Bloomberg, Deloitte analysis
**Includes S&P 1200 non-financial companies
*2013 figures are for the companies which have reported as of date of publication.

An unexpected rebound in European deals

European companies were involved in 35% of all global deals by disclosed values in Q1 2014, which is up from 27% during same period in 2013.

This trend is consistent with the 15% drop in cash reserves of the European companies from $970 billion to $822 billion.

Figure 8. Region-wise M&A values Q1 2013 vs. Q1 2014



Source: Thomson Reuters, Deloitte analysis
Note: This data set includes all deals where a company from a particular geography was involved either as a buyer or seller. Q1 2014 figures are based on figures disclosed as of date of publication.

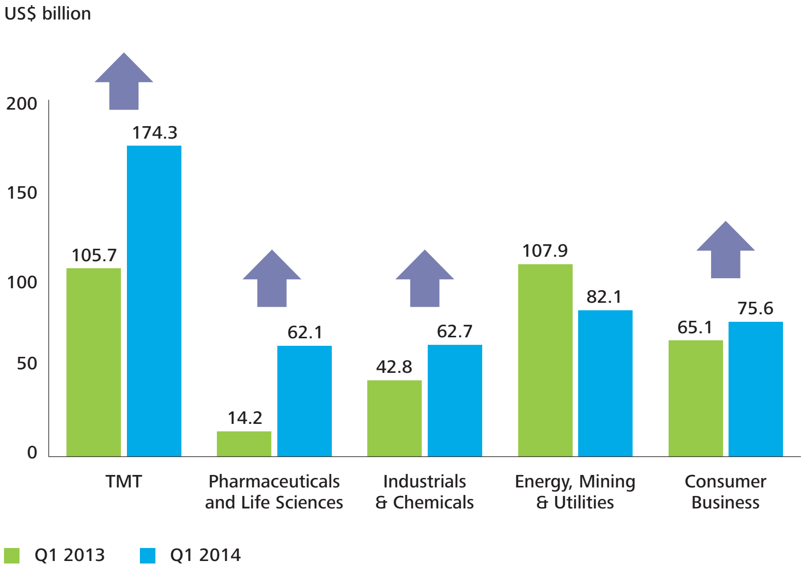
Sectors

We expect M&A activities to be strong in the following sectors:

Technology, Media & Telecommunications (TMT) sector

Technology, Media and Telecommunications companies are at the forefront of M&A activities. The ongoing revolution in media consumption habits is likely to fuel convergence inspired mergers. We expect both vertical and cross-industry convergence deals. Successful mergers could create whole new market categories.

Figure 9. Deal values Q1 2013 vs. Q1 2014

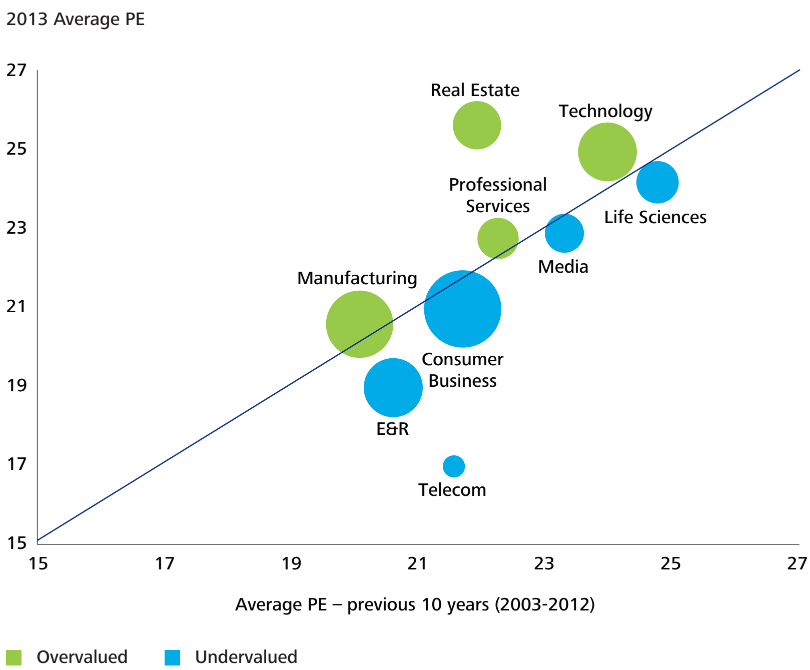


Source: Mergermarket, Deloitte analysis
*Deal values for Q1 2014 based on deals disclosed as of date of publication.

Pharmaceuticals and Life Sciences

Pharmaceutical and Life Sciences companies are once again under pressure due to weak R&D pipelines. Indeed for some companies replenishing their pipelines is now a matter of survival. Historically they have responded through acquisitions and we expect this trend to continue with bolt-on deals, rather than block-busters. We also expect them to divest non-core assets to free up cash for pipeline related acquisitions.

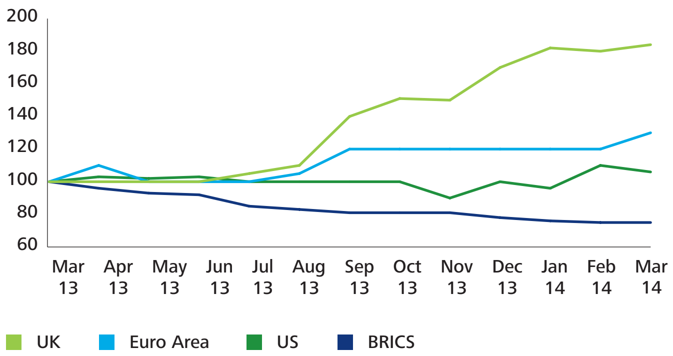
Figure 10. Average PE valuations as per sectors



Source: Thomson M&A, Deloitte analysis
*Bubble size denotes the deal volumes

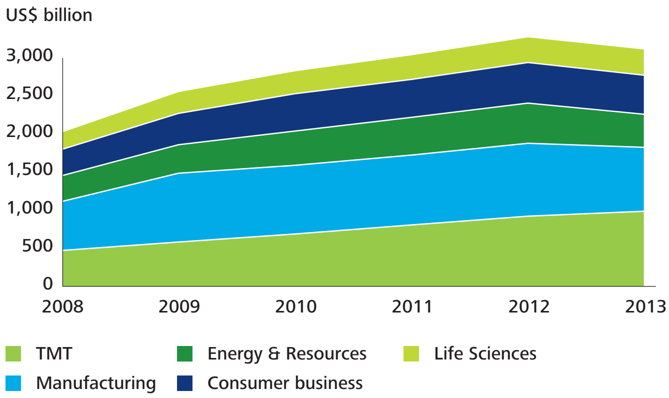
Charts we like

Figure 11. Growth prospects in major economies



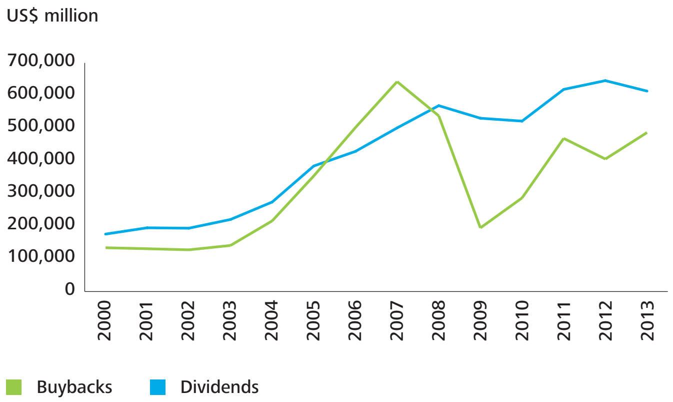
*Consensus forecasts for 2014 GDP growth, March 2013 = 100
Source: Economics & Markets, Deloitte Research

Figure 12. Cash position S&P 1200 sectors



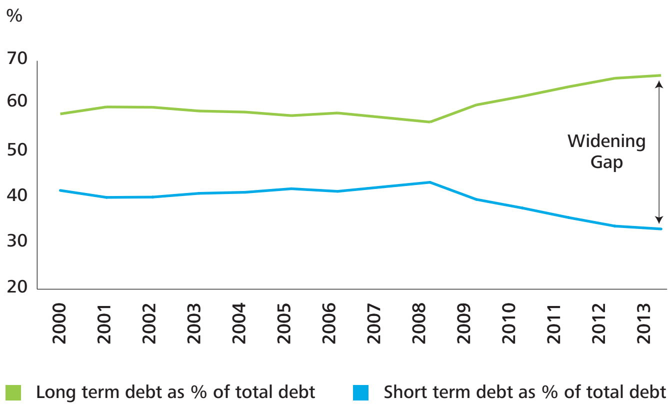
Source: Bloomberg, Deloitte analysis

Figure 13. S&P 1200 buybacks vs. dividends (2000-2013)



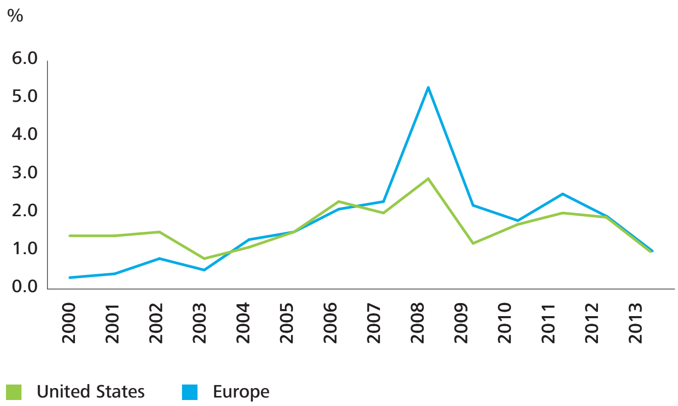
Source: Bloomberg, Deloitte analysis

Figure 14. S&P 1200 short vs. long term debt



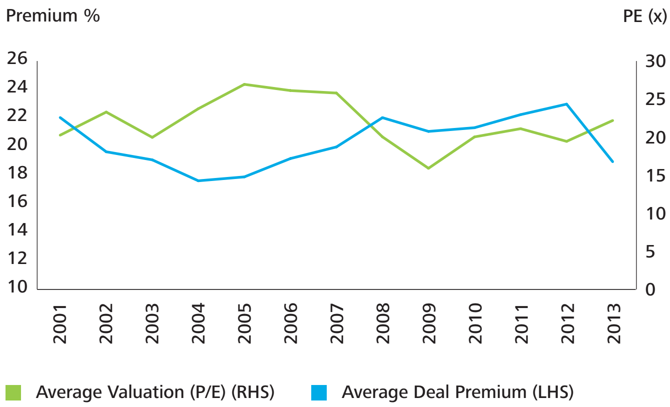
Source: Bloomberg, Deloitte analysis

Figure 15. S&P 1200 M&A spend as % of market capitalisation



Source: Bloomberg, Deloitte analysis

Figure 16. Average deal P/E multiples vs. average deal premium (%) (2001-2013)



Source: Thomson Reuters, Deloitte analysis

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
- S&P 1200 company fundamentals
- Valuations trends

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 per cent dating back to Q1 2008.

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

About the authors

Sriram Prakash and Russell Shoult are from the Deloitte M&A Insight team, based in London, UK. Ravi Sekar, Haranath Sriyapureddy, and Abhimanyu Yadav are M&A analysts in the Business Research Center, at Deloitte (DTTL) in India.

Deloitte LLP is a limited liability partnership registered in England and Wales with registered number OC303675 and its registered office at 2 New Street Square, London EC4A 3BZ, United Kingdom. Tel: +44 (0) 20 7936 3000 Fax: +44 (0) 20 7583 1198.

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