Deloitte.

Future of the Deal

Winds of Change

2019

M&A

Executive Summary

Winds of Change

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The last five years have witnessed an unprecedented bull run in global M&A markets and 2018 was the fifth consecutive year when deal values exceeded the $3 trillion mark. However there are signs we might now be witnessing a late-cycle phase. Indeed last year was a tale of two halves, with H1 contributing nearly 60% of the year-end total, while for the first time since 2014 we saw a year-on-year decline in M&A volumes.

The winds of change are evident in the rise in political and economic uncertainties, the prospect of a US-China trade war, the slowdown in major economies, likely rise in borrowing costs and increased regulatory scrutiny that is driven by protectionist instinct, all of which will continue to have an impact on corporate confidence.

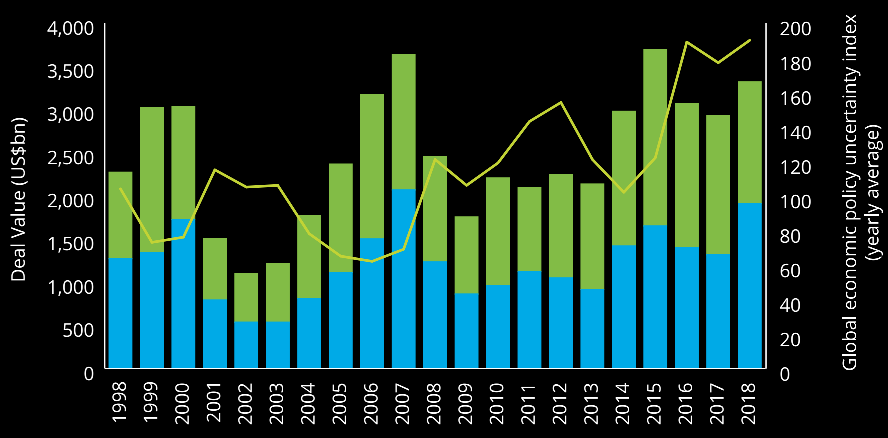
At the same time, the momentum created over the last five years will not simply evaporate. Indeed, corporate cash reserves remain at record levels as companies have tapped into debt markets to raise record levels of M&A financing, while asset price readjustment has led to a more realistic valuation environment.

The US M&A market in particular is expected to grow on the back of favourable tax reforms, while Japan is filling in the gap left by China in cross-border deals. Private equity had its best year in 2018 since the financial crisis and activist hedge funds have emerged as major global players in M&A markets as they are using their significant firepower to agitate for non-core divestments. The unrelenting pace of innovation is driving companies to acquire disruptive technologies and take advantage of opportunities arising from cross-industry convergence. We estimate that since 2015 companies have spent $877 billion on acquiring such capabilities.

M&A is inherently a long-term decision, so while current conditions could prompt caution, we do not expect dealmakers to become dormant. Instead we expect greater emphasis on creating value from deals and this means expending more effort in mitigating risk, undertaking thorough diligence, reassessing business portfolios, pursuing rapid turnaround interventions and optimising the integration process.

Headwinds – Economic and Political Uncertainty

M&A markets react to uncertainty



H1 M&A value H2 M&A value Global economic policy uncertainty index (yearly average)

Source: Deloitte analysis, Policy Uncertainty Index

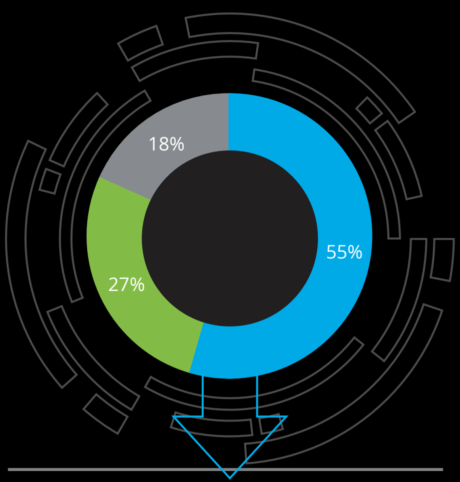
Deloitte Perspective

- M&A markets are driven by sentiment and they react to uncertainty. There is typically a lag correlation of 6-12 months between economic policy uncertainty index and M&A.
- 2018 ended with the economic uncertainty index hitting new highs – concerns cover US-China trade wars, Brexit, domestic slowdown in China all point towards a more cautious M&A market in 2019.
- Periods of economic downturn are characterised by subdued stock markets, a fall in deal P/E multiples and a slowdown in mega-deals.
- During downturns, typically more sector consolidation deals come to market and we expect an increase such deals in the coming months.
- Non-core divestments should also be accelerated whilst markets and multiples remain relatively buoyant.

Headwinds – Regulatory pressures

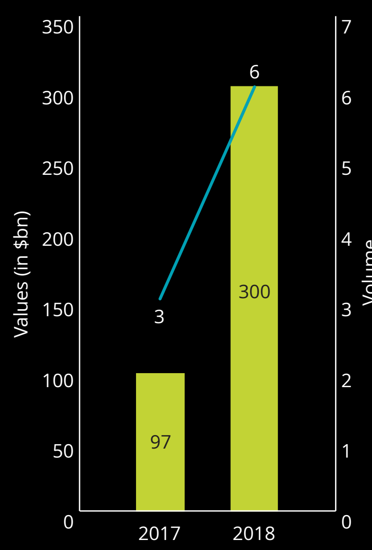
Greater regulatory scrutiny is leading to increase in withdrawn deals

Withdrawn mega-deals rationale (2018)



- Political/Regulatory pressure
- Target Rejected
- Voluntarily withdrawn

Mega-deals withdrawn due to political/regulatory pressure



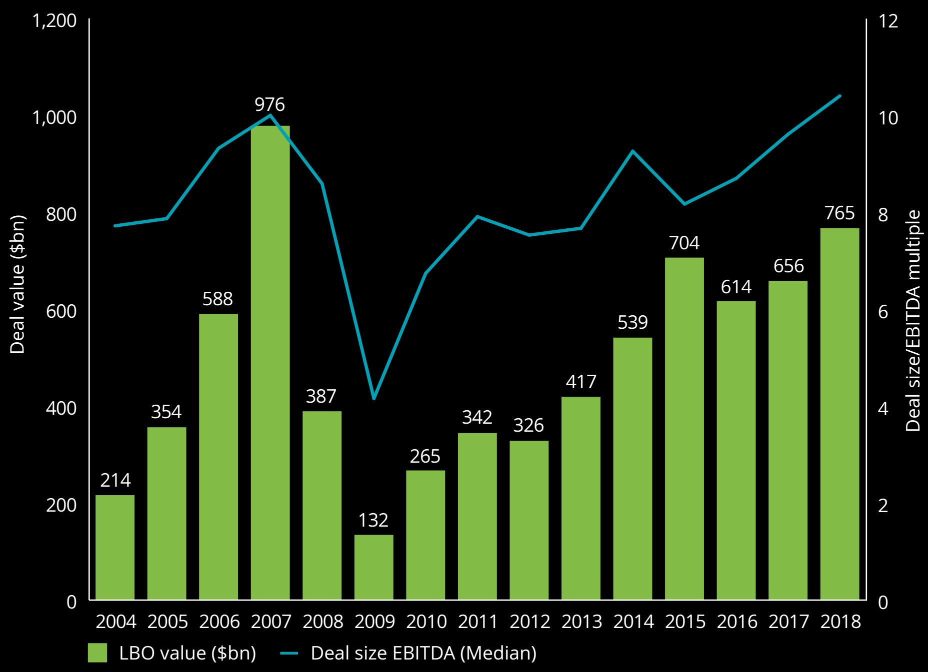
Deal Values ($bn) Deal Volume

Deloitte Perspective

- The growth in mega-deals means that companies have to secure regulatory approvals from dozens of countries before they can close deals.
- The tightening of regulatory regimes around the world, coupled with political pressures and protectionist instincts, means more deals are getting withdrawn.
- Last year 55% of withdrawn deals were due to political and regulatory pressures amounting to $300 billion worth of deals.
- Companies should expect more scrutiny from regulators and politicians. In order to alleviate deal risks, they need to consider detailed regulatory risk impact reviews and other measures before they initiate deals.

Tailwinds – Private Equity

Private Equity expected to be a major force in M&A markets in 2019



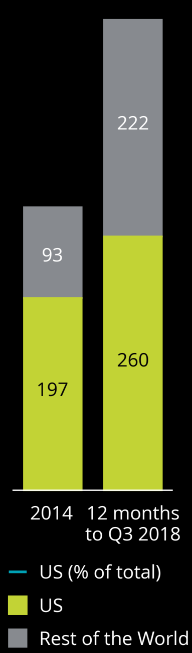
Deloitte Perspective

- The private equity sector is sitting on $1.1 tn worth of dry powder and in 2018 it concluded $765 billion worth of deals, while the median EV/EBITDA has ticked up to 10.4x, the highest level since 2007. In addition a third of the PE deals last year were secondary buyouts, the highest proportion since 2006.
- There has been an increase in platform and add-on deals, suggesting that PE firms are playing the role of industry consolidator and using the economies of scale and investment in technologies to drive down costs, increase efficiencies and create value.
- This presents opportunities for corporates to off-load non-core assets to PE firms that are following platform strategies and generate capital for growth investments.

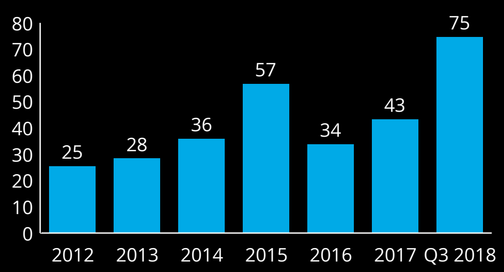
Tailwinds – Activism

Activist investors have emerged as major influencers in corporate M&A decisions and they are increasingly going global

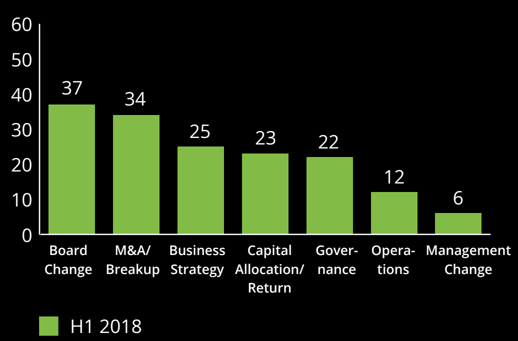
Activist campaigns US vs RoW



Activist investors funds deployed, $bn



Top demands of Activist Investors, % of campaigns



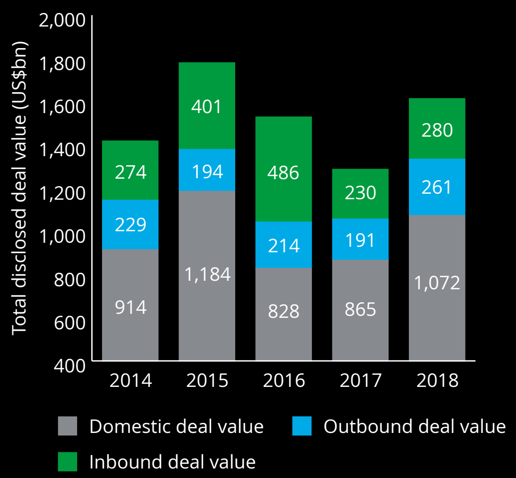
Deloitte Perspective

- Activist investors have invested nearly $300 billion in campaigns. While US companies remain their key target market, in recent years the share of global campaigns has increased from 31% in 2014 to 46% in 2018 led by growth in UK, Canada and Japan.
- M&A is a high activist priority both in terms of promoting spin-offs, and in blocking high profile mergers. Activism activity shines a spotlight on the workings of the board and can often result in public showdowns.
- Boards need to understand the motivations of activists and take pre-emptive actions. This means taking difficult decisions related to financial and operational performance and take concrete steps, including divesting non-core assets to improve shareholder returns.

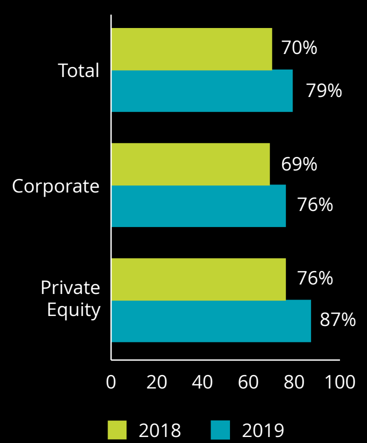
Tailwinds – US market

US is expected to be a dominant force in M&A markets in 2019

US M&A



Percentage of organizations that expect an increase in the average number of deals



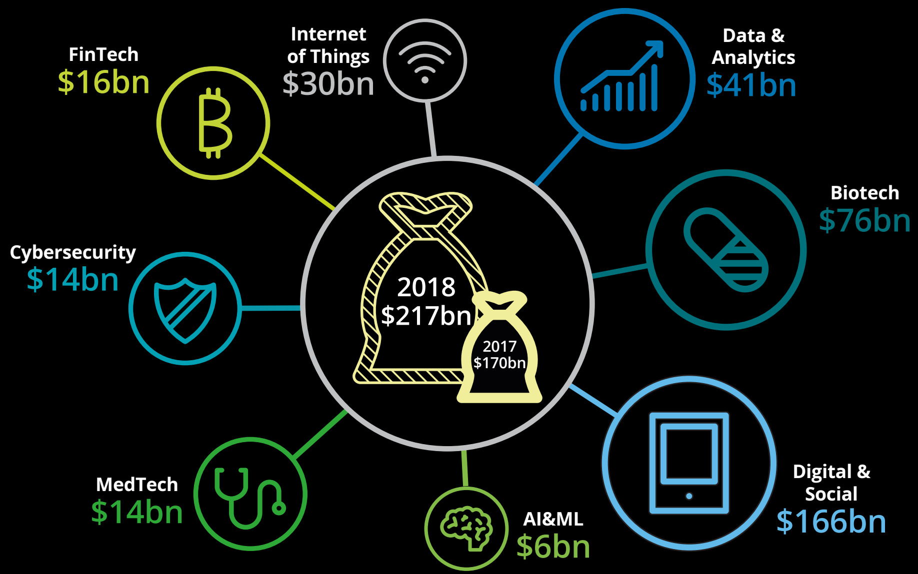
Source: The state of the deal: M&A trends 2019, Deloitte

Deloitte Perspective

- The US economy is in good shape and is expected to grow in 2019. Yet there are clouds on the horizon, particularly the potential for a fully-fledged US-China trade war and the wider economic impact of US government shutdowns.
- However, dealmakers remain optimistic and US companies were involved in $1.6 trillion worth of deals. The Deloitte US M&A Survey shows that 79% of respondents expect the number of deals they close in the next 12 months to increase.
- This optimism is fuelled by US tax reforms, a favourable US regulatory climate and growing cash reserves. Dealmakers place emphasis on traditional customer base expansion and diversification of products suggesting that domestic consolidation could be a key driver for M&A in 2019.

Tailwinds – Disruption

Disruptive M&A is a key growth area



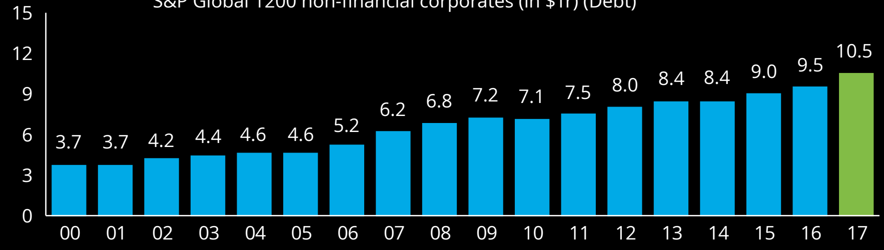
Deloitte Perspective

- Disruptive M&A is a key growth area and last year companies spent $217 billion on acquiring disruptive technologies and business models - an increase of 28% over previous year.
- Since 2015, companies have spent $877 billion on such acquisitions.
- While Digital and Analytics are the largest segments, there has been a sharp increase in Fintech, Cyber and Healthtech deals and we expect these to grow in 2019.
- Such disruptive deals are inherently complex: we recommend a significant rethink at every stage, from deal origination in major innovation eco-system hubs through to undertaking diligence on emerging areas like deep technology and cyber and post deal value creation that involves cultural assimilation of such start-up companies.

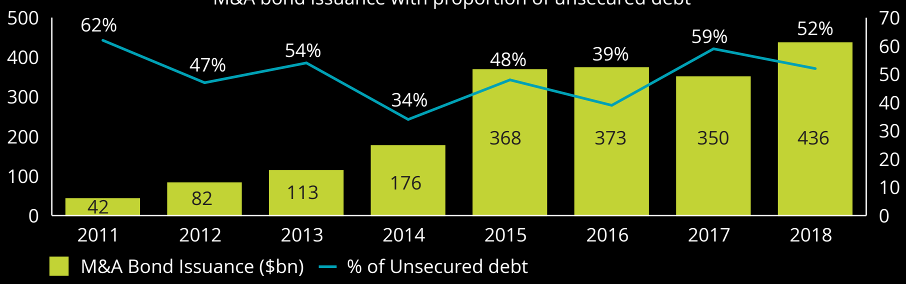
Implication for Debt markets

Economic uncertainty has an impact on debt markets and companies should take this into consideration while planning M&A financing

S&P Global 1200 non-financial corporates (in $Tr) (Debt)



M&A bond issuance with proportion of unsecured debt

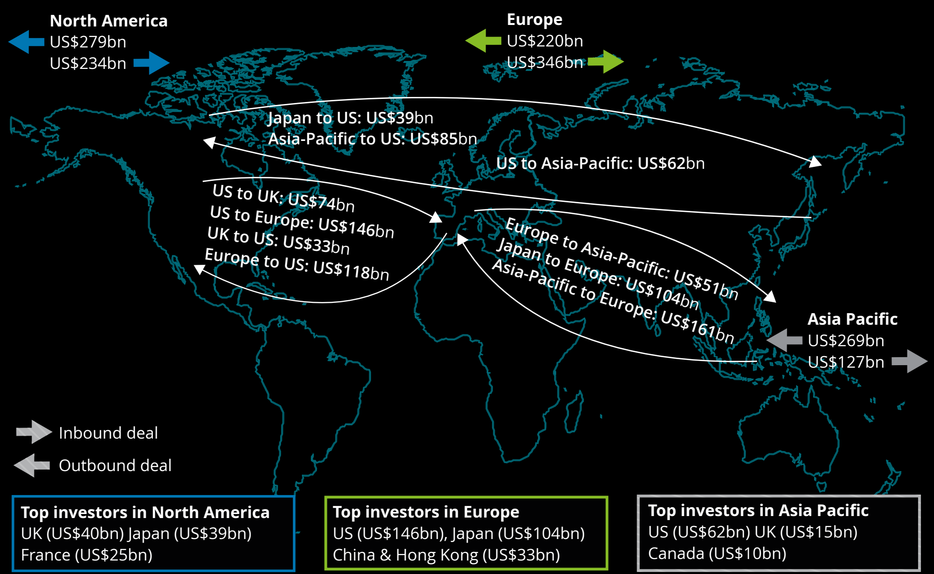


Deloitte Perspective

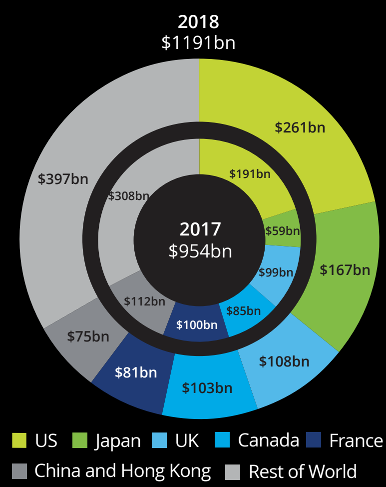
- Over the last 10 years, companies took advantage of ultra-low interest rates to raise cheap debt and balance sheet leverage grew from $6.2 trillion in 2007 to $10.5 trillion in 2017, but the economic headwinds are promoting calls from investors for the corporate sector to deleverage.
- Looking ahead, US Federal Reserve has started taking a dovish stance and this could mean cost of capital remains close to historic lows.
- The widening yields in alternative asset classes will push yields up in the debt markets. We expect "A" rated assets to have small upticks in cost of capital, while the impact on "BBB" and below could be more pronounced.
- Companies raised a record $436 billion in M&A financing from bond markets in 2018. We expect it to continue in 2019, however borrowers need to be mindful of the economic headwinds and need to demonstrate robust financial plans while raising debt.

Implication for Cross border

Despite the dip in Chinese outbound, $1.2tn worth of cross-border were announced in 2018, an increase of 25% over the previous year and this was due to strong deal flow from US and Japan. The US-Europe deal corridor was the most active with $264bn worth of deals and we expect this to remain the dominant corridor in 2019

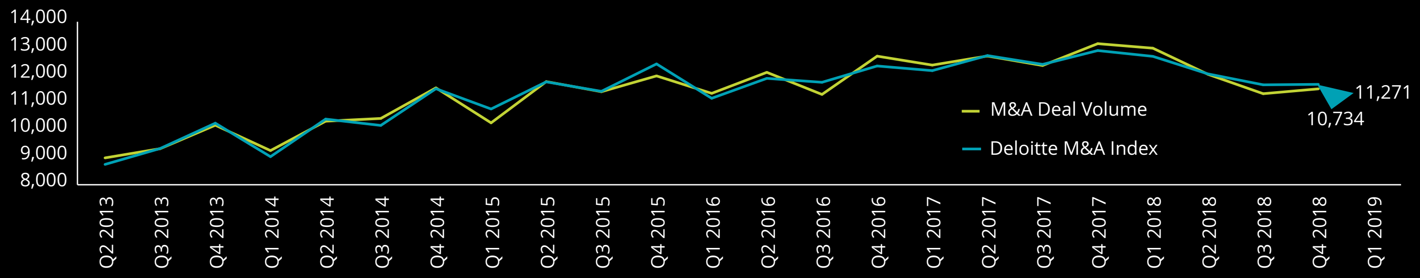


Cross-border M&A by top investors

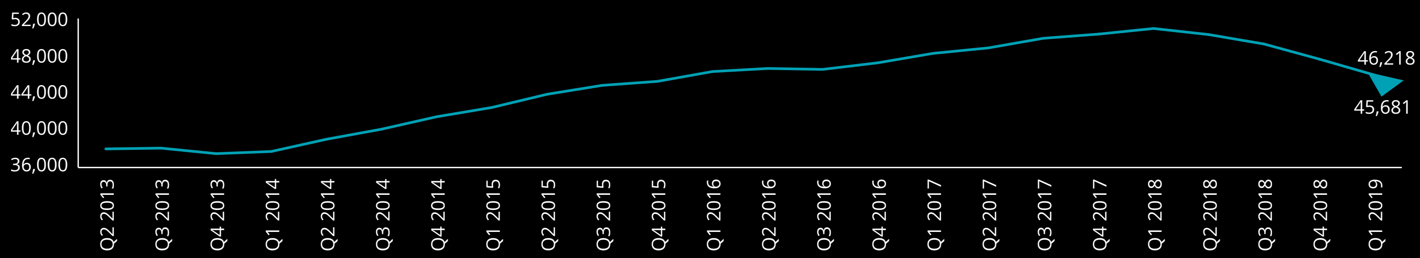


Deloitte M&A Index Prediction

In 2018, we saw the first y-o-y decline in volumes since 2014. We expect this slowdown to continue and the Deloitte M&A Index predictive analytical model forecasts a first quarter decline in M&A volumes between 4-7% over the previous quarter



Global M&A LTM chart



M&A in numbers

Economic and Political Uncertainty

341bps

the **economic policy uncertainty index** hit record highs towards late last year and continues into 2019

M&A Debt markets

$436bn

a record level of M&A financing was raised from the **bond markets** in 2018

Regulatory pressures

$300bn

worth of **mega-deals** were withdrawn due to regulatory or political pressure, the highest since 2016

Activist Investors

46%

of the campaigns launched in 2018 were global, up from 31% in 2014, with significant **growth** in UK, Canada and Japan

Private Equity

$765bn

worth of deals were done by **private equity** in 2018, the highest levels since 2007

Disruptive M&A

$217bn

was spent by corporates in 2018 to acquire disruptive **technologies**, the highest on record and up by 28% from the previous year

Cross-border deals

$1.2tn

of cross-border deals were announced in 2018, up by 25% over the previous year and this was due to **strong outbound deal flow** from US and Japan

US M&A Market

79%

of survey respondents in our US M&A Survey expect the number of deals they close in the next 12 months to be **greater** than last year

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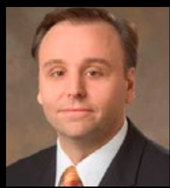

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