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The Deloitte

M&A Index Q3 2014

Rising 'animal spirits' continue to stoke M&A activity

Key points

- Following the sharp rebound in deal volumes in Q2, Deloitte forecasts a continued uptick for Q3 2014, bolstered by strong economic results and renewed market confidence.
- We expect global deal volumes to reach around 8,350 by the end of Q3 2014, up 9% over the same period in 2013.
- The IPO boom continues and in H1 2014 companies have raised proceeds of $103 billion which is a 20 per cent increase over the same period in 2013. However, our analysis shows IPO proceeds earmarked for investment in growth are declining, which may prompt closer investor scrutiny.
- The animal spirits are spilling over to M&A markets and we are seeing the return of hostile bids.

Contacts

Jean François Lagassé
Managing Partner,
Corporate Finance
+41 58 279 8170
jlagasse@deloitte.ch

Konstantin von Radowitz
Partner, M&A Transaction Services
+41 58 279 6457
kvonradowitz@deloitte.ch

Dr. Philipp Merkofer
Manufacturing Research,
Deloitte Insight
+41 58 279 6046
pmerkofer@deloitte.ch

Figure 1. The Deloitte M&A Index

About the Deloitte M&A Index

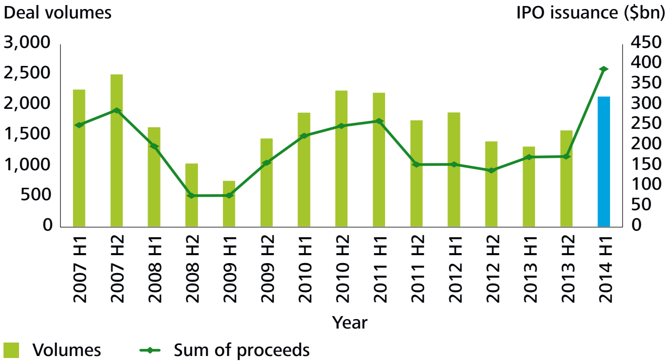
The Deloitte M&A Index is a forward-looking indicator that forecasts future global M&A deal volumes and identifies the factors influencing conditions for dealmaking. The Deloitte M&A Index has an accuracy rate of over 90% dating back to Q1 2008.

Factors influencing M&A in Q3 2014

The IPO boom continues…

The IPO market continues to perform strongly underlining the continued market confidence while a number of high profile listings are still due to take place this year across a number of sectors. Year to date, over 700 companies have come to market globally totalling 53% of 2013 volumes, the highest recorded first half IPO volumes since 2011. Companies have raised proceeds of $103 billion which is a 20 per cent increase over the same period in 2013.

Figure 2. Global IPO volume and issuance ($bn) (H1 2007 – H1 2014)



Source: Thomson Reuters; Deloitte analysis

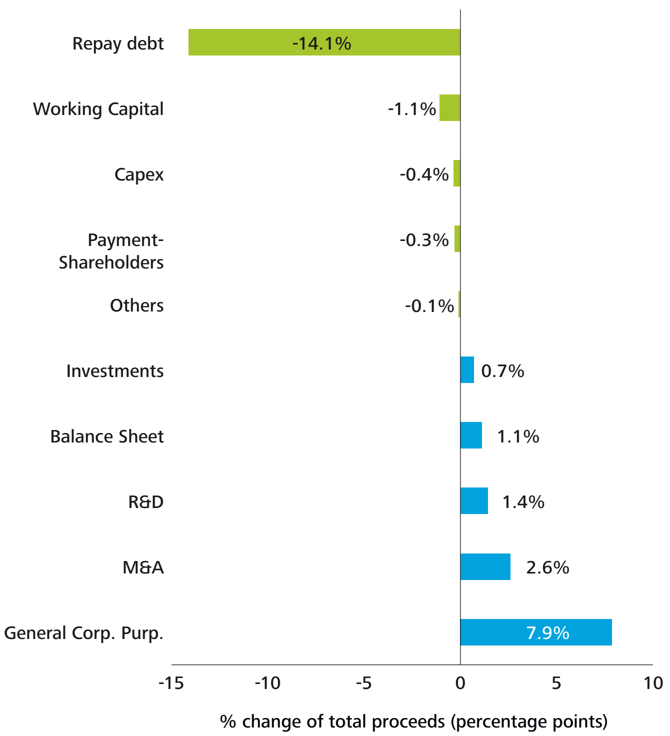
…however, only small amounts of the IPO proceeds are being channelled towards growth

An interesting feature of the IPO surge in 2014 is that only a modest amount of the proceeds are being channelled towards growth. When we analysed the disclosed use of the proceeds, we observed that in 2014 only 14.5% is earmarked for capex activities, 1% for working capital and 8% for future M&A activities. In addition, we found nearly 34% of the proceeds were channelled towards general corporate purposes, an 8% increase over 2013. It seems companies are taking advantage of the favourable conditions to raise equity, but have not yet decided how they want to use the proceeds.

However, there are significant variations across geographies. Companies listing in Asia-Pacific have earmarked nearly 37% for capex, as compared to 21% by North American companies and a meagre 4% by European companies. On the other hand, European companies have earmarked around 11% for M&A activities, compared with just 0.4% for North American companies.

With recent turbulence in the post-IPO performance of some companies, as well as some withdrawals, we expect investors may require companies to show greater transparency and clarity on how they plan to use proceeds to fund growth.

Figure 3. YoY percentage change in IPO proceeds (2013 v 2014)



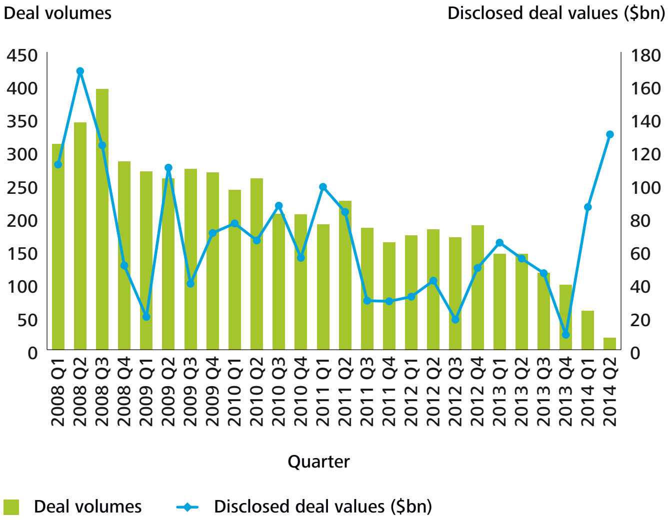
Source: Thomson Reuters; Deloitte analysis

Factors influencing M&A in Q3 2014

Withdrawn deals

The M&A market saw $216 billion of withdrawn deals within the first six months of the year. Deloitte estimates that on average around 3% of deals are withdrawn each year and 2014 is no different. The key difference this year is that a handful of high profile deals account for the majority of the withdrawn deal values. For instance, one high profile pharmaceutical deal alone accounts for 43% of total withdrawn deals by value.

Figure 4. Withdrawn deal volumes and disclosed deal values ($bn) (Q1 2008 – Q2 2014)

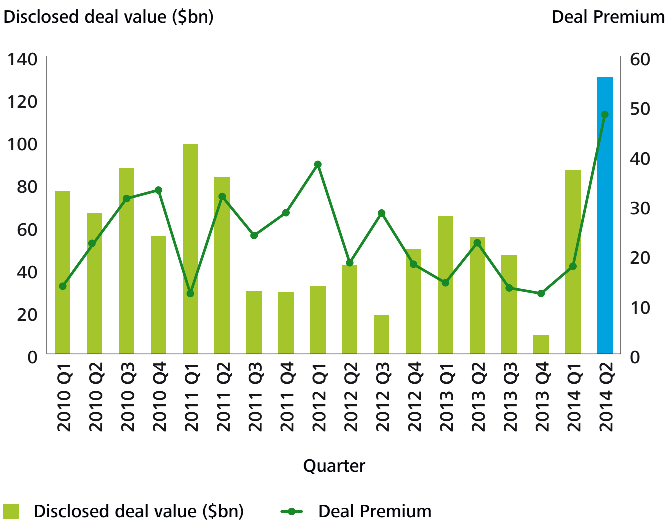


Source: Thomson Reuters; Deloitte analysis

Animal spirits

Such high profile deal withdrawals also point to a trend of rising hostile bids. It is indeed striking that of the deals that were withdrawn this year, the average premium offered was 27x compared with the average deal premium of just 13x for announced deals. Looking ahead, it seems likely that getting deals to completion, particularly for larger deals, is going to get more complex due to increased political and regulatory scrutiny, wider stakeholder interests and rising valuations. Going hostile is an expensive alternative and fraught with problems, but it also indicates that animal spirits are returning.

Figure 5. Disclosed deal values and deal premiums of withdrawn deals (Q1 2010 – Q2 2014)



Source: Thomson Reuters; Deloitte analysis

Corporate barometer

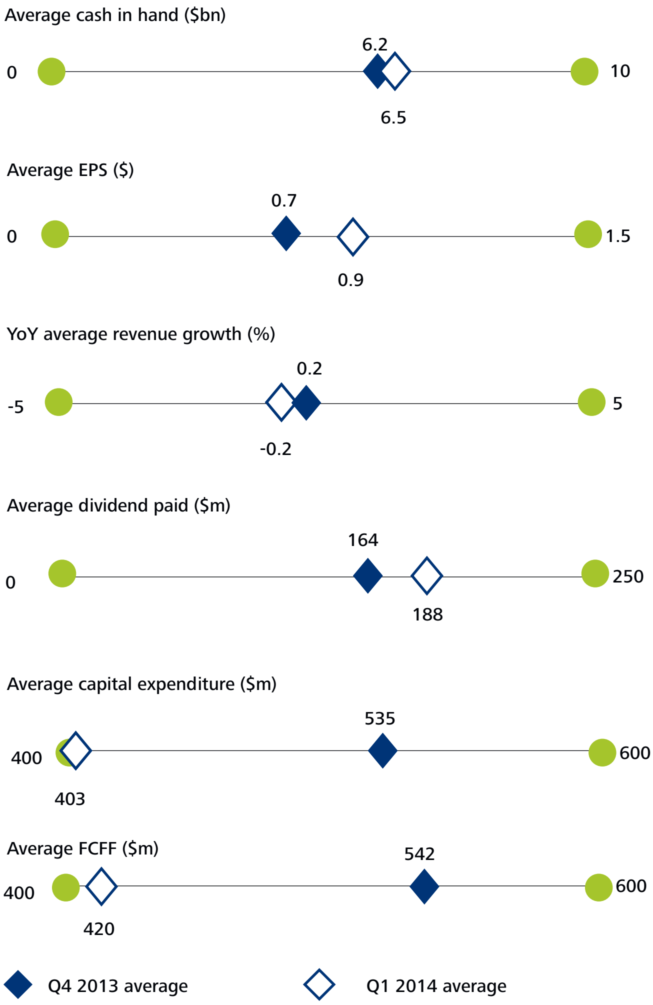
Analysis of the S&P Global 1200 company fundamentals yields four key insights. First, average revenue growth fell from 0.2% in Q4 2013 to -0.2% in Q1 2014 with corporates struggling to keep pace with analyst earnings estimates.

Second, overall average cash in hand increased from $6.2 billion in Q4 2013 to $6.5 billion in Q1 2014. However, average cash held by US corporates fell by $209 million per company while European and Asia-Pacific corporates increased their cash reserves by $372 million and $1.6 billion respectively. The drop in US cash reserves can be attributed both to severe weather disrupting output and a two-speed recovery in the M&A markets, with US companies leading the way.

Third, average dividend payments increased from $164 million in Q4 2013 to $188 million in Q1 2014 continuing the trend of returning cash to shareholders.

Finally, average capital expenditure saw a sharp fall from $535 million to $403 million after four consecutive quarters of increased investment. Much of this fall can be attributed to energy and resources companies shrinking their capital intensive projects.

Figure 6. Company fundamentals (S&P Global 1200) (Q4 2013 vs. Q1 2014 average)



Source: Bloomberg; Deloitte analysis

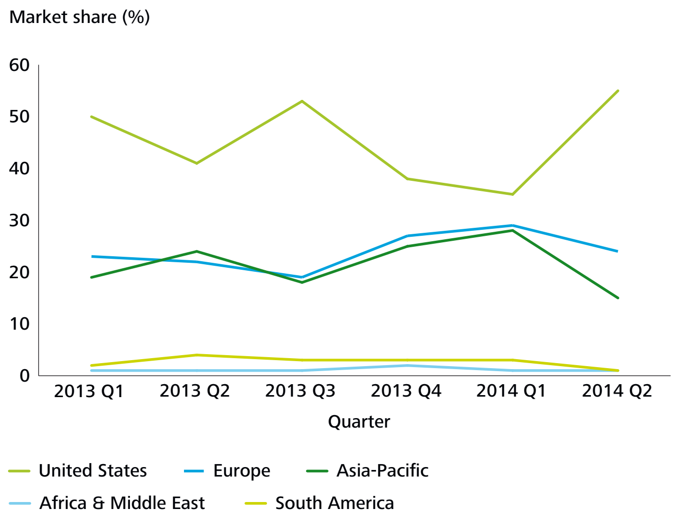
Geographies

Two-speed M&A recovery

Since Q1 2013, North America has been gaining M&A market share over other geographic regions. Their market share has increased from 37% of involvement in global M&A deal volumes to 43% in Q2 2014. North American firms have also been involved in 58% ($427 billion) of all disclosed deals by value in Q2 2014.

Despite the severe weather related setbacks which saw the US economy shrink 2.9% in the first quarter, US companies are at the forefront of dealmaking and have record levels of cash held overseas. Specifically, US acquisitions account for 55% ($404 billion) of all disclosed deal values in Q2 2014, more than any other geographic region.

Figure 7. US dealmaking versus other geographic regions (Q1 2013 – Q2 2014).



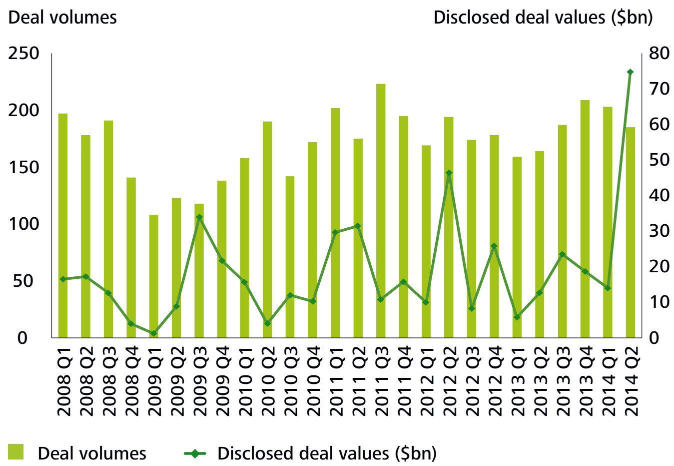
Source: Thomson Reuters; Deloitte analysis

Europe a target for US companies

After years of tepid growth, European companies appear sub-scale compared to their peers and may now be attractive M&A targets for global competitors. US companies are particularly acquisitive; in Q2 2014 they recorded the highest deal values into Europe since Q2 2012. Much of this increased deal activity can be attributed to the large cash reserves that US companies are holding overseas and, with high tax levies imposed on repatriating cash back to US, they have started spending it more aggressively in Europe. Many European countries have lower corporate tax rates than in the US making the prospect of tax inversion particularly attractive.

Year-to-date, US companies have spent $89 billion on European companies and we expect them to spend in excess of $150 billion on European deals this year.

Figure 8. US acquisitions into Europe (Q1 2008 – Q2 2014)



Source: Thomson Reuters; Deloitte analysis

Sectors

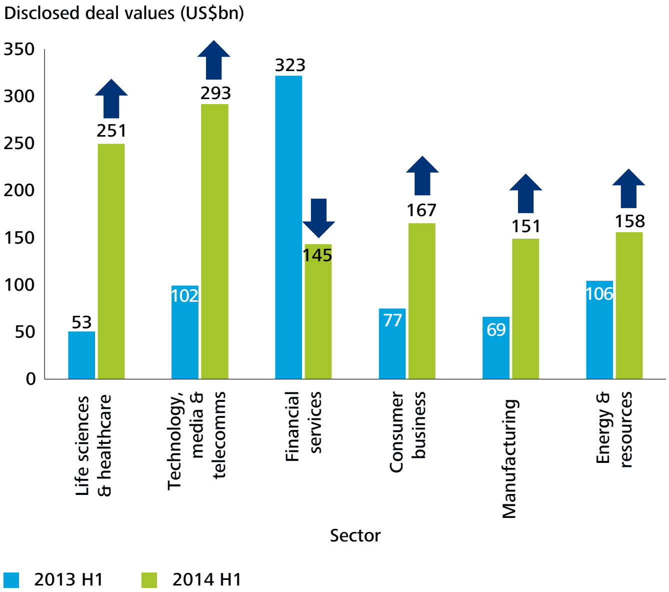
Positive signs of M&A recovery across sectors

M&A deal volumes and disclosed deal values have increased in every major industry sector except for financial services in H1 2014 compared to H1 2013, signalling a step-change in the M&A environment.

The biggest benefactor of increasing deal activity has been the TMT sector which has seen H1 2014 deal volumes increasing 18% year-on-year and disclosed deal values up 187%. The TMT sector is currently sitting on cash piles of over $1 trillion and continued M&A and consolidation is highly likely.

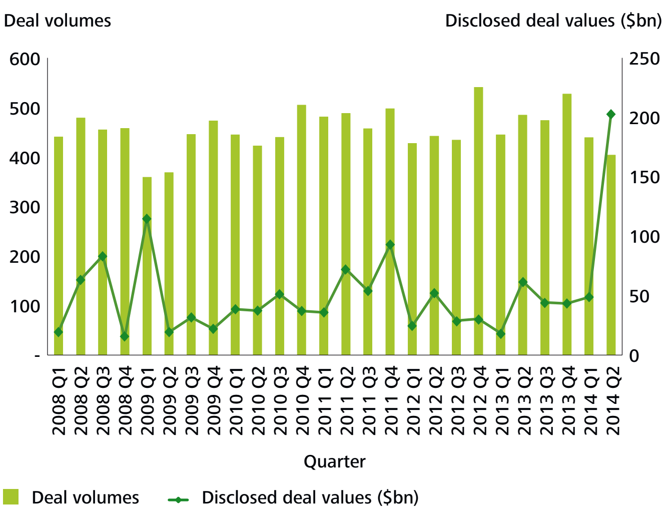
The life sciences and healthcare sector has seen a significant increase in dealmaking with disclosed deal values up 369% year-on-year. The patent 'cliff' is one of the primary drivers behind this surge. The top 12 pharmaceutical companies globally are due to be hardest hit and are expected to lose $50 billion of global sales.[1] Companies are also using M&A to focus on preferred therapeutic areas and are doing so through asset swaps, divestments of non-core businesses and partnerships.

Figure 9. Global deal values by sector (H1 2013 v H1 2014)



Source: Thomson Reuters; Deloitte analysis

Figure 10. Global deal values and volumes in life sciences and healthcare sector (Q1 2008 vs. Q2 2014)

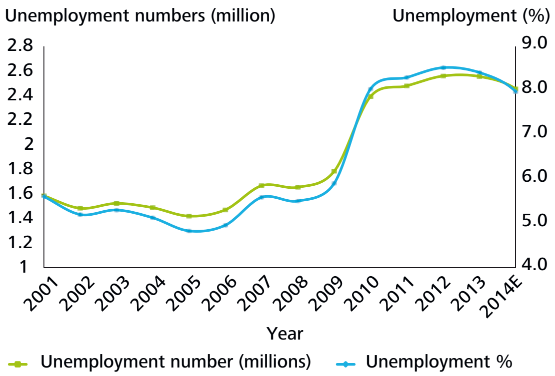


Source: Thomson Reuters; Deloitte analysis

1 Evaluate, Evaluate Pharma World Preview 2013

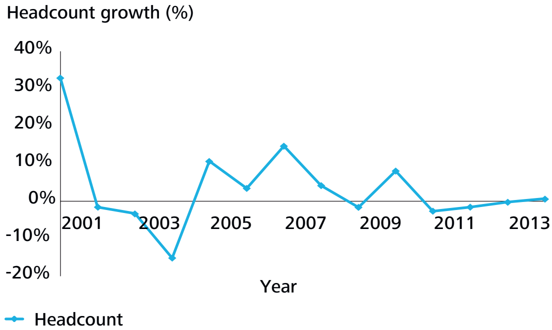
Charts we like

Figure 11. UK unemployment figures (2000 – 2014E)



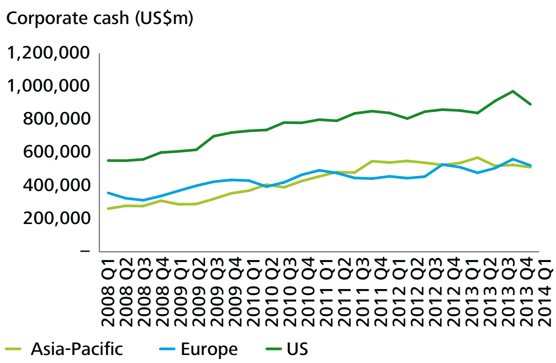
Source: Economist Intelligence Unit; Deloitte analysis

Figure 12. S&P Global 1200 headcount growth (2001 – 2014YTD)



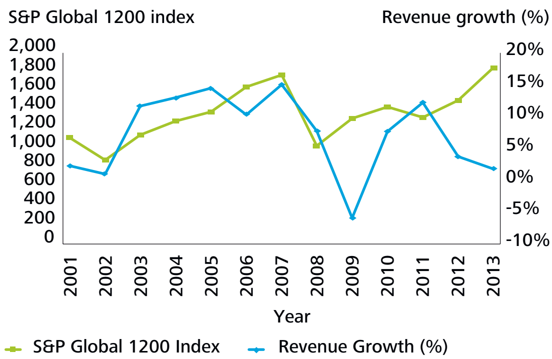
Source: Bloomberg; Deloitte analysis

Figure 13. S&P Global 1200 cash by geography (Q1 2008 – Q1 2014)



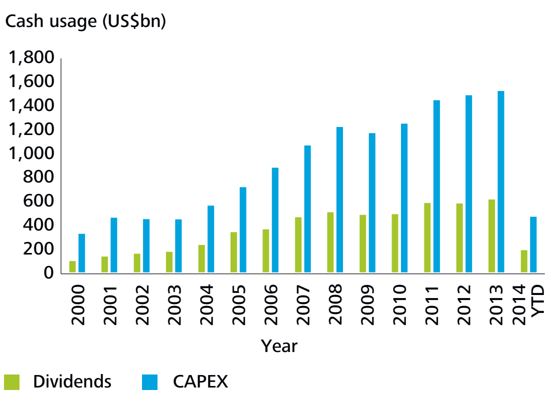
Source: Bloomberg; Deloitte analysis

Figure 14. S&P Global 1200 revenue growth vs. share price (2001 – 2013)



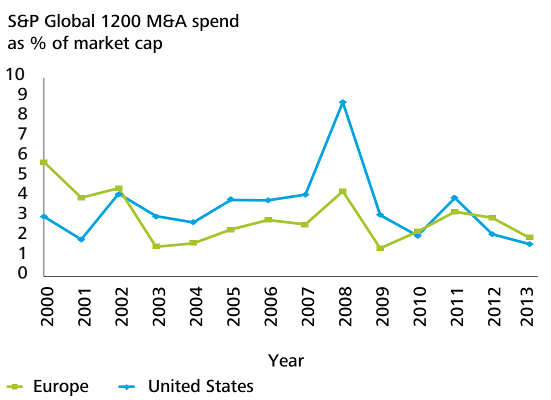
Source: Bloomberg; Deloitte analysis

Figure 15. S&P Global 1200 spend on dividends vs. capex (2000 – YTD2014)



Source: Bloomberg; Deloitte analysis

Figure 16. S&P Global 1200 M&A spend as % of market cap (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 Russell Shoult are the UK Deloitte Insight team for M&A, based in London.
Haranath Sriyapureddy, Abhimanyu Yadav and Sukeerth Thodimaladinna are M&A analysts in the Business Research Center at DTTL.

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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