The Deloitte

M&A *Index* Q3 2015

US companies leading surge in M&A

Key points

- The first half of 2015 has emerged as one of the strongest for M&A, with more than $1.8 trillion worth of deals announced globally, a 22% increase over H1 2014. US corporates are leading this surge fuelled by a strengthening dollar, low funding costs and strong earnings.
- Growth markets are making an impact and in 2014 for the first time outbound M&A from growth markets into G7 countries surpassed inbound M&A from the G7 into those markets, with China leading the way. The recent Chinese IPO boom is expected to boost M&A activity by publicly-listed companies.
- However, in Europe despite favourable credit conditions and strong corporate earnings, political and currency risks are weakening confidence among European companies.
- Taking these factors into consideration, the Deloitte M&A Index predicts that M&A activity in Q3 will remain at a similar level to Q2.
- We expect market conditions to remain favourable and boards to continue reorganising to pursue growth. Our analysis shows that over the last six years, 63 of the FTSE 100 companies had replaced their CEO. A key aspect of this reorganisation is a shift towards CEOs whose skills could be more suited to pursuing growth and M&A opportunities.

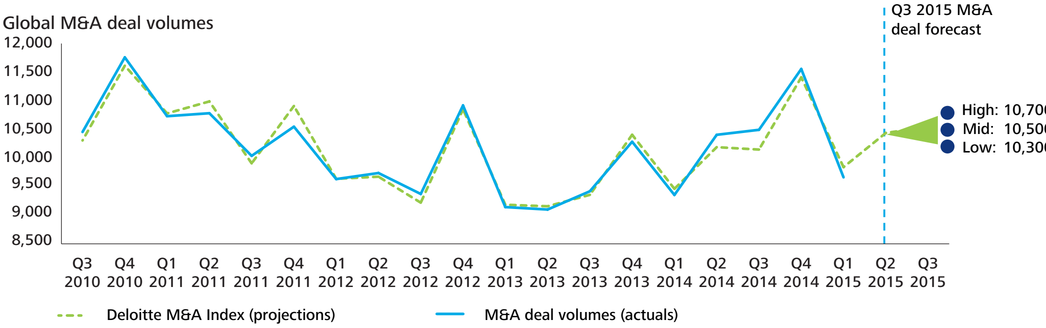
Contacts

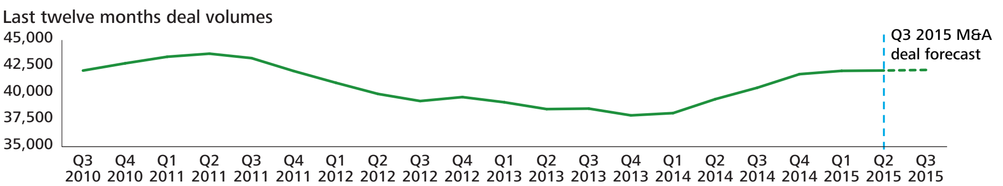
Jean François Lagassé
Managing Partner,
Financial Advisory
+41 58 279 8170
jlagasse@deloitte.ch

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 2015

Political and currency risks undermine European corporate confidence

The European Commission is forecasting 1.5 per cent growth in the euro area in 2015, the highest since 2011. This positive outlook is mirrored by strong corporate sector earnings that will further benefit from potential increases in exports due to the weakening euro.

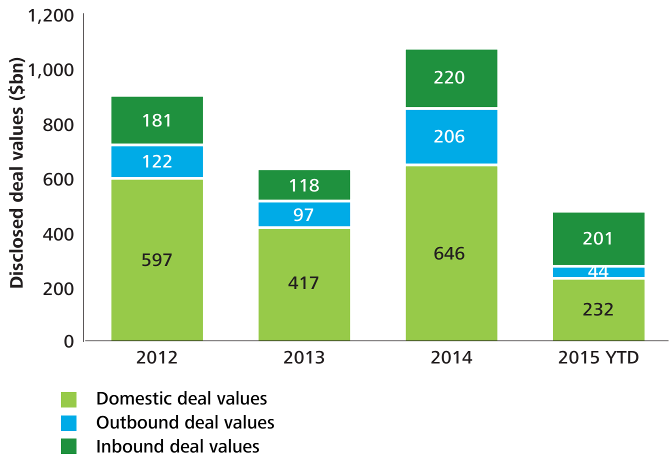
The European Central Bank's quantitative easing programme is resulting in a decline in yields of euro denominated bonds and an increase in asset valuations of European companies.

This in turn is prompting European businesses to sell to overseas acquirers. So far this year $201 billion worth of inbound deals have been announced, almost surpassing the $220 billion announced during the whole of 2014.

However, with the euro depreciating by 18 per cent against the dollar since the beginning of 2014, it has become more expensive for European companies to make overseas acquisitions. So far this year only $44 billion worth of outbound deals have been announced by European companies, much lower than the $206 billion in 2014.

Against this backdrop, political risks in Europe have also heightened, and together with currency pressures, are dampening corporate confidence for acquisitions.

Figure 2. Domestic and cross-border European M&A deal values ($bn), 2012-15 YTD*



*2015 YTD as at 23 June 2015
Source: Deloitte analysis based on data from Thomson One Banker

Factors influencing M&A in Q3 2015

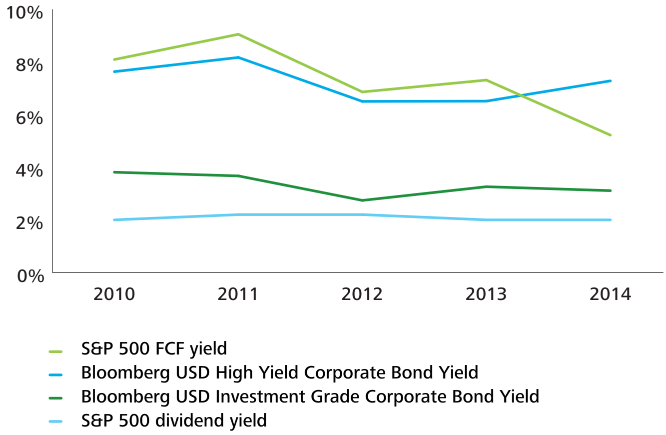
A surge in US M&A

In past editions, we highlighted that while global indices were hitting record highs, annual revenue growth for their constituent companies is challenged, putting CEOs under pressure from investors.

S&P 500 non-financial constituent companies had $1.62 trillion in cash reserves for the year 2014. The free cash flow yield for the S&P 500 was 5.22%, the dividend yield 2% and the Bloomberg USD corporate bond yield 3.11%. Current funding conditions and cash positions should give potential acquirers the confidence to do M&A, since they can fund acquisitions by borrowing at favourable rates and service debt payments using free cash flow.

There has also been a rise in activist shareholders, who are putting pressure on boards to pursue growth or give cash back to shareholders. Meanwhile some companies are taking more aggressive measures while pursuing M&A and we are seeing an increase in hostile deal announcements. So far this year $240 billion unsolicited deals have been announced globally, the highest levels since 2007.

Figure 3. S&P500 FCF and dividend yields and Bloomberg corporate bond yields, 2010-15 YTD



Cash reserves of non-financial constituents of the S&P500 ($bn), 2010-14

Source: Deloitte analysis based on data from Bloomberg

Factors influencing M&A in Q3 2015

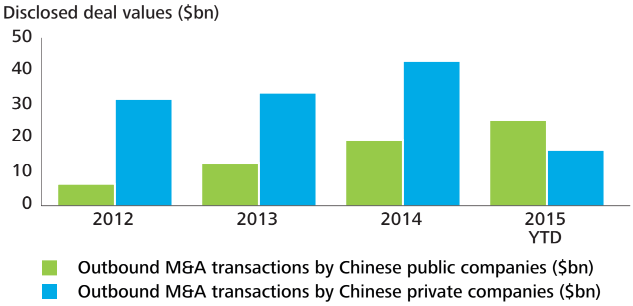
China's IPO boom could fuel M&A

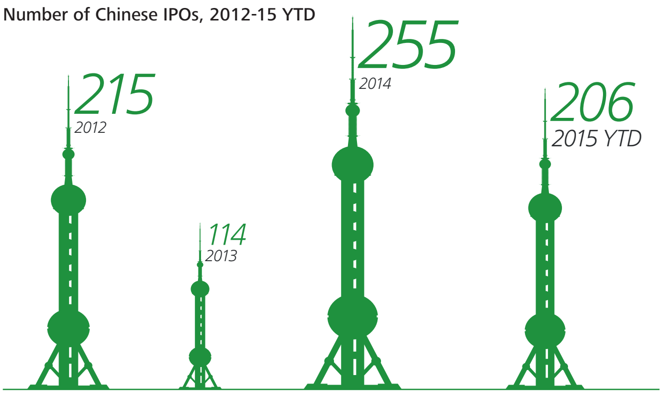
China is in the midst of an unprecedented IPO boom and recent developments such as the launch of the Shanghai-Hong Kong Stock Connect are creating windows for Chinese companies to tap into the institutional investor market.

Increasingly these companies are using the IPO proceeds to pursue their M&A ambitions. So far this year almost 40 per cent of international acquisitions were done by publicly-listed companies, the highest percentage for the last five years.

A slowing Chinese economy is spurring companies to seek growth through overseas acquisitions. Chinese companies have announced $42.4 billion worth of overseas deals, of which publicly-listed companies accounted for $25.6 billion, outpacing private sector companies for the first time.

Figure 4. Chinese outbound M&A deal values by status of acquirer, 2012-15 YTD





Source: Deloitte analysis based on data from Thomson One Banker

Spotlight on CEOs

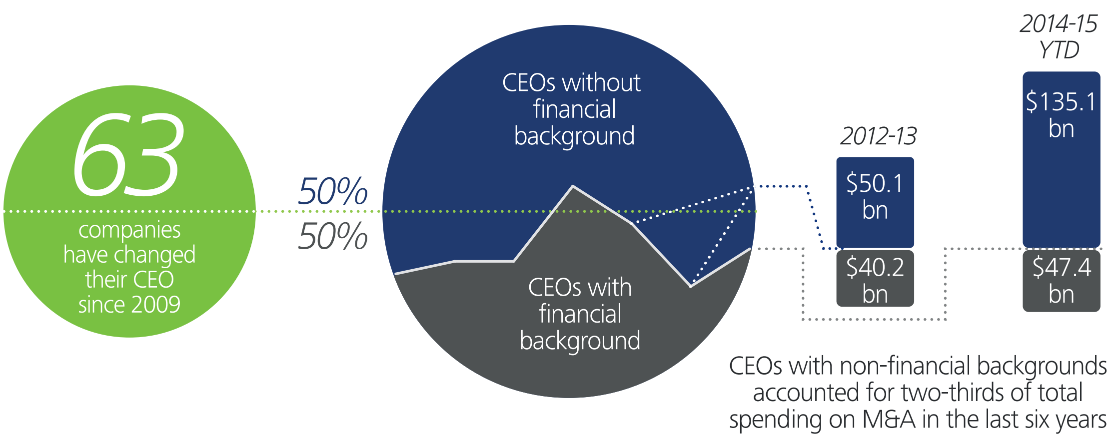
CEOs background and corporate appetite for M&A

One of the consequences of the global financial crisis was the realignment of many boardrooms. Deloitte analysis shows that since 2009, 63 of the FTSE 100 companies replaced their CEOs.

At the beginning of 2009, only 45 per cent of FTSE 100 CEOs had a financial background. This increased to 52 per cent in 2012 in the middle of the recovery when financial prudency was required. As market conditions started improving, CEOs with a more diverse set of skills were being recruited and CEOs with a financial background has fallen back to 47 per cent.

The changing skills of CEOs has had an impact on corporate attitudes towards M&A. In the last six years, FTSE 100 companies spent an estimated $430 billion on acquisitions, and the CEOs with a non-financial background accounted for $291 billion, which represents two-thirds of total spending.

Figure 5. Total M&A spending by constituents of FTSE100 ($bn) and background of CEOs of FTSE100 companies, 2009-15 YTD



Source: Deloitte analysis based on data from Thomson One Banker, Bloomberg and BoardEx

Spotlight on growth markets

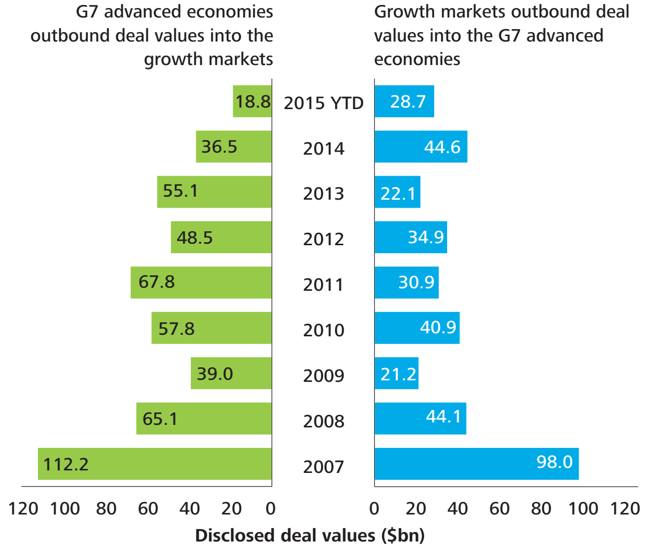
Rebalancing the M&A flows

In 2014, for the first time cross-border outbound M&A investment from growth markets into G7 countries exceeded G7 outbound M&A investment into growth markets. Last year growth market companies announced $45 billion worth of deals into G7 countries, whereas companies from G7 countries announced only $37 billion worth of M&A deals into growth markets.

This trend is continuing in 2015 and to date nearly $29 billion worth of deals have been announced by growth market companies in G7 countries, whereas only $19 billion of outbound deals were announced by G7 in growth markets.

While China is the most active growth market dealmaker, we can expect to see more deal flows from countries such as India, Mexico and Turkey in future. Growth markets will continue to offer growth prospects, such as ASEAN Economic Community (AEC) which aims to integrate the region economically and create the world's seventh largest economy.

Figure 6. M&A transactions flows – G7 vs growth markets ($bn), 2007-15 YTD



Note: The G7 comprises of Canada, France, Italy, Germany, Japan, UK and US. The growth markets are defined as: Brazil, China (incl. Hong Kong), Czech Republic, Egypt, Hungary, India, Indonesia, Malaysia, Mexico, Morocco, Peru, Philippines, Poland, Russian Federation, South Africa, Taiwan, Thailand, Turkey, Saudi Arabia, United Arab Emirates. We define growth markets as countries referenced in *The Economist* as emerging markets in 2012.

Source: Deloitte analysis based on data from Thomson One Banker

Corporate barometer

Analysis of S&P Global 1200 company data:

Average revenue growth fell from 0.3 per cent in the first quarter of 2014 to negative 6.2 per cent for the corresponding period of 2015.

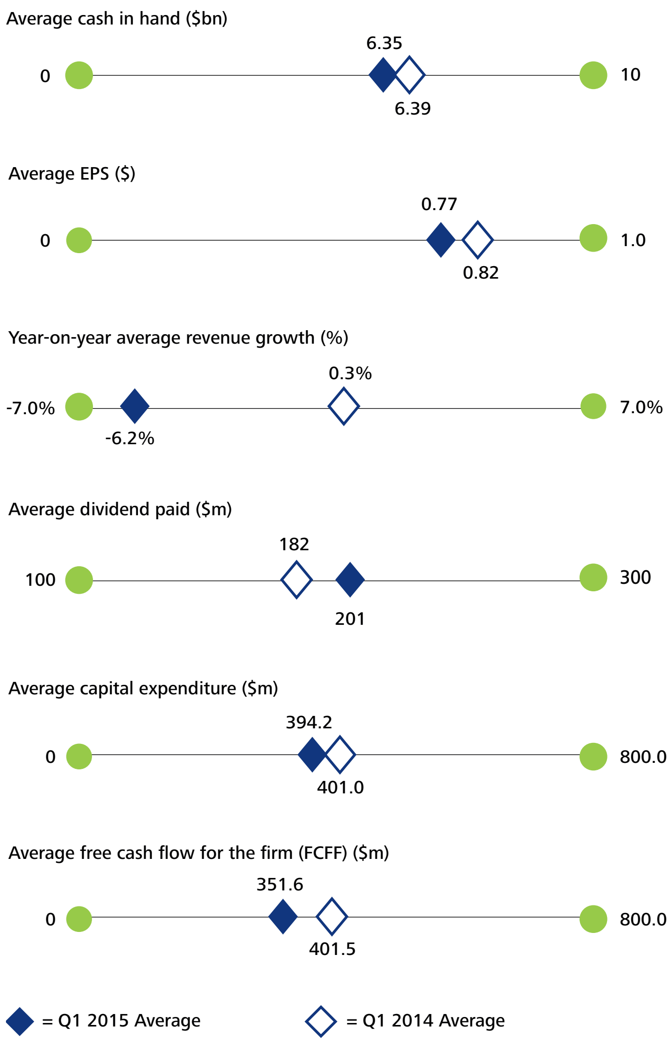
The average cash in hand per company decreased from $6.39 billion at the end of the first quarter 2014 to $6.35 billion at the end of the first quarter of 2015. The free cash flow for the firm (FCFF) across the S&P Global 1200 shows a similar pattern, averaging $401.5 million in Q1 2014 and $351.6 million in Q1 2015.

The average dividend payments per company increased from $182 million in Q1 2014 to $201 million in Q1 2015, continuing the trend of returning cash to shareholders.

The average EPS decreased from $0.82 in Q1 2014 to $0.77 in Q1 2015.

Finally, average capital expenditure per company fell slightly from $401 million to $394.2 million.

Figure 7. Company fundamentals, S&P Global 1200: Q1 2014 vs Q1 2015 average



Source: Deloitte analysis based on data from Bloomberg

Geographies

M&A trends in geographies

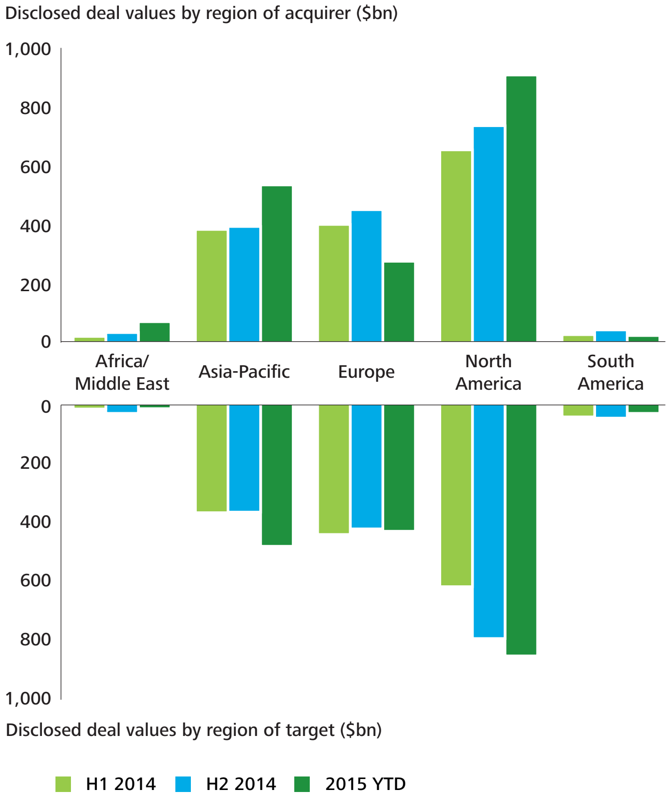
So far this year more than $1.8 trillion worth of deals have been announced, compared to $1.5 trillion in H1 2014. This is the result of a surge in dealmaking by North American companies, which accounted for 50 per cent of the announced deals globally. However, there has been a 6 per cent decline in global M&A volumes compared to H1 2014.

There has also been a sharp pick up in Asia – so far $535 billion worth of deals have been announced by Asia-Pacific acquirers, compared to $384 billion in H1 2014.

Europe is fast becoming the preferred destination for inbound M&A investment. So far this year $433 billion worth of deals have been announced, of which $147 billion were from North American companies, representing 73 per cent of all cross-border investment into Europe.

In contrast, European companies have been less active as acquirers and have announced only $276 billion worth of deals, representing a global share of just 15%, which is down from 27% in 2014. European outbound M&A into North America has fallen dramatically and only $30 billion worth of deals have been announced so far in 2015 as compared to $156 billion for the whole 2014.

Figure 8. Global deal values by region of acquirer and target ($bn), 2014-15 YTD



Source: Deloitte analysis based on data from Thomson One Banker

Sectors

M&A sector trends

The surge in M&A has been led by the Life Sciences and Healthcare (LSHC) and the Telecoms, Media and Technology (TMT) sectors. In the TMT sector, $434 billion worth of deals have been announced, an increase of 44 per cent over H1 2014. TMT is followed by the LSHC sector, where $304 billion of deals have been announced, an increase of 37 per cent over first half of 2014.

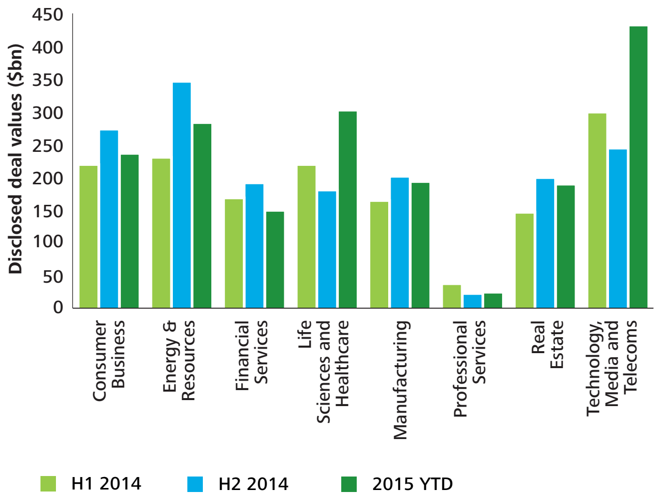
Spotlight on pharmaceutical M&A

The combination of challenging economic conditions and sector dynamics is driving the surge in healthcare M&A. Some of the key drivers include the rebuilding of drug portfolios and the disposing of non-core operations. In addition, companies are consolidating to mitigate the expected cost pressures from governments and insurers and improve their operational efficiency.

So far in 2015, $200 billion worth of acquisitions have been announced involving pharmaceutical companies, the highest H1 figure for well over a decade. This includes two hostile deals worth $77 billion announced earlier this year.

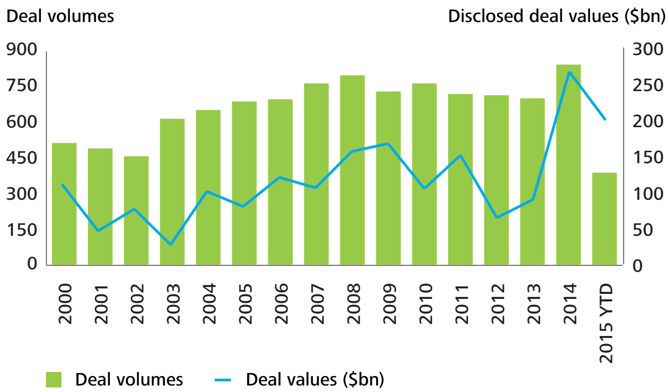
The current M&A wave is likely to continue until major pharmaceutical companies fully align their portfolios and trim their product lines. Once the cycle is complete, we expect companies will pursue smaller deals with more innovative deal structures such as venturing to tap into the opportunities brought by the convergence in some parts of the healthcare, insurance and technology sectors.

Figure 9. Global deal values by target sector ($bn), 2014-15 YTD



Source: Deloitte analysis based on data from Thomson One Banker

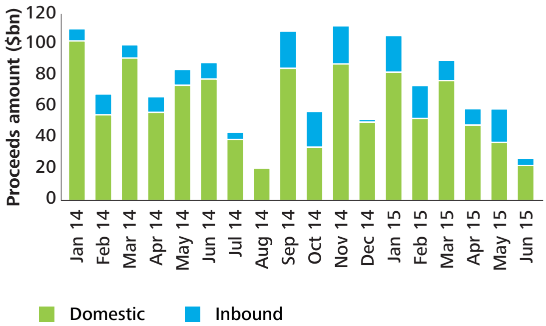
Figure 10. Total volumes and values of M&A involving pharmaceutical companies ($bn), 2000-15 YTD



Source: Deloitte analysis based on data from Thomson One Banker

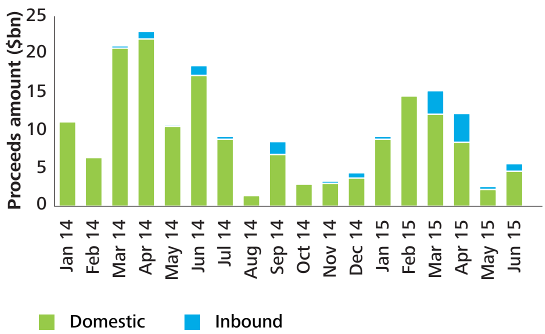
Charts we like

Figure 11. Euro denominated investment grade bond issuance: European domestic and inbound ($bn), 2014-15 YTD



Source: Deloitte analysis based on data from Thomson One Banker

Figure 12. Euro denominated high yield bond issuance: European domestic and inbound ($bn), 2014-15 YTD



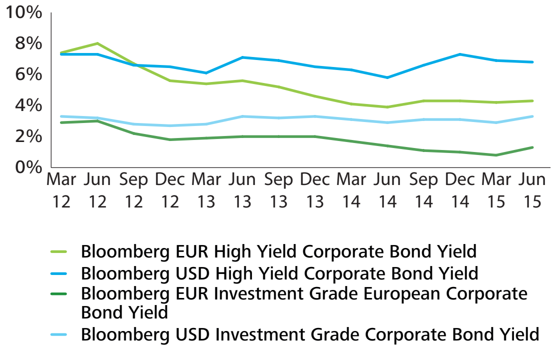
Source: Deloitte analysis based on data from Thomson One Banker

Figure 13. Total volumes and disclosed deal values of unsolicited offers, 2007-15 YTD*

*2015 YTD as at 25 June 2015

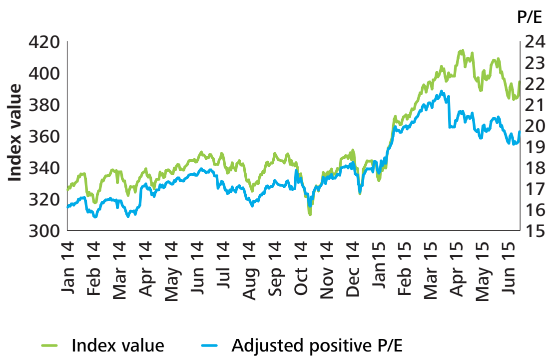
Source: Deloitte analysis based on data from Thomson One Banker

Figure 14. Yields to maturity of investment grade and high yield corporate bonds in euros and dollars (%), 2012-15 YTD



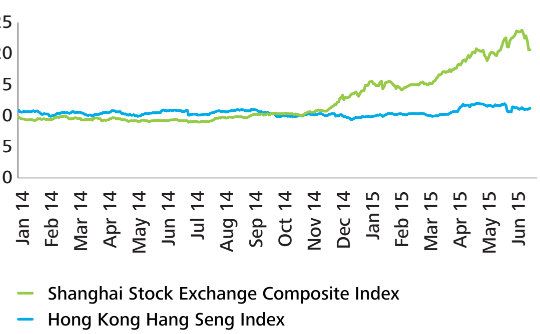
Source: Deloitte analysis based on data from Bloomberg

Figure 15. STOXX® Europe 600 Index and P/E performance, 2014-15 YTD



Source: Deloitte analysis based on data from Bloomberg

Figure 16. Shanghai Stock Exchange Composite Index and Hong Kong Hang Seng Index price to earnings multiples



Source: Deloitte analysis based on data from Bloomberg

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. M&A volumes include M&A transactions for majority/remaining interest, minority stake purchases and leveraged buyouts. 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, based in London. Haranath Sriyapureddy, Sukeerth Thodimaladinna and Jugal Rajeshkumar Limbachiya are research analysts in the Client Research Center, at DTTL. The team would like to thank Abhimanyu Yadav for his contribution in production of the M&A Index.

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.

Designed and produced by The Creative Studio at Deloitte, Zurich. 45953A