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M&A *Index* H1 2015

The deal momentum continues into 2015

Key points

- In our previous reports we highlighted that globally corporates are in a strong position to pursue M&A. They have rebuilt their balance sheets, accumulated record levels of cash and stock market rallies have boosted their valuations.
- Our projections of the M&A volumes show that the momentum that started last year is continuing in 2015. Despite the expected dip from Q4 to Q1, the Deloitte M&A Index forecasts deal volumes for H1 2015 are likely to be 8% higher than for the same period in 2014. So far this year $583 billion worth of deals have been announced, surpassing the $563 billion announced in Q1 last year.
- M&A volumes are being influenced by factors such as the decline in oil prices, appreciation of the dollar, the rise of China as a global player in M&A and pressure from investors to focus on top-line growth. The diverging growth trajectories between the US and other economies are opening 'deal corridors' for US corporates to acquire attractively priced assets abroad. We estimate nearly one in four dollars spent on deals in Europe last year was either from the US or Asian countries such as China.
- In addition to the UK, six other European nations are planning to hold elections in 2015. The build up to US elections next year will also start in the coming months. These events could have a temporary impact on the pick-up in deal momentum.

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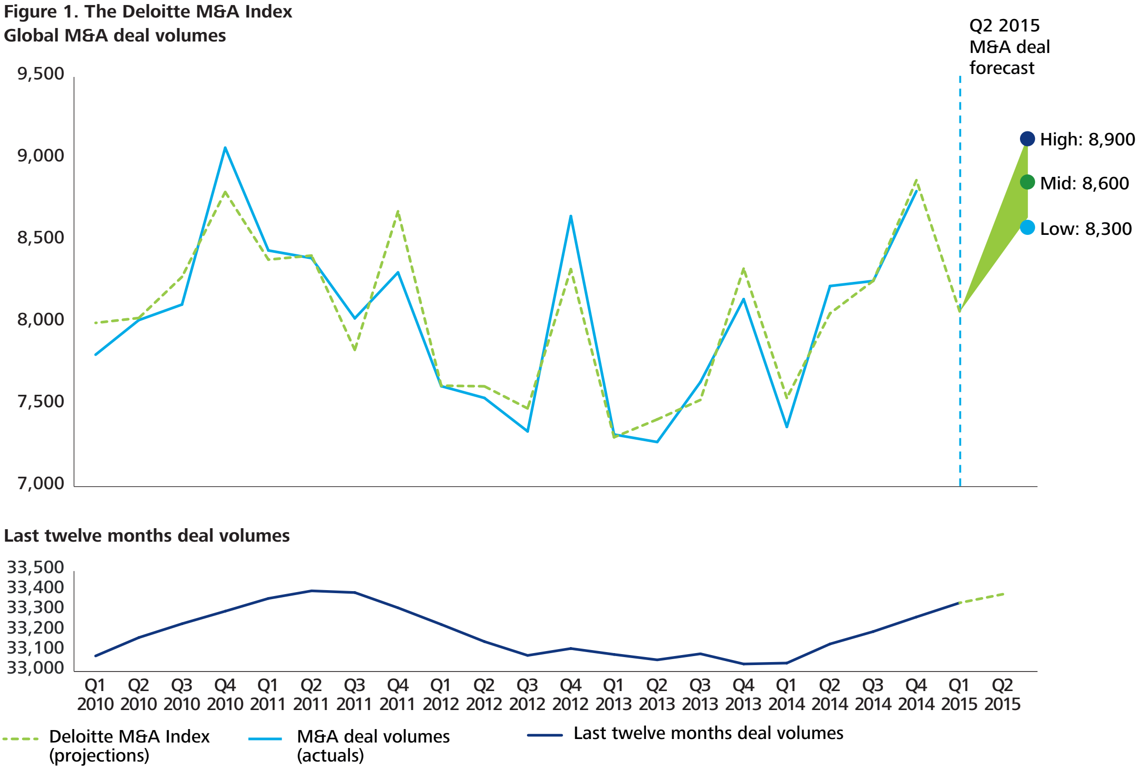
Figure 1. The Deloitte M&A Index
Global M&A deal volumes



Sources: Deloitte analysis based on data from Thomson One Banker

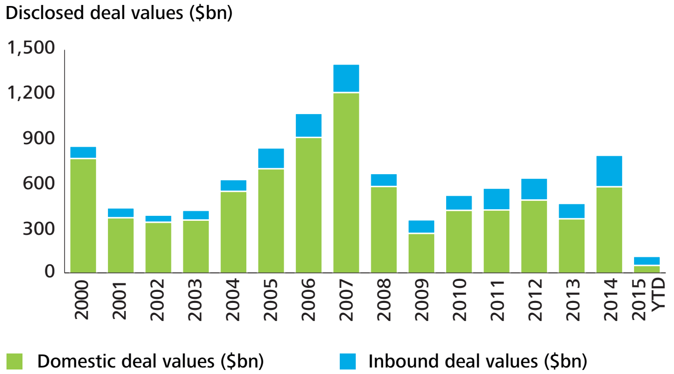
Factors influencing M&A in H1 2015

Europe emerging as the preferred target region for inbound acquisitions

So far this year six of the top ten deals in Europe were from non-European acquirers. Last year $797 billion worth of deals were announced in Europe of which $212 billion, or 27 per cent, were deals with non-European acquirers, the highest percentage of inbound deals into Europe in well over a decade. This means that nearly one in four dollars spent on European M&A came from either the US or Asia.

The European Commission has recently upgraded its growth forecasts for Europe citing weak oil prices and the declining euro as the factors that should boost recovery prospects. We anticipate that the positive growth outlook combined with favourably priced assets are likely to continue attracting dealmakers into Europe in 2015.

Figure 2. Total deal values for domestic and inbound European M&A (2000-15 YTD)[1]



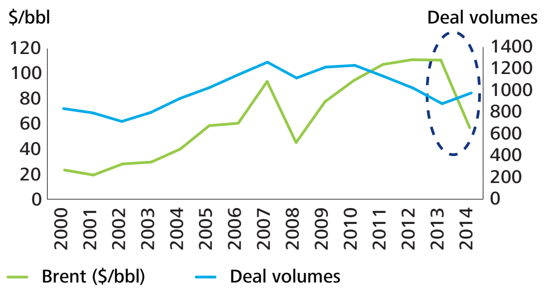
Source: Deloitte analysis based on data from Thomson One Banker

Oil: Race to the bottom could give a boost to M&A

The sharp decline in oil prices has eroded the profit margins of oil companies and put pressure on capital expenditures, refinancing and the ability to raise additional debt. The decline has increased the risk of asset impairment and has had an adverse impact on the valuation of many companies.

The shape and time frame of the oil price recovery is widely debated. The challenge for the industry is to adjust to new market conditions to improve returns on capital. This means that both conventional oil companies and shale producers are now under pressure to drive down costs and improve operational efficiencies. M&A is one way to achieve this.

Figure 3. Price of Brent vs. M&A deal volumes by oil and gas, petrochemicals and pipeline companies as acquirers (2000-14)



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

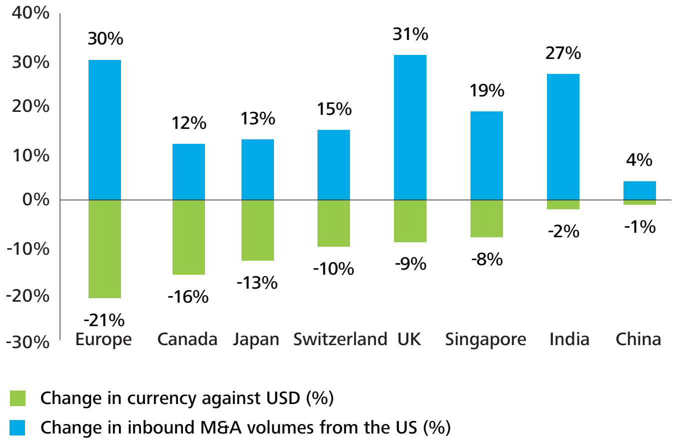
1. 2015 YTD as at 18 March 2015

Factors influencing M&A in H1 2015

The strengthening dollar is fueling cross-border M&A activity for the US corporate sector

The strengthening US economy has led to a weakening of many global currencies against the dollar. These conditions are giving a boost for cross-border M&A activities for the US corporate sector as many assets abroad now look more attractive in dollar terms. We have observed an increase in inbound deal volumes from the US in countries whose currency has depreciated against the dollar. For example, since the beginning of last year the euro lost 21% of its value against the dollar while in 2014 inbound deal volumes into Europe from the US increased by 30%.

Figure 4. Global currencies depreciation against the dollar since the beginning of 2014 vs. increase in deal volumes (%), 2013-14



Source: Deloitte analysis based on data from Thomson One Banker and Oanda

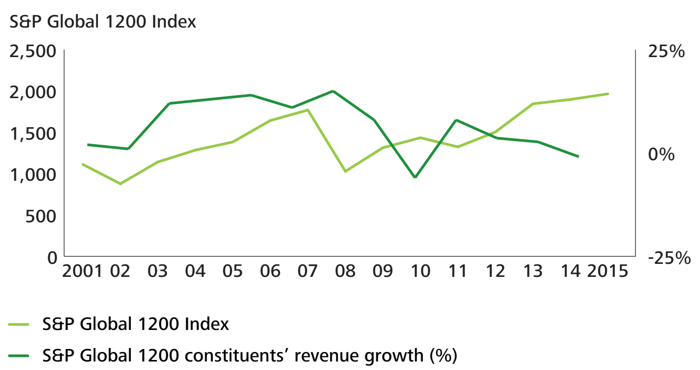
'Economy of expectations'

In 2015 the S&P Global 1200 Index reached record highs; however, annual revenue growth for its constituents has been declining for three consecutive years.

The search for yield by investors following the US programme of quantitative easing, coupled with major corporate share buyback and dividend programmes, has driven valuations and sent indices to new highs. Following the end of quantitative easing in the US, investors are likely to focus on fundamentals and CEOs will be under more pressure to meet market expectations.

With top line performance still hard to realise we anticipate that companies will increasingly need to pursue options such as M&A to achieve growth.

Figure 5. S&P Global 1200 Index vs. S&P Global 1200 constituents' revenue growth (2001-15 YTD)[2]



Source: Deloitte analysis based on data from Bloomberg

2. 1,165 companies reported their full year results by 23 March 2015

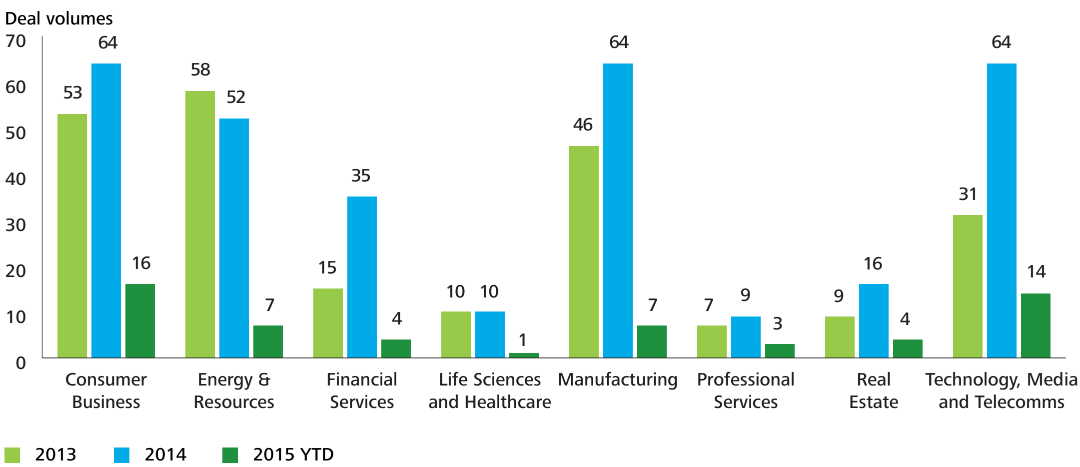
China emerging as a powerhouse in cross-border M&A

Chinese companies are countering the slowdown in their economy with a remarkable international expansionary programme. In 2014, Chinese companies announced a record $46.8 billion of outbound M&A, the highest figure so far and more than ten times the amount spent a decade ago. Europe received the largest share of China's foreign M&A investment with deal values tripling from $4.1 billion in 2013 to $13.5 billion in 2014. State-owned enterprises seeking growth opportunities abroad received a boost when the regulatory approval threshold was raised to $1 billion.

M&A deal flows reflect the shift in China's economy from export-oriented to consumption driven. For instance, in the last few years the consumer business sector has been steadily increasing as an investment destination, overtaking the traditional manufacturing and E&R sectors. In fact acquisition volumes in the E&R sector declined by 10.3% in 2014 over the previous year.

Another major ongoing shift is the sharp increase in acquisitions in the TMT sector, where deal volumes rose by 106% as Chinese companies spent nearly $11 billion on M&A. Deals such as Baidu's investment in Uber and Lenovo's acquisition of Motorola Mobility reflect China's ambitions to acquire technologies and capabilities to drive innovation.

Figure 6. Total Chinese outbound M&A volumes by target sector (2013-15 YTD)[3]



Source: Deloitte analysis based on data from Thomson One Banker

3. China includes Hong Kong (SAR)

Spotlight on mobile sector M&A

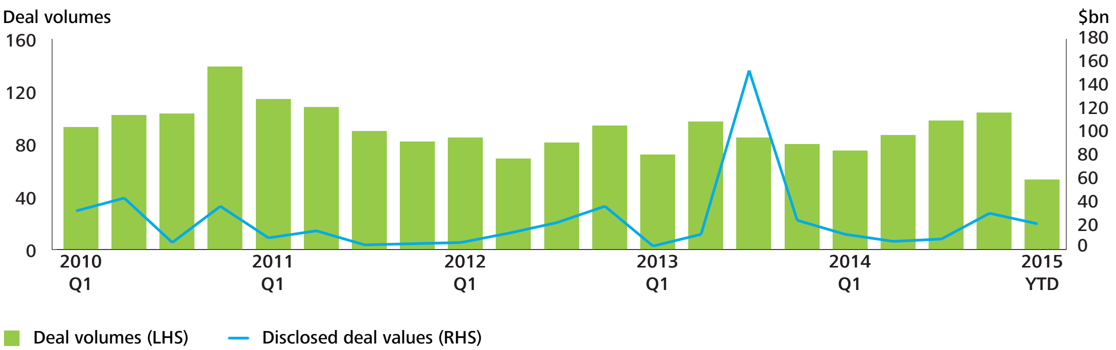
Last year 364 deals were announced involving mobile operators, the highest since 2011. In the UK, rapidly changing consumer consumption habits have led to M&A and joint venture announcements that are reshaping the telecoms market. The ramifications of these deals could be far reaching as sellers could use their proceeds to invest or do more M&A in other markets once they exit the UK.

In Europe intense competition has eroded the margins of mobile operators. Consolidation is widely expected, following which the remaining operators will be able to realise cost synergies and free up capital to invest in infrastructure and digital technologies.

In two of the world's biggest mobile markets, China and India, increasing competition is encouraging mobile carriers to look abroad for growth opportunities. China Mobile recently announced the acquisition of an $881 million stake in True Corp, one of Thailand's leading operators.

Carriers will need to innovate to drive future revenues and to that end we expect them to make smaller acquisitions in areas such as telematics and the Internet of Things to derive new revenue streams.

Figure 7. Total volumes and values of M&A involving mobile carriers (2010-15 YTD)

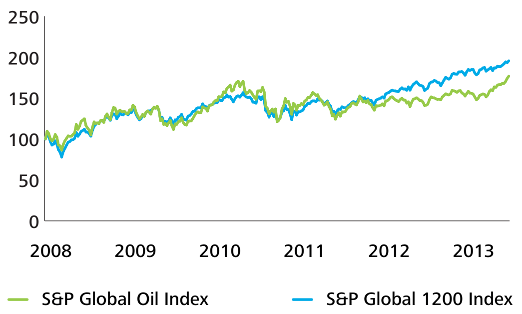


Source: Deloitte analysis based on data from Thomson One Banker

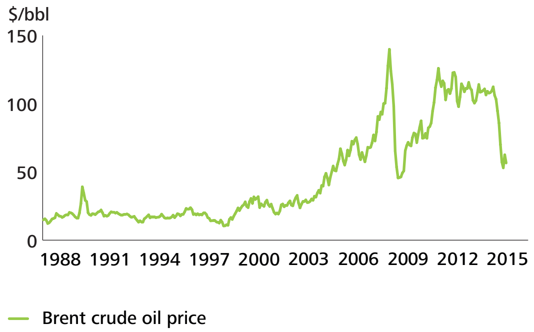
Impact of oil prices on M&A

Oil companies were under pressure to deliver growth and returns even before the collapse in oil prices. Between December 2008 and June 2014 the S&P Global Oil Index annual returns were 10.9% compared to the S&P Global 1200 Index that on average returned 13.0%.

S&P Global 1200 Index vs. S&P Global Oil Index rebased to the end of 2008

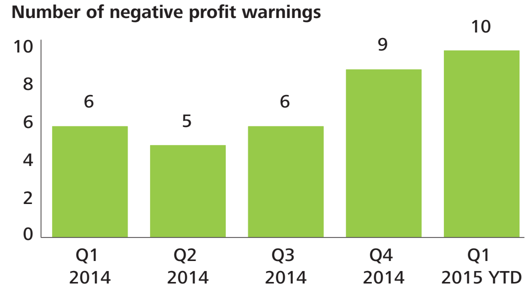


Price of Brent



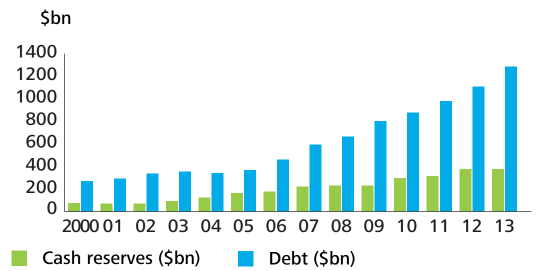
The sharp decline in oil prices has created a new set of challenges for the oil industry.

Number of negative profit warnings



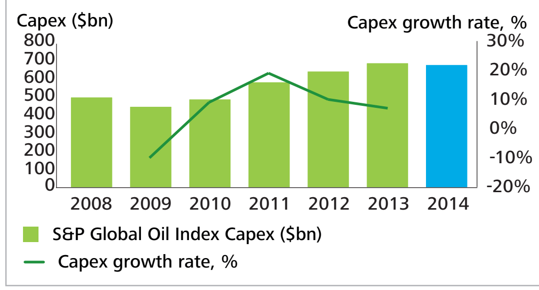
The immediate impact was a rise in profit warnings. Since the beginning of 2014, we estimate that 36 oil companies have issued profit warnings…

Cash reserves and debt of S&P Global Oil Index constituents (2000-14)



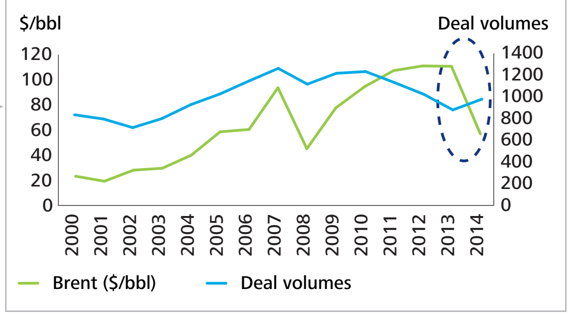
…at the same time the cumulative debt of the S&P Global Oil Index constituents has reached more than $1 trillion in 2013, outpacing the growth on cash reserves. This presents a challenge for both debt servicing and refinancing …

Capital expenditure of S&P Global Oil Index constituents (2008-14)[4]



…and also placing additional pressure on capital expenditure investments.

Price of Brent vs. M&A deal volumes by oil and gas, petrochemicals and pipeline companies as acquirers (2000-14)



- We estimate that 26% of the companies in the Index hold 80% of the cash reserves. Companies with strong balance sheets may want to acquire assets at attractive valuations. The current environment creates opportunities for companies to use M&A to reposition themselves
- We expect some consolidation deals as many oil production and services companies now need to focus on cost reduction due to cut backs on capital expenditure.

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

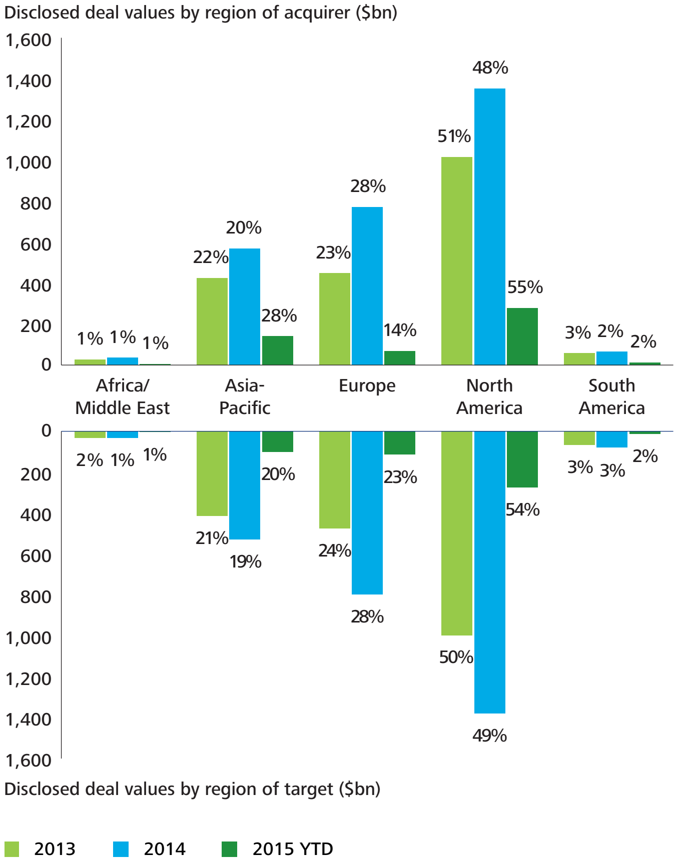
4. 7 companies are yet to report their capital expenditures for 2014, Bloomberg estimates are used instead

M&A trends in geographies

In 2014 European companies as acquirers were involved in $771 billion worth of deals, which represented 28% of global M&A market. So far in 2015 European companies have been less active as acquirers and have announced only $68 billion worth of deals, representing a global share of just 14%.

In contrast, the pace of M&A has picked up in the US and Asia. As of mid-March 2015 North American companies announced $279 billion worth of deals representing 55% of the global M&A market and during the same period Asian companies announced $141 billion worth of deals, a 28% share of the global M&A market.

Figure 8. Global deal values by region of acquirer and target ($bn) and the share of each region in the global M&A market by year (%), 2013-15 YTD



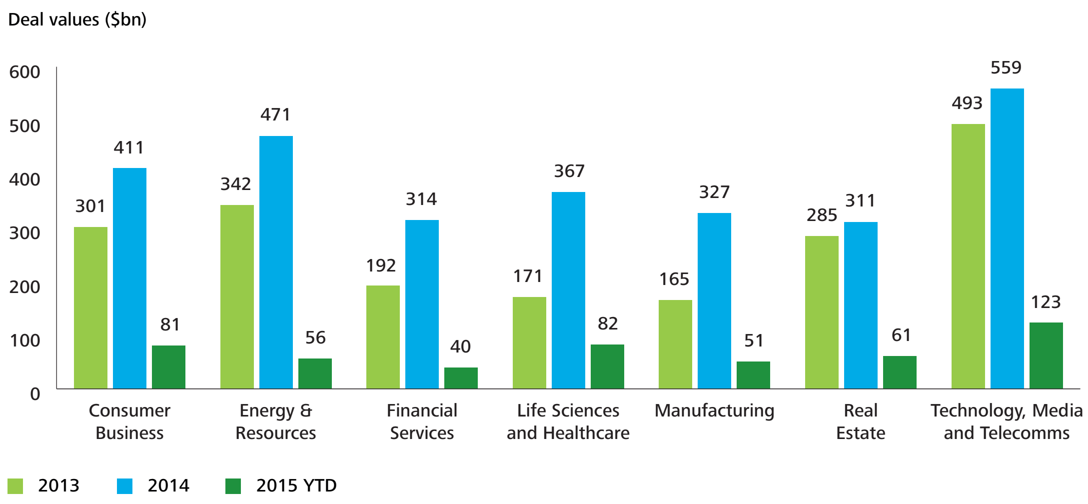
Source: Deloitte analysis based on data from Thomson One Banker

M&A trends in sectors

Last year there was a strong rebound in deal values across all sectors. TMT led the way with $559 billion worth of announced deals and this trend seems likely to continue in 2015. So far this year, $123 billion worth of deals have been announced, outpacing all other sectors.

Dealmaking in the consumer business sector also picked up in 2014 with a total of $411 billion worth of deals announced, an increase of 37% over 2013. Since the beginning of this year nearly $81 billion worth of deals have been announced and with many consumer business companies reviewing their portfolio and divesting non-core assets, we expect a strong H1 for this sector.

Figure 9. Global deal values by target sector ($bn), 2013-15 YTD



Source: Deloitte analysis based on data from Thomson One Banker

Corporate barometer

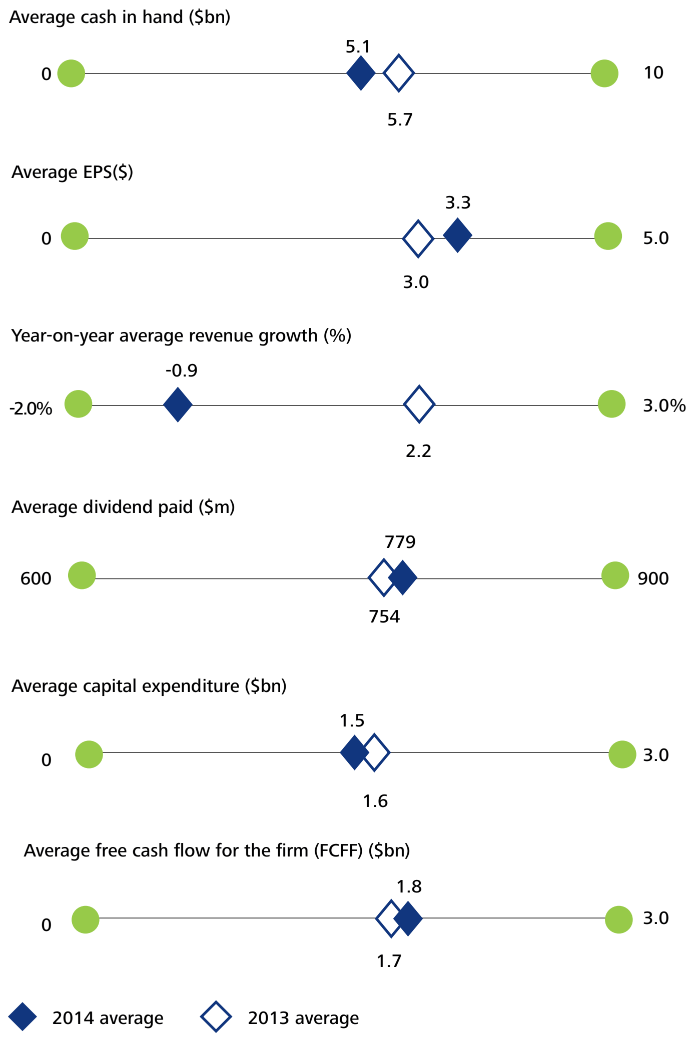
Analysis of the S&P Global 1200 company data:
Average revenue growth fell from 2.2% in 2013 to -0.9% in 2014.

Second, average cash in hand per company decreased from $5.7 billion as at the end of 2013 to $5.1 billion for 2014. This compares with FCFF across the S&P Global 1200, which increased from an average of $1.7 billion in 2013 to $1.8 billion in 2014.

Third, average dividend payments per company increased from $754 million in 2013 to $779 million in 2014, continuing the trend of returning cash to shareholders. The average EPS also increased from $3.0 in 2013 to $3.3 in 2014.

Finally, average capital expenditure per company fell slightly from $1.6 billion to $1.5 billion.

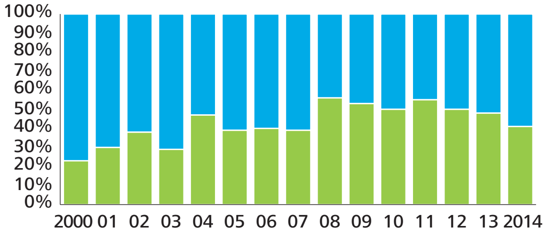
Figure 10. Company fundamentals, S&P Global 1200: 2013 v 2014 average



Source: Deloitte analysis based on data from Bloomberg

Charts we like

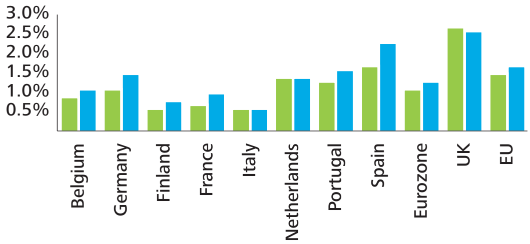
Figure 11. Market valuation over book value and total equity capital of non-financial constituents of the Bloomberg World Index (2000-14)



Total equity including minority interest and preferred equity
Market valuation over book value

Sources: Deloitte analysis based on data from Bloomberg

Figure 14. European Commission 2015 growth forecasts (annual percentage change in real GDP)

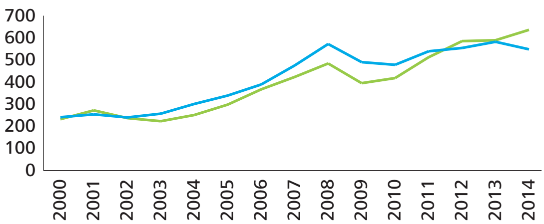


Autumn 2014 forecast
Winter 2015 forecast

Source: European Commission

Figure 12. Capital expenditures of non-financial constituents of the STOXX Europe 600 Index and the S&P 500 Index (2000-14)

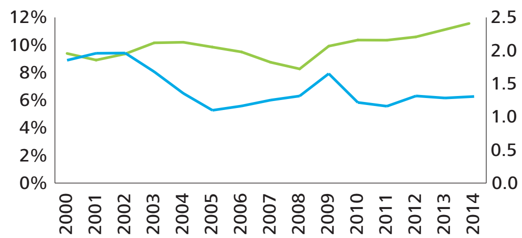
$bn



STOXX Europe 600 Capex
S&P 500 Capex

Source: Deloitte analysis based on data from Bloomberg

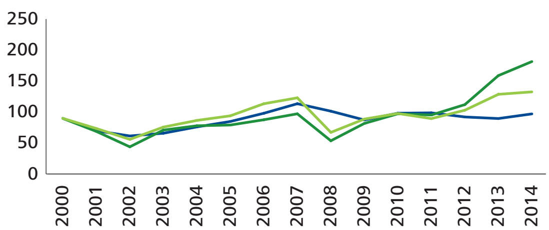
Figure 15. Cash to assets vs. the debt to EBITDA of non-financial constituents of the S&P Global 1200 (2000-14)



Cash to assets (LHS)
Net debt to EBITDA (RHS)

Source: Deloitte analysis based on data from Bloomberg

Figure 13. M&A deal volumes and the S&P Global 1200 and Nasdaq Composite Index rebased to 2000

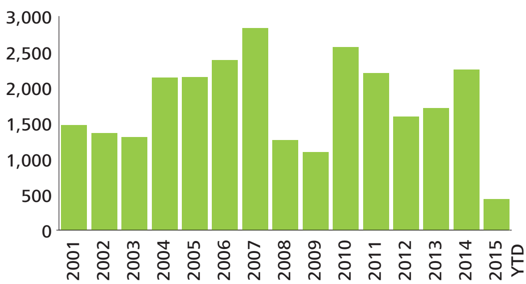


S&P Global 1200
Nasdaq Composite Index
Global M&A volume

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

Figure 16. Global IPO volumes (2001-15 YTD)[5]

IPO volumes



Source: Deloitte analysis based on data from Thomson One Banker

5. 2015 YTD as at 23 March 2015, IPOs live and in progress

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 Irina Bolotnikova are the UK Deloitte Insight team for M&A and New Growth, based in London. Haranath Sriyapureddy, Abhimanyu Yadav and Sukeerth Thodimaladinna are research analysts in the Business Research Center, at DTTL.

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