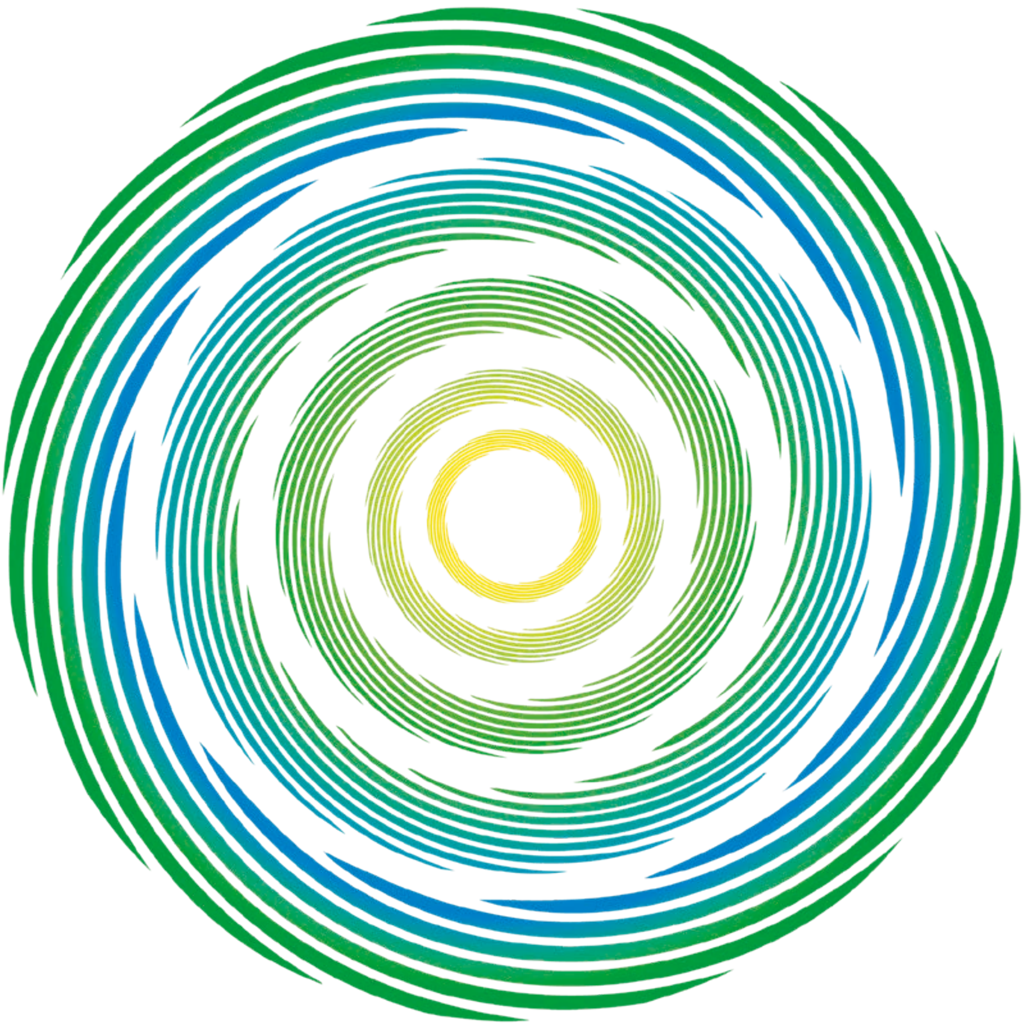
Deloitte.



# Past as prologue

Navigating through the 2018-2020 M&A cycle

M&A

# Contents

# Executive summary

Giant sequoias are the largest single trees and among the oldest living things on earth. While the disruptive forces of extreme weather, fire, and other natural phenomena drive most forest life into decline, the sequoias have capitalized on these cyclical events and evolved the last several centuries. Similarly, organizations, armed with the right tools, can withstand the adverse conditions of both macro and micro environment and manage cyclicality to grow and thrive.

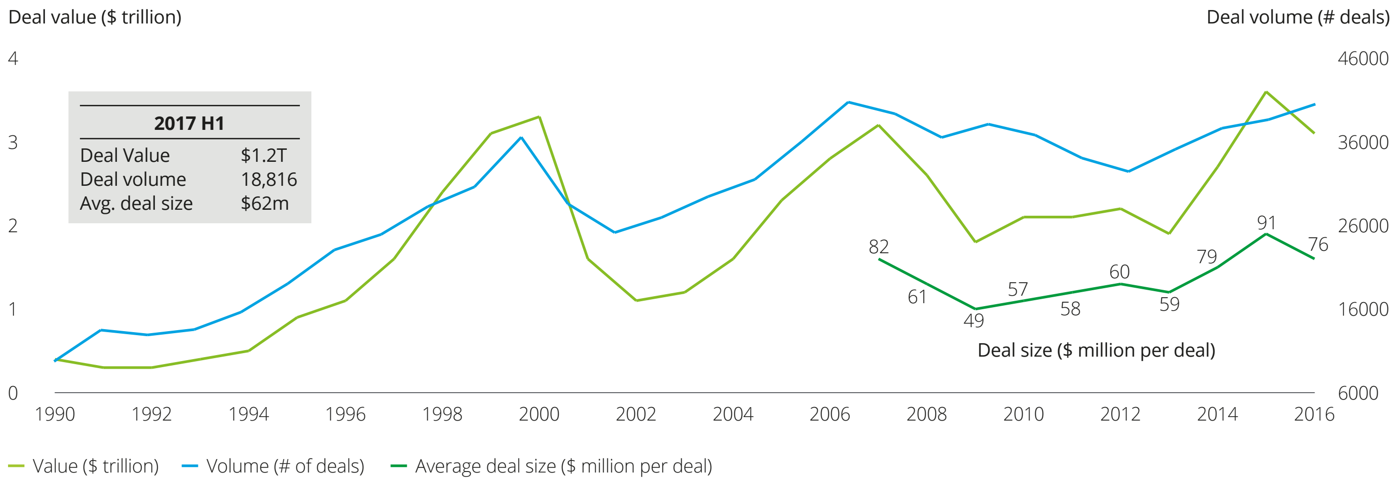
Since 2014, M&A has been used extensively by companies to pursue growth. Many companies took advantage of low interest rates, rallying share prices, readily availability of cheap debt, and record levels of cash reserve to pursue M&A activity and it resulted in nearly $10 trillion worth of deals in the last 3 years.

The conditions for the current year and beyond are rapidly changing. Political events across the globe have given rise to uncertainty both in trade as well as economic policy. Across both sides of the Atlantic, the regulators are putting mega-deals to greater scrutiny and many are getting withdrawn. Technology is also disrupting several industries and in turn driving many companies to invest in innovative capabilities.

Taking this into account we expect this year, with its fast start, will have deal activity broadly similar to 2016; however, we are expecting specific headwinds and tailwinds to shape the next short-term downward cycle from the latter part of 2018.

In fact, over the past 25 years, we have observed a trend of cyclical M&A activity for strategic buyers corresponding to overall negative trends in the market, with the average cycle lasting 9 to 10 years. In order to thrive during the projected downturn, strategic buyers must accept and understand how to navigate the disruptive events driving the downturn. We believe the specific forces and M&A cyclicality identified in this paper will help illuminate the pockets of opportunity in an otherwise challenging environment and enable organizations to continue using M&A as a tool for growth.

**Figure 1. Strategic Deal Activity Summary**
Global M&A 1990-2017 (Strategic deals only)




Source: Thomson Reuters

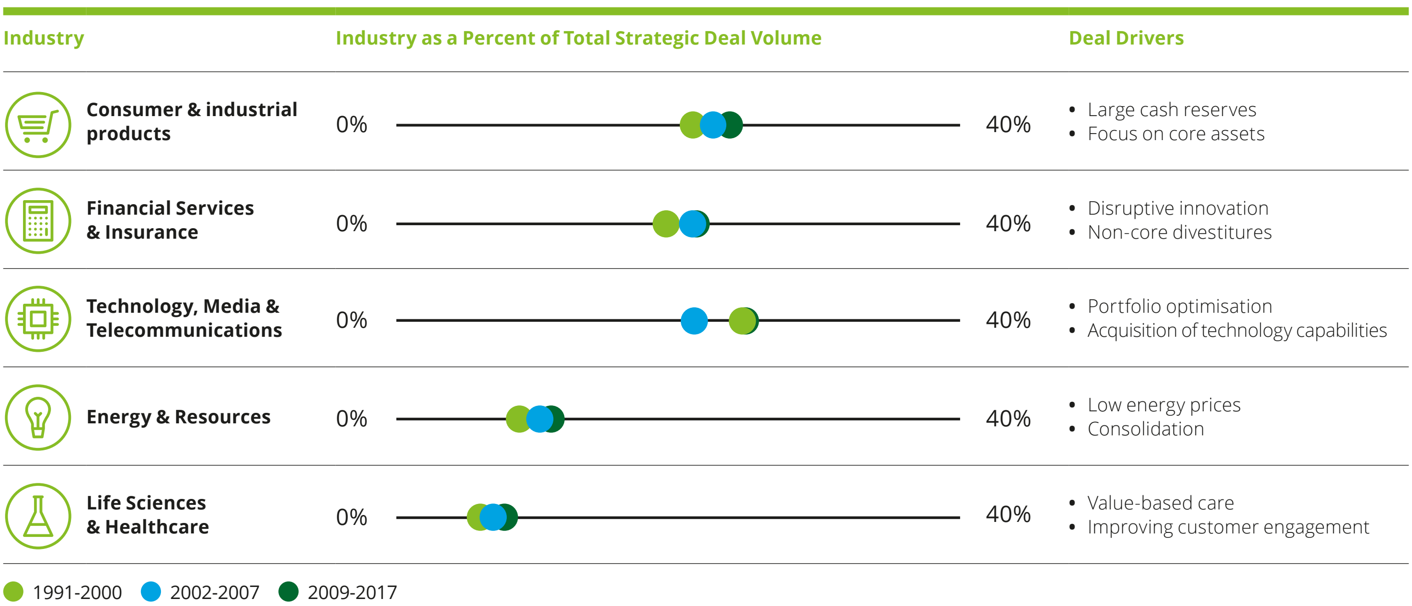
# History as context

Traditionally, M&A activity is cyclical, driven by industry shifts, scale economies, regulations, and shakeouts in fragmented industries. For example, the upward 1995-2000 M&A cycle was largely fueled by innovation, rapid technology and Internet company growth and commercialization, and the real estate boom. Conversely, the downward 2000-2003 cycle was, for the most part, triggered by the burst Internet bubble and stock market crash, and market declines due to national security. The M&A cycle again shifted upward in 2003-2007, aided by increased global liquidity, growth in foreign exchange reserves, and a weak dollar; it reversed course in 2007-2009, due largely to tightening of financial regulations that led to a dramatic reshaping of financial services firms after the 2008 crash.

In the recovery years between 2009 and 2013, the M&A markets remained weak as many companies were still rebuilding their balance sheets, focusing on their core business, divesting non-core assets, and accumulating record levels of cash reserves. However, in 2014, the first signs of economic turnaround began to surface, largely led by the United States. This gave corporations the necessary confidence to embark on a deal-making spree, taking advantage of favourable funding conditions, strong balance sheets, and a sustained rally in share price performance.

Strategic buyers have dominated deal-making during the current rebound, as many consumer, financial, and energy companies seek to improve margins through M&A-driven operational improvements and portfolio diversification. Strategic deals have represented 85 percent of deal value in the 2009-2016 cycle and 87 percent in the last 25 years. However, strategic deals represent a much smaller portion in Energy & Resources and Life Science & Health care in terms of deal volume. (Figure 2).

**Figure 2. Strategic Deal Activity by Sector**



## Themes influencing the current M&A wave

We have identified three main themes influencing the current upward cycle: divestments and spin-offs, mega deals and cross-border deals.

**Divestments and spin-offs:** We have observed two waves of spin-offs since 2009 – the first, from 2009-2011, was largely led by the financial sector, which offered plenty of assets at fire-sale prices due to post-bailout regulations and other operational requirements. At the same time, there were numerous spin-offs in the Energy & Resources industry, which was unwinding some of its 2007 mega-deals. The second wave of spin-offs, from 2012-2014, was focused on non-core divestitures and strategic realignment driven by activist and/or regulatory pressure to complete mega-deals. Due to continuous pressure it is observed that companies tend to focus on multiple smaller divestments instead of one divestment.

**Mega deals**: Slow-growing industries such as Consumer Products are seeing major players consolidate as they pursue scale, operational and market synergies, and tax reductions. A stronger dollar and cheap cost of capital have helped companies raise funds for these mega deals. Activist investors tend to favor mega deals, as they generally provide more synergies and cost-saving opportunities. Beginning of 2017 has seen cross-border mega deals in the Consumer Products and Pharmaceuticals sectors. However, regulatory disapprovals, rejected offers, protectionism and high valuation may act as possible deterrents for future mega deals.

**Cross-border deals:** Cross-border M&A also has been strong during the current upward cycle. The strengthening US dollar is producing more attractive assets abroad. Meanwhile, many Chinese companies have been countering their country's economic slowdown by expanding internationally. M&A activity is expected to increase as China shifts from an export-oriented to consumption-driven economy. Finally, Europe is emerging as a preferred region for inbound acquisitions due to favorably priced assets by the weak pound and euro.

## Observations and Projections

We looked at three methods to project the next M&A cycle (Figure 3).

**Figure 3. Projection summary**

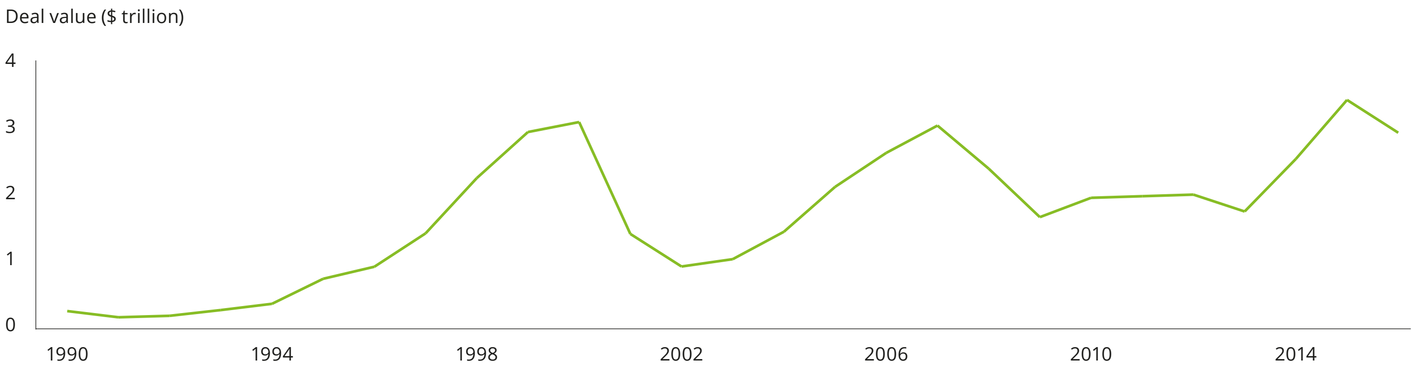
| Method | Discription | Projection |
|---|---|---|
| A | **Top – Down:** Market and economic indicators | Room for growth, but high valuations |
| B | **Top – Down:** Historical cycle analysis | Decline in 2018, extending through 2020 |
| C | **Bottom – Up:** Expectations by industry | Positive expections by industry and mixed by region |

| **Industry projections** | | **Regional projections** | |
|---|---|---|---|
| **C&IP** | Positive | **Americas** | Positive |
| **FSI** | Positive | **Europe** | Positive |
| **TMT** | Positive | **Africa/Middle East** | Mixed |
| **E&R** | Positive | **Asia Pacific** | Mixed |
| **LSHC** | Positive | | |

# Projections results

**A** While some top-down metrics (e.g. interest rates, cash) look attractive, valuations and deal premiums are close to previous cycle peaks and are not conducive for mega-deals. (Figure 4). Moreover, companies with huge cash reserves may remain immune to rate hikes but others may be negatively impacted and limiting growth in deal activity.

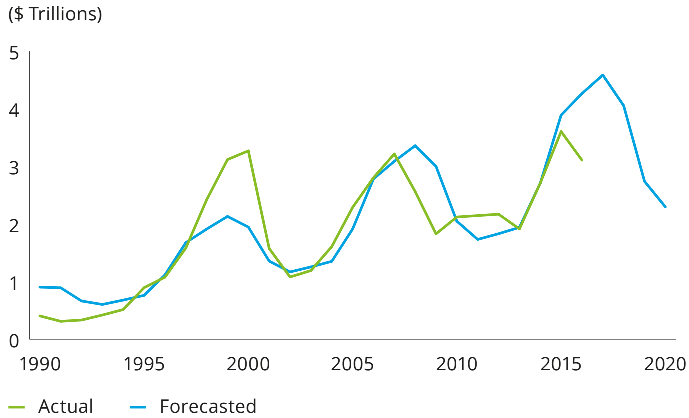
**Figure 4. Historical observations**
Global M&A Value 1990-2016 (Strategic Deals only)




| Method | High point | Low point | Current | Room to grow |
|---|---|---|---|---|
| **Deal Premiums (4 Weeks prior to announcement)** | 22.1% | 19.9% | 22.2% | 🔴 |
| **EV/ EBITDA (S&P 500)** | 10.8x | 7.8x | 12.1x | 🔴 |
| **Leverage ratios: Net Debt to EBITDA (S&P 500)** | 2.38x | 1.38x | 1.03x | 🟢 |
| **Vix Value** | 17.54 | 31.48 | 11.56 | 🟢 |
| **Corporate Cash Balances (Non-Financial S&P 500) (USD, T)** | 0.77 | 1.04 | $1.70T | 🟢 |
| **Interest Rates (5Y treasury rate)** | 3.49% | 2.34% | 1.77% | 🟢 |

**B** Method B uses a top-down, cyclical time series analysis of past M&A value to forecast future growth in M&A activity. Projected results indicate slight decline in 2017 that will likely extend through 2020 (Figure 5). This analysis shows that M&A activity has an upward trend in the long term, with cyclical swings in the short term. The cycles are nine years in length, with five to six years of growth until reaching an activity peak.

**Figure 5. Historic cycle analysis**
Projected Global M&A Value 1990-2020 (Strategic)




Source: Thomson Reuters

**C** Bottom-up Method C examines M&A trends and expectations in specific industry sectors (Figure 6) and geographical regions (Figure 7).

### Figure 6. Industry Analysis

| Industry | Headwinds | Tailwinds | Deloitte Viewpoint |
|---|---|---|---|
| **Consumer & Industrial Products** | • M&A activity tied to economic health | • Divesting of non-core assets<br>• Large cash reserves | Increase |
| **Financial Services & Insurance** | • SIFI threshold | • Increased rate hike<br>• Product and service integration<br>• Disruptive innovation | Increase |
| **Technology, Media & Telecommunications** | • Increasing regulatory complexities | • Companies buying technology capabilities<br>• Portfolio optimization | Increase |
| **Energy & Resources** | • Slow global economic growth | • Attractive valuation<br>• Consolidation of mainstram players | Increase |
| **Life Sciences & Health Care** | • Increasingly stringent regulations<br>• Challenges of entering new regions | • Trend toward value based care<br>• Cost pressures drives consolidation<br>• Improvement in customer engagement | Increase |

### Figure 7. Regional Analysis

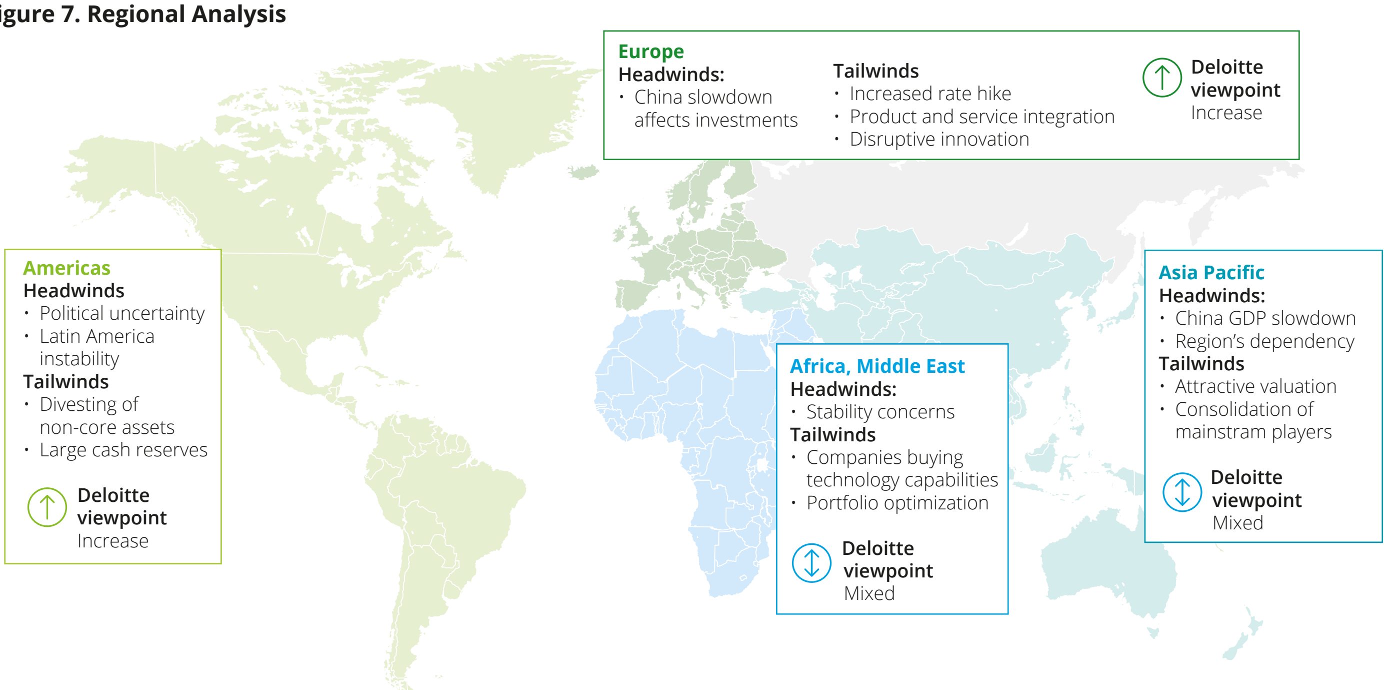
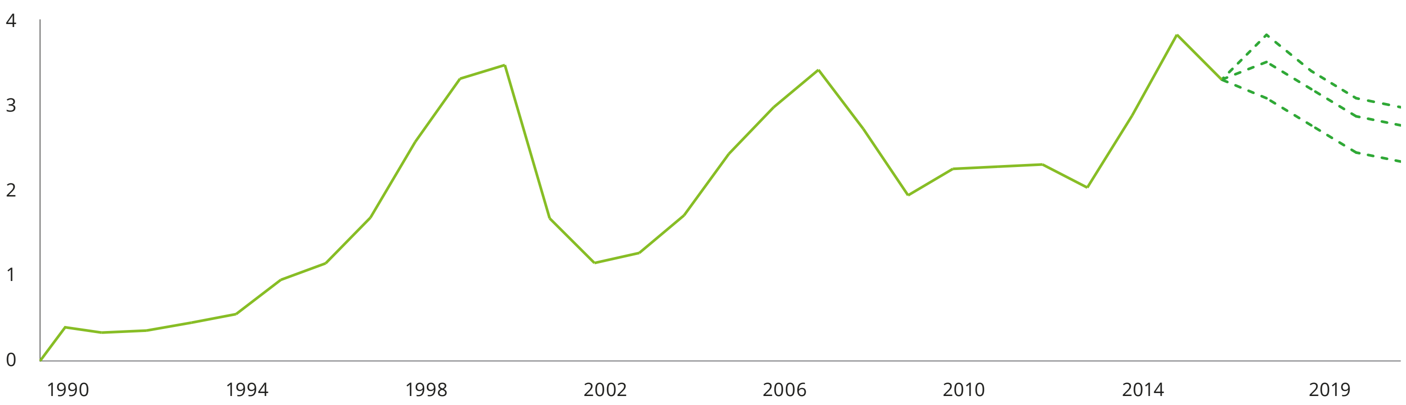


**Figure 8. Deloitte's Viewpoint of M&A Growth**
Global M&A Value 1990-2020 (projected)




Favourable debt market conditions, strong cash balances, and use of offshore capital

Stable oil prices

Activists pressure to increase returns

Slowdown in China, Brexit

Increased scrutiny of mega deals by regulatory bodies

Policy uncertainty

## Summary of projections

Method A signals a peak in average deal value with limited room for growth, while method B projects a decline in 2018 and C strengthens a case for growth in deal activity in the short term. After analyzing the combined findings from these methods, Deloitte's viewpoint is 2017 (Figure 8) may show a modest increase in deal activity, but is unlikely to reach the heights of 2015. Furthermore, 2018 may lack the potential to spike and we expect it to become part of a down cycle. Currently, the industry forces in play and policy uncertainty surrounding trade and tax policy are counter balancing continued solid forces for deal activity. Hence, companies should reassess their acquisition and divestiture strategy and timeline for implementing them. In the following section, we offer a viewpoint on strategies and lessons to apply from prior downturns in M&A.

## Creating Value in the Next M&A Downward Cycle

There appear to be numerous opportunities for companies to create value in the next downward M&A cycle. Strategic buyers should have a robust M&A strategy, clear objectives, and internal capabilities to proactively identify market opportunities and react quickly when they find one. Among key observations and suggestions for the next cycle:

- Look for divestments and spin-offs from companies that were not able to successfully integrate and achieve the synergies envisioned or economic returns promised to investors. We estimate there is a synergy expectation of $2 trillion from deals transacted over the past two years. Some companies may fail to deliver those synergies and, as a result, boards and activist investors may pressure them to divest some of the acquired assets. Key industries to follow are Life Sciences & Health Care, Energy, Consumer Products and Manufacturing.

- As valuations reach previous peaks, driven in part by private equity firms seeking to put their funds to work, it will be critical to stress test key assumptions of the deal valuation models and to question multiples that are based on unproven business models or small acquisitions pursued under the supposition they can achieve scale relevant to large acquirers.

- Expect significant M&A activities within non-related industries. Some organizations are undergoing profound restructuring to reduce regulatory exposure, increase ROE/ROA, and counter market disruption by investing in technology (Fintech/InsurTech/Medtech/Cognitive Technology/Automation) companies.

- Assess attractive valuations in the Energy & Resources industry in light of ongoing consolidation, especially among midstream players.

- Remember that this may not be the time for big risk-big return strategies, especially for companies that play in industries which have been driving the peak cycle (e.g., Life Sciences & Health Care and Energy & Resources)

- Though Brexit initially slowed M&A activity, the weakening of the euro is increasing opportunities for foreign investors (US, China, and Japan) and making Europe an even more favorable market on top of attractive valuations, a positive growth outlook, and lower political uncertainty relative to the U.S.

Be mindful of deal structures in broad business ecosystems and investments in adjacencies. Business ecosystems are dynamic and co-evolving communities of diverse "actors" who create and capture new value through collaboration and competition. For example, the "mobility ecosystem" is comprised of companies in the automotive, technology, insurance, and energy industries as they collaborate, adapt, and respond to each other's moves to provide consumers with self-driving cars. As business ecosystems evolve, companies should ask whether outright acquisitions add more value than the flexibility offered by strategic alliances.

Once they identify opportunities, strategic buyers should move quickly. Develop an end-state vision that considers the business ecosystem in which the new company will play. In addition, as technology continues to influence diligence and pre-close planning processes, companies should begin planning before announcing the deal and start executing the plan before Day 1 by using regulatory-compliant mechanisms such as clean rooms that are physically and electronically separate from the buyer and seller. In contrast to prior M&A cycles, buyers now have innovative approaches such as social media scans and fuzzy matching software to gain better insight into target company businesses. In addition, analytical tools and processing power now permit sophisticated acquirers to sort through terabytes of data pertaining to contracts, pricing and customers thereby accelerating the path to synergies.

All potential players should prepare now to manage risks and capitalize on opportunities in the next M&A cycle. Specifically, we suggest that companies scrutinize corporate and business unit strategies that involve M&A in 2018; push for decisions/action on marginal assets while good conditions prevail; tighten criteria, targets, and pipelines in preparation for the 2018-2020 downward cycle; and mind market indicators (premiums, earnings multiples) that foreshadow a peak and decline.

# Outlook for industries 2018-2020

# Consumer & Industrial Products (C&IP)

## Industry Trends & Outlook

Deal activity may moderately increase in the CI&P sector due to availability of cash for deals, strong deal pipeline, and favorable industry outlook.

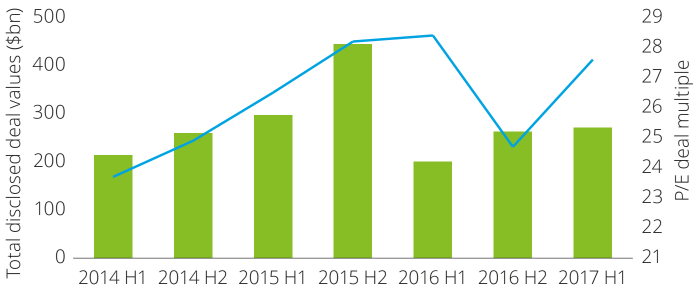
- **Large cash reserves** – Many C&IP companies are under pressure to make use of (invest or return to shareholders) their large cash reserves. 24% of C&IP S&P 500 companies have more than $1B in cash in 2016. With increased uncertainty on tax reform, US companies would likely have more efficient access to offshore cash. That coupled with anemic organic growth opportunities in several C&IP sectors could spur increased deal activity[1].

- **Strong deal pipeline** – Although uncertainty in macroeconomic conditions persist, consumer companies should continue to keep pace with innovation and increasing competition, particularly from non-traditional entrants[2]. M&A is seen to replace R&D as many companies continue to invest or acquire smaller brands, which have been willing to make the risky bets on innovation that traditional companies avoided[3]. The changing patterns of global demand (e.g. preference for wellness, social impact) may only amplify the necessity of swiftly finding opportunities to capitalize on trends.

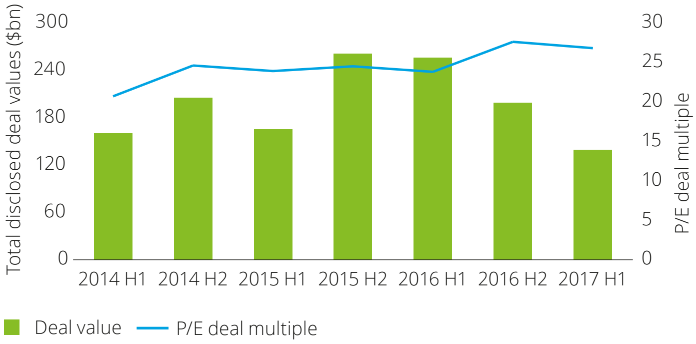
- **Industry & regulatory outlook** – Many C&IP companies are looking for M&A as a growth strategy, improved market share, increased revenue, reduced cost, market diversification and technology. For example, we have seen a large retailer acquire an online marketplace company due to technological advancement and improve their presence in ecommerce market[4]. In the consumer business sector, acquiring technology assets has surged in importance as a top strategic driver of M&A.

  Many acquirers are looking to technology companies specializing in IoT, AR/VR and other disruptive innovations to position themselves for the future and so the industry is facing a unique competition from non-traditional new entrants, the technology sector and this in turn is leading to participation in cross-industry strategic alliances and venture investments[5]. The number of deal activities and the size of the deal both are expected to increase in 2017. Also, the market expects to see increase in divestitures mainly due to change in company strategy and also to reduce debt or raise capital[6].

**Global disclosed deal values for Consumer Business as a target ($bn), H1 2014 - H1 2017**

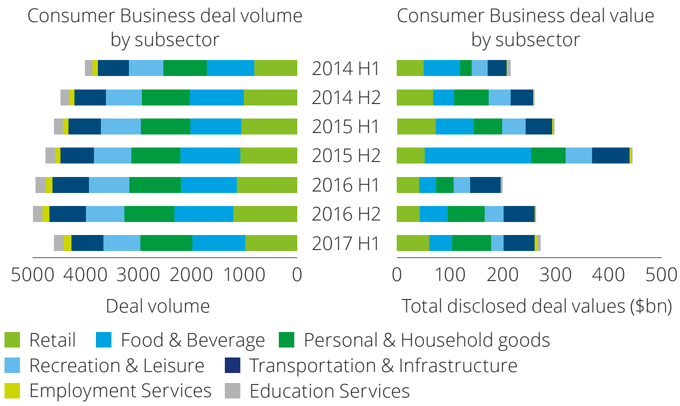



**Global disclosed deal values for Manufacturing as a target ($bn), H1 2014-H1 2017**

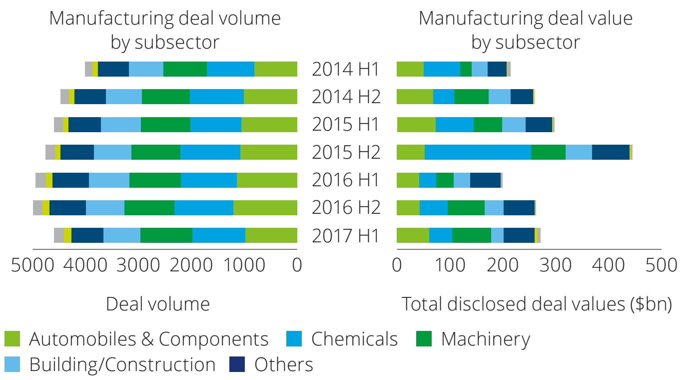



Source: Deloitte analysis based on data from Thomson One Banker

**Consumer Business deals by target subsector**

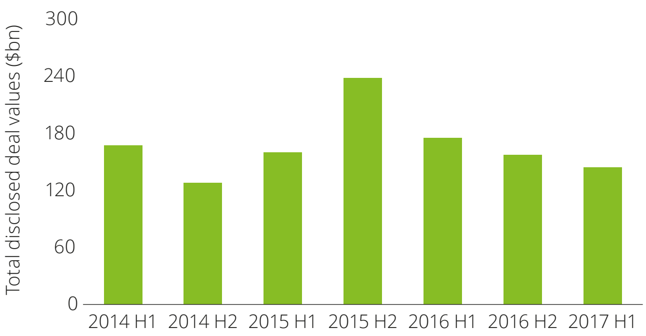



**Manufacturing deals by target subsector**



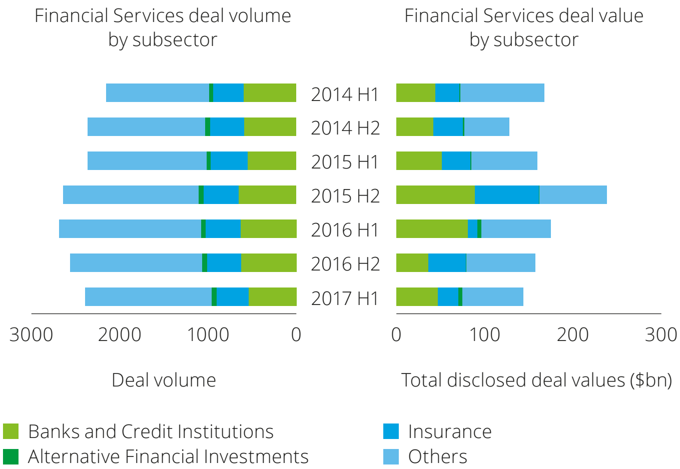
# Financial Services (FSI)

**Global disclosed deal values for Financial Services as a target ($bn), H1 2014-H1 2017**




Source: Deloitte analysis based on data from Thomson One Banker

**Financial Services deals by target subsector**




Deal activity will likely increase as the FSI industry seeks to transform business models, drive ROE/ROA, and divest non-core operations.

- Industry overhaul –
  - **Interest rates:** The prospect for banks and capital markets firms looks stable with an expected increase in the interest rates, perhaps by as much as 75bps this year and 50-100bps over the next two. This could give a boost to the industry to undergo selective partnerships and improve ROE. It is also expected that the number of mega deals would increase in 2017 if the stock market continues to rally[7].
  - **Capital requirements:** The Capital requirement is expected to shift based on the size of the FSI companies, specifically for Banking & Securities (B&S) firms. It is anticipated that smaller to mid-sized institutions will be benefitting from softening of both compliance reporting and capital requirements, this may increase the potential for peer-peer consolidation. However, large banks are expected to see ongoing carve-outs and divestitures to improve focus on core segments, geographies, markets and products[8].
  - **Sector-wise consolidation:** As per the market scenario, the sectors prone to consolidation are Investment Management/Asset Management (IM/AM) and mid-tier B&S institutions. It is also anticipated that the Real Estate (RE) sector will also witness some consolidation based on size/scale/capabilities and political situations. In RE the public and private partnership will likely be in upswing to address major infrastructure development requirements[1].
  - **Regional outlook:** US is repositioning for growth which in turn is attracting foreign FSI institutions for making investments and acquiring US institutions. Large FSI companies from EMEA, Japan, and China showing renewed interest and are actively making moves. LATAM FSI institutions are also seeking consolidation as foreign large banks are diversifying their regional presence[1]. In the longer-term, firm prospects will likely vary widely by region; growth, especially for banks, is expected to be much stronger in emerging markets, and yet just 31% of bank assets were located in developing countries, according to the EIU[9].
  - **Product and service integration:** As individual demands for outcomes become a driving force in the industry, IM M&A transactions may reflect combinations of products and services designed to support more holistic advice. Such deals might include: insurers and wealth managers or banks and wealth managers combining forces; asset managers and intermediaries new age technology companies to improve visibility on distribution and offer value-added services; etc[10].

- **Disruptive innovations** – The fintech sector has experienced an increase in activity. Banks, Insurance and IM/AM companies have bought these companies to drive ROE/ROA, generate additional revenue, and provide a competitive advantage. Pertaining to the current market scenario, in December 2016, the Office of Controller of the Currency (OCC) announced that a special purpose bank charter will be granted to the fintech companies to encourage digitization of the banking industry[11]. Technologies like Automation, Blockchain and IoT are disrupting the FSI sector by bringing in product and service innovation, faster claim settlement, improved transactional activities and increased level of customer satisfaction. This is widening to scope for business and product diversification. The new digital entrants with product innovation and adoption of SMAC (Social, Mobile, Analytics, and Cloud) are outperforming incumbent banks, but these entrants often face significant cost outlays, increasing M&A probability with a traditional incumbent[12].

- **Dealmaking in the insurance sector** – M&A activity during H1 2016 was slow, however, dealmaking accelerated notable in H2 2016. The total 2016 underwriter deal volume ended up by increasing 5% y-o-y, but the aggregate deal value was down by 60%[13]. Insurance M&A in 2017 is expected to see a mix of activities with nature of deals shifting towards being strategic over mega deals. Sector consolidation is anticipated to be high in P&C and reinsurance. Brokerage deals will grab attention of the PE brokers[13]. Investments (buy, invest or partner) towards InsurTech is expected to see some increase both in number and strategic significance over the next couple of years. Sensors, aggregators and business process enablement are emerging as a key focus for insurers and innovator start-ups, instead of claims and underwriting solutions[13]. Regulatory uncertainty is expected to inhibit M&A activity in the near term, but if the administration is able to implement its policies – most favorable to the industry – dealmaking may accelerate. The hike in interest rates is giving a virtual certainty to the financial market as well, and is helping in building investor confidence which will favor increased M&A activities[13]. Inbound insurance M&A is expected to continue through 2017, but at slightly lower levels than 2015-16; nonetheless, the US insurance market remains an attractive opportunity to Japanese, Chinese and European buyers[13].

- **Regulatory developments** – Regulatory complexities, such as high capital requirements, and growth strategies associated with diversifications and divestiture are encouraging M&A activity[14]. In addition, as banks begin to reach pre-recession capital levels and pass stress tests with increasing ease, risk appetite may grow and, with it, so may dealmaking.

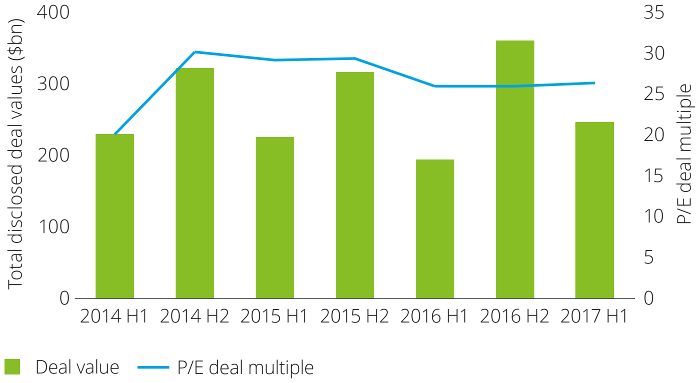
  – **SIFI designation (Systematically Important Financial Institutions)**

    » 2017 will likely continue to see consolidation of smaller banks to generate revenues through diversified portfolios and ease out regulatory and operational costs. Meanwhile, recent testimony by Federal Reserve Chair Janet Yellen indicated that the Fed is open to raising the current SIFI threshold of $50 billion, among other ways to ease regulatory burdens[15]. The realization of such a softening could widen the scope for larger banks looking for growth through M&A without incurring the additional regulatory burden of becoming a SIFI[14].

    » In 2017, large US insurance company's divestments can be avoided if the insurance sector is exempted from the statutory asset threshold which triggers the SIFI designation and subjects the institution to heightened supervision and regulation. Upon such circumstances, M&A activities in the insurance sector are expected to increase[13].

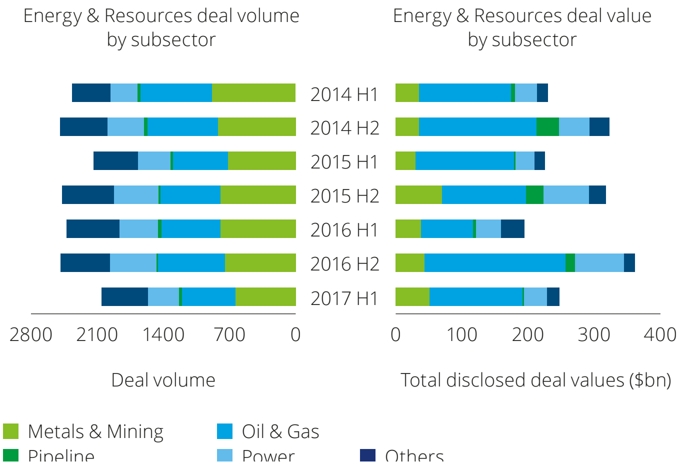
# Energy & Resources (E&R)

**Global disclosed deal values for Energy & Resources as a target ($bn), H1 2014-H1 2017**




Source: Deloitte analysis based on data from Thomson One Banker

**Energy & Resources deals by target subsector**




Deal activity was moderately low in the first part of 2017 due to uncertainty in oil prices. However, investors are beginning to sense that prices are stabilizing and are more likely to make deals in the second half of 2017.

- **Stabilizing energy price** – Oil prices went down significantly following the downturn, leading to lower than expected M&A activity, but recently oil prices have begun to stabilize. The second half of 2017 activity will largely depend on a sustained confidence in steady oil prices, translating into higher probabilities of reaching consensus about transaction valuations between buyers and sellers[16]. However, as oil demand is often impacted by macroeconomic trends, slow global growth could prove a challenge to current market rebalancing efforts[17].

- **Deal activity** – As 2016 drew to a close, we saw the beginning of an increase in M&A and divestitures activity, OPEC finally announcing production cuts of 1.2 million barrels per day in 2017, and rig counts growing, albeit slowly, once again. There is a sense that better times are ahead[18]. There were seven deals that were more than $10 billion in size. However, upstream transactions did not include any major mega-deals[16].

- **Industry outlook** – The EIU projects energy demand to increase 2.1% per year through 2020. While consumption growth in natural gas (3.4%) is projected to exceed that of oil (1.6%) and coal (0.3%), renewables are expected to grow the fastest, at 15% per year. However, renewable energy consumption will likely still be smallest in terms of quantity[19].

  - For 2017 and beyond, supply and demand balance and corresponding oil price stability will be driven by[18]:

    » OPEC countries delivering on the promise to cut production

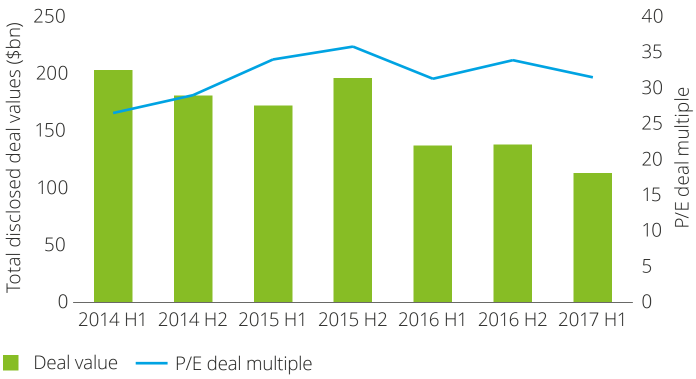
    » US shale oil drillers resumption of active drilling programs

  - Appetite for big capital projects such as deepwater plays and oil sands may take more time to establish and hence may lead to increase in smaller projects and M&A deals[17]

  - As per Deloitte's 2017 study conducted on Resources, both residential and business consumers are shifting towards adopting clean technology largely in the means of generating electricity by utilizing renewable resources[19].

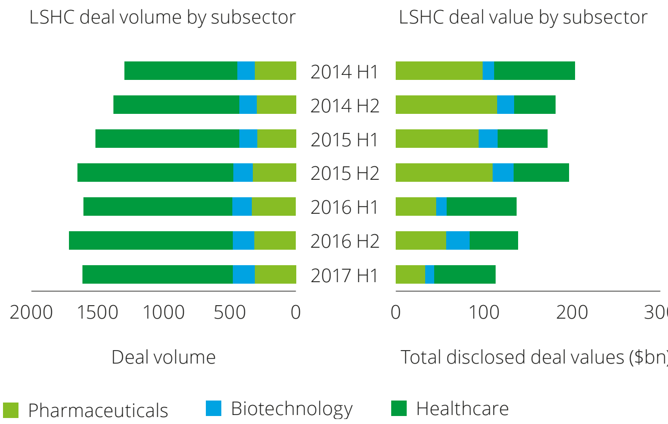
# Life Sciences and Healthcare (LSHC)

**Global disclosed deal values for LSHC as a target ($bn), H1 2014-H1 2017**




Source: Deloitte analysis based on data from Thomson One Banker

**LSHC deals by target subsector**




Global opportunity, strategic acquisitions, portfolio optimizations, cost/risk driven partnerships, and rapid disruptions are driving deal volumes.

- **Dealmaking in the life sciences and health care** – Both the life sciences and health care sectors are expected to see sector consolidation in the near future as the industry seeks to add scale to manage financial, regulatory and competitive pressures. The regulatory environment is becoming more demanding and detailed which, in turn, will require businesses to implement stricter compliance policies, increase cross-functional collaboration, and improve data management and data integrity[21]. Big pharma and medtech companies are anticipated to drive life sciences consolidation in an effort to strengthen portfolios and add data analytics capabilities, respectively. However, these acquirers may be more likely to focus on smaller company acquisitions in light of failed mega deals in recent past[22]. Within health care, consolidation is occurring across the spectrum of sub-sectors to achieve economies of scale: providers are increasingly opting to form health systems through M&A to address increasing competition and rising costs while health plans are combining with providers to improve integration across the continuum of care[23].

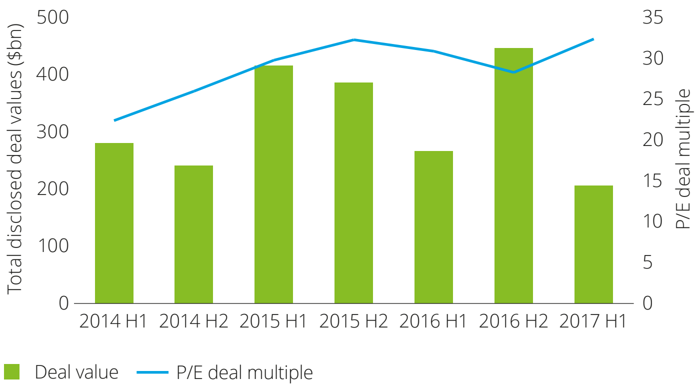
- **Cautious cross-border activity** – Cross-border M&A will likely be deliberate and cautious, favoring well-vetted and small strategic investments[24]. LSHC companies face unique hurdles when entering emerging market (e.g., lack of knowledge about the market, ability to evaluate targets, complex regulatory frameworks, reimbursement uncertainty, and cultural differences). However M&A in emerging markets have given a mixed result, but Germany and US have contributed to the maximum of cross-border acquisition with valuing $19.8 billion and $15.4 billion respectively[21].

- **Collaboration** – In the United States and elsewhere, health plans are also "defragmenting" via mergers and acquisitions (M&A) and collaborative relationships with providers to create powerful data-sharing networks that help drive integration across the continuum of care[23]. Trends toward Value-based Care (VBC) encourage collaborations that drive value, control costs, and distribute risk. Through both M&A and non-M&A partnerships (e.g., asset swaps, alliances, joint-ventures), payor-provider-developer collaboration facilitates knowledge sharing, specialization, and distribution of risk[23]. Though the number of transactions will likely continue to grow, deal value will not be as high, as companies look for growth in innovation and divestiture of non-core assets. Moreover, to free-up cash, address patent cliffs and demand for less expensive drugs, management may focus on core businesses and next-generation innovations[21].

- **Industry outlook** – Overall, combined global health spending is projected to grow at an average of 4.4% per year in 2017-21, though this may be unevenly spread among countries. In wealthier countries, spending will likely be driven by the aging population, while in developing countries it will likely be driven by rising wealth. As the focus on value-based care continues, this puts pressure on pharmaceutical companies to justify the cost of their products. Nonetheless, the EIU predicts pharmaceutical sales to grow at 4.9% in 2017-21. Underlying this projection is an expected slowdown in patent expirations and consolidation in generics markets; moreover, though wealthy countries are increasingly using generics, less mature markets are likely to see an increase in the use of expensive, advanced medicines[25].

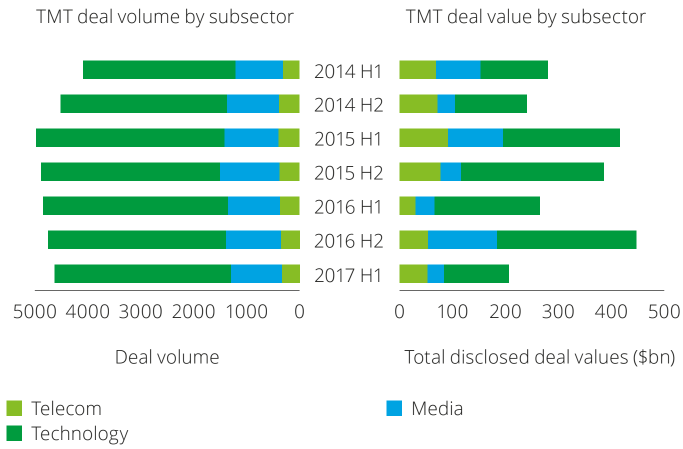
# Technology, Media and Telecommunications (TMT)

**Global disclosed deal values for Telecom, Media and Telecommunications as a target ($bn), H1 2014-H1 2017**




Source: Deloitte analysis based on data from Thomson One Banker

**Technology, Media and Telecommunications deals by target subsector**




As Digital Transformation picks up pace, many Tech and Non-Tech companies are exploring different business models and looking out for disruptive technologies through M&A.

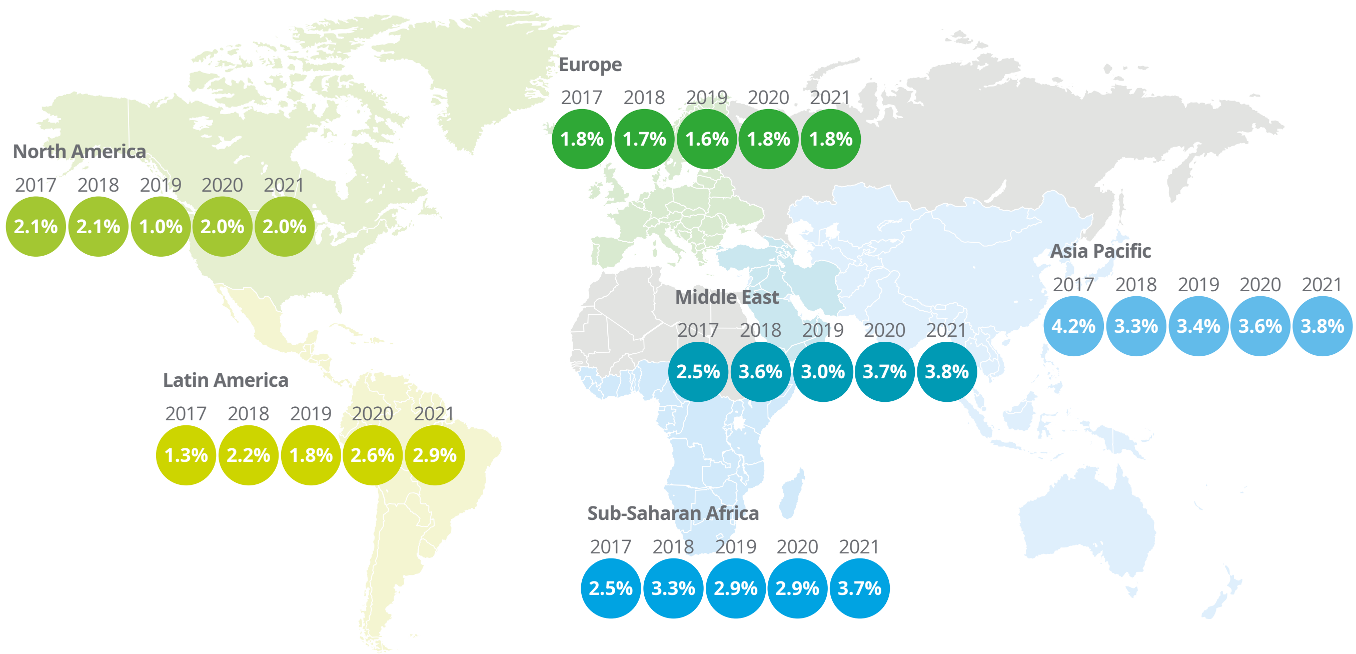
- **Flexible consumption model** (FCM) – Regardless of whether software resides on premise or in the cloud, many customers are demanding subscription based model. Such a model provides flexibility and perception of affordability. Gartner predicts that 80% of software providers will have migrated to subscription based model by 2020[26]. While some streaming services providers are born FCM, others content providers are transitioning in to FCM.

- **Cross-sector convergence and consolidation** – Drive to acquire consumers and provide them an all-inclusive experience has led many media firms to buy technology companies and vice versa. For instance, mobile subscribers are forecast to grow 3.7% per year during 2016-20, benefitting traditional network operator revenue streams; however, finding opportunities to monetize existing customers will become paramount in the long-term as the market saturates[27]. Companies from other industries (e.g. Pharma, health care) also exhibit a strong inclination to acquire technology assets[28]. Many technology giants are competing in the race to acquire private AI and IoT companies and are exploring partnerships and joint ventures. A case in point is a partnership between two major Tech companies, focused on growing revenues in emerging fields like AI, IoT to offset declining sales in more traditional areas[29].

- **Portfolio optimization** – In order to improve their response time to market opportunities/threats specific to their sphere of activity, many slow-moving corporate giants spin-off into two or more nimble entities. This gives an opportunity for both entities to refine their market positioning into distinct strategies and business model. The pressure to be nimble – to be able to turn on a dime – has led many of these companies to pursue a "shrink to grow" strategy[30]. The scope for M&A in technology is booming as legacy technology companies shed old assets and consolidate, and companies in other industries scoop up tech assets at a historic pace[31].

# Regional trends & outlook

**Figure 9. GDP Growth Forecasts**




## Americas

Deal activity will likely increase in the Americas driven by strategic acquisitions.

- **Growth and key economic trends** – The International Monetary Fund (IMF) raised the growth outlook for the US in 2017 from 2.2% to 2.3% due in part to an underlying assumption that the US will benefit from expansionary fiscal policy; however, this forecast is subject to the prevailing uncertainties surrounding the current administration[31]. The US dollar has appreciated in recent years and future Federal Reserve rate increases are likely to strengthen it further. Higher interest rates starting early 2017 indicates that new economic policies will lead to higher deficits and full-employment economy, which suggests a further increase in future interest rates[24]. In 2019, the Economist Intelligence Unit (EIU) foresees a short-lived U.S. recession caused by a slower growth in China and rising borrowing costs, followed by a swift rebound to the new normal of approximately 2.0% GDP growth in 2020-21. The Latin America and Caribbean economy is expected to see a gradual emergence from recession.

- **Investor appetite** – The deal activity in North America slid lower in 2016 due to increased political volatility, although the numbers began to rebound in Q4, 2016[34]. Americas (US$1.7T) was the leading region by deal value in 2016. Energy and Resources (US$362B) and High Technology (US$298B) were the leading contributors to the Americas M&A value 2016, followed by Media & Entertainment (US$167B), Life Sciences & Healthcare (US$161B) and Materials (US$153B)[34]. Europe and North America have led cross-border M&A activity in Latin America as companies from these mature economies look to invest in faster growing markets[36].

- **Regional outlook** – Despite volatility affecting markets and the impending increase in interest rates which will increase the cost of capital, M&A activity in the Americas will likely be driven by large strategic transactions[37]. Reforms in the energy sector in Mexico have opened the door to foreign participation in the country's energy industry and has raised hopes of renewed growth in foreign investment in this sector[36]. The currency depreciation reported in several countries of Latin America, alongside regulatory changes in key markets are likely to keep fueling cross-border M&A activity led by foreign private equity firms and multinational companies[37].

**Europe**

Deal activity is projected to continue to grow in Europe in the coming years.

- **Growth and key economic trends** – The European economy is expected to grow modestly in 2017 at 1.8%, impacted by low investments and decline in exports[33]. Moving into the medium-term, the EIU predicts the region to grow between 1.6% and 1.8% through 2021, driven by the passage of structural reforms supporting private-sector activity and accommodative monetary policy. However, there may be significant divergences in performance among countries within this average, in part dependent upon the other European economies to which they are tied (e.g., Germany vs. Russia)[33].

- **Investor appetite** – Europe reported a deal volume of 15,357 deals in 2016. Industrials (2,472 deals), High Technology (1,938 deals), Consumer Products & Services (1,749 deals) and Financial Services (1,639 deals) accounted for more than half of Europe's deal volume for the same period[34]. M&A activities increased by 5.9% in Q4 2016 with Germany, UK and France posted an increase of 4.2%, 4.2% and 11% respectively[38]. Cross-border deals between Asia and Europe, led by China and Japan is expected to emerge[24].

- **Regional outlook** – The weakness of the euro, favorable debt market conditions, attractive valuations, and a positive growth outlook all will offer opportunities for M&A activity. European companies have access to local markets that are expected to grow faster than many other developed economies, making them attractive acquisition targets. Moreover, European P/E multiples are trading close to their 15-year average, in contrast to those in the U.S. and Asia which are well above[24]. The Brexit vote might have temporarily slowed down the M&A activities due to political and market uncertainty, but it is expected to bounce back mostly driven by interest from Asian buyers in UK assets due to the drop in the value of the Pound[39]. With over $1.6 trillion in cash reserves held by North American non-financial companies, they are also in a strong position to make acquisitions[24].

**Africa & the Middle East**

Deal activity may decline in Africa but grow in the Middle East, as persistent geopolitical instabilities continue to affect the region's overall ability to grow.

- **Growth and key economic trends** – Middle East and North Africa GDP is expected to grow at an average of 2.5% to 3.6% in 2017-18, buoyed by the projected recovery in oil prices[33,40]. Growth in the medium term will likely be moderate due to planned production cuts and necessary fiscal adjustments, but is expected to be mitigated somewhat by growth in non-oil activities[41]. By the EIU's estimates, GDP growth is expected to be 3.5% on average in 2018-21[33]. Sub-Saharan Africa is projected to grow GDP from 2014 to 2018 at 4.8%. This strong growth is underpinned by population growth, a rise of the middle class, and rapid urbanization[42]. The key policy challenges are to improve government finances; reduce economic dependence on oil; and address longstanding business environment, labor market, and financial sector shortcomings[43]. Future growth is expected to vary across the region, but in light of numerous persistent constraints (tighter fiscal policies, difficult operating environments among them) and only moderate anticipated price growth in major exports, the region's 2018-21 GDP growth is expected to average less than 3.4% per year[33].

- **Investor appetite** – Despite the opportunities that African economic development presents to investors, M&A activity is challenged by political instability, historic under-investment in infrastructure, and recent humanitarian disasters such as the Ebola outbreak[42]. As international relations warm in Iran, optimism on the Iranian economy has generated interest from foreign companies[42]. The sharp drop in oil and other commodity prices adversely impacted M&A activities for the natural resources exporting nations in the Middle East and Africa which is expected to continue in 2016[24].

- **Regional outlook** – Persistent geopolitical instabilities and varied macroeconomic factors will likely continue to affect the region's overall ability to promote M&A activity. Moreover, organizations in South Africa are expected to continue diversifying operations through outbound acquisitions, depressing domestic M&A activity[24].However, within the region are key markets that may prove to be oases of inbound M&A, including Israel (whose innovative start-ups remain attractive to US buyers) and the UAE[43].

**Asia-Pacific**

The growth in M&A activity in Asia-Pacific will likely slow after a decade of high volume, especially in light of China's economic slowdown.

- **Growth and key economic trends** – IMF estimates the region's growth to be stable at 5.4% in 2016 and 5.4% in 2017[45], while the EIU projects slightly lower overall growth of 4.2%[33]. In 2018, the EIU predicts a sharp slowdown to 3.3% growth, driven primarily by China, followed by a slow recovery to 3.8% growth in 2021[33]. The growth in China is expected to be slow with an average outlook of 6.4% in 2017-18, assuming reforms are implemented and their impact is eased by additional regulatory policies[44]. By 2018, the EIU predicts Xi Jinping will have sufficient party support to begin using tight monetary policy as a tool to further suppress an overheated credit market. Thus may begin a managed downward adjustment period in the economy's growth, expected to be concentrated primarily in the industrial sector. India's GDP growth of 7.2% was impacted by government's decision to demonetize over 85% of the currency under circulation. However, on a positive note, the increased liquidity in banking system might further push the Reserve Bank of India to cut rates indicating a shift in policy from controlling inflation to boosting growth[46]. The EIU projects an average annual growth rate for India of 7.6% over the next five years, the highest in the region[33].

- **Investor appetite** – Domestic deals in Asia-Pacific region are at decade highs, largely led by China. However, with the slowdown in the domestic M&A activities the outbound investment will likely increase in China as the companies seek to expand in new markets, even despite capital outflow regulations. Outward Chinese investment has been heavily financed by the government since state-run companies' high debt would likely not qualify for commercial debt[24]. Moreover, China has balanced its capital restrictions with policies simplifying other elements of overseas deal making, including tax convention and approval processes. China is in the midst of rebalancing from an investment led, export oriented economy to a consumption driven one. This shift is signaled by the dominance of the services sector. The decline in Chinese GDP growth and the shift to a consumption driven economy is mirrored by a steep increase in M&A activities, both domestic as well as cross-border[24]. Asia-Pacific (15,519 transactions) recorded the highest deal volume in 2016. Within Asia-Pacific, High Technology (2,368 deals), Industrials (2,308 deals) and Financial Services (1,810 deals) were the top targeted industries in 2016[47]. M&A activity of Indian companies has grown by 82% to US$27 billion during the first two quarters of 2016, driven by improved policies[24].

- **Regional outlook** – With a cooling economy in China and continued focus on outbound acquisitions, domestic dealmaking and overall M&A activity in the region is likely to face headwinds. However, we expect India to continue as a growing market for inbound acquisition and corporate venture capital, continuing to attract investments from U.S., Japan and China[43].

# Research methodology

This paper was developed through quantitative and qualitative analysis of a diverse set of sources:

### Overall approach

- The authors looked at historical trends in M&A activity over the past 25 years, focusing the analysis on strategic deals only, to identify key drivers and indicators of M&A value/volume, with specific attention to cyclical patterns.

- The authors conducted a qualitative analysis of the landscape for M&A across individual industries and regions to determine current tailwinds and headwinds within each sphere.

- These insights, combined with the perspective of global M&A experts, informed the key themes and conclusions in this paper.

### Quantitative resources

- The Thomson Reuters database was used to generate annual M&A statistics, including industry, cross-border, and PEI/financial data. The database was accessed for the year 2017.

- Deloitte analysis was used in Method B's top-down, cyclical time series analysis on past M&A value to forecast future growth. Specifically:

  – Global M&A value can be modeled as a cyclical time series to forecast future activity. The classic multiplicative model is defined as; where,, are defined as the M&A value, cycle component and time component at year,

  – **Cyclical component**: On average, a full cycle in the data is 9 years (low, high, low). Therefore, a 9 year moving average is calculated in order to isolate the data's cyclical component, at each year,

  – **Trend component:** yields the "de-cyclical" M&A values, at each year,. A regression is performed on these values (since they do not have the cyclical influence) to calculate the trend component

Statistical information related to economic and market indicators (e.g., corporate cash balances, interest rates, economic growth) comes from FactSet and Federal Reserve Economic Data.

### Qualitative resources

- Deloitte global economic and M&A eminence provided context for the analysis of statistical information (e.g., trends, peaks, dips). Predictions are supported by a range of Deloitte industry and regional publications.

- Other sources in this POV include InvestmentMin, MergerMarket, the International Monetary Fund, the Economic Intelligence Unit, and the World Bank.

Interviews with Deloitte M&A industry leaders provided additional insights.

# Authors and contacts


## Authors

**Larry Hitchcock**
Global M&A Lead
Deloitte Consulting LLP
lhitchcock@deloitte.com

**Sriram Prakash**
Global Head of M&A Insight
Deloitte Touche Tohmatsu Limited
sprakash@deloitte.co.uk

**Maria Negrete**
M&A Senior Manager
Deloitte Consulting LLP
marnegrete@deloitte.com

**Shyam Ramdevkrishna**
M&A Manager
Deloitte Consulting LLP
sramdevkrishna@deloitte.com

## Contacts

**Susan Dettmar**
U.S. M&A Lead
Deloitte Consulting LLP
vkennedy@deloitte.com

**Venus Kennedy**
LATAM M&A Lead
Deloitte Consulting LLP
vkennedy@deloitte.com

**Mirko Dier**
EMEA M&A Lead
Deloitte Consulting LLP
mdier@deloitte.de

**Hideo Matsue**
APAC M&A Lead
Deloitte Touche Tohmatsu Limited
hmatsue@tohmatsu.co.jp



## Acknowledgements

**Contributors:** Inu Agarwal, Enzo Azarcon, Saheli Chakraborty, Lauren Putney, and Vijay Sivasailem.

**Advisory Panel:** Mirko Dier, Eamonn Kelly, Iain Macmillan, Hideo Matsue, Renata Muramoto, Joel Schlachtenhaufen, Trevear Thomas, and Jeffery Weirens.

**M&A Industry Leads:** Susan Dettmar, Paul Legere, Jason Langan, Boris Lukan, Ollie McCoy, Marco Sguazzin, and Shashi Yadavalli.

**Research and Development Team:** Tyler Crown, Matt Felumlee, John Forster, Harry Goldberg, Aijaz Shaik Hussain, Marguerite Pressley, Nancy Tseng, Amit Kumar Sudrania, Daniela Trigo, Chandrakala Veerabomma, Mercy Wakweika, Laura Walzer, Trevor Wirsig, and Jeffrey Yang.

# Endnotes


1. Deloitte Analysis
2. Barr, Steven. "Consumer Markets M&A are Poised for Growth in 2017." Forbes. February 3, 2017. http://www.forbes.com/sites/stevenbarr/2017/02/03/consumer-markets-are-ma-poised-for-growth-in-2017/#4048f4e6335f
3. TechCrunch (https://techcrunch.com/2016/11/12/we-are-on-the-verge-of-a-consumer-ma-avalanche/)
4. Golman, Jeff. "Four Reasons 2016 Will be A Strong Year." Forbes. Forbes Magazine. Web. https://www.forbes.com/sites/jeffgolman/2016/01/11/four-reasons-2016-will-be-a-strong-year-for-ma/#6a4509915c0d
5. CB Insights (https://www.cbinsights.com/blog/consumer-goods-companies-acquisitions/)
6. M&A trends report 2016, year-end edition (https://www2.deloitte.com/us/en/pages/mergers-and-acquisitions/articles/ma-trends-report.html)
7. Banking and Securities Outlook 2017: https://www2.deloitte.com/us/en/pages/financial-services/articles/banking-industry-outlook.html#
8. http://www.fsb.org/wp-content/uploads/2016-list-of-global-systemically-important-banks-G-SIBs.pdf
9. The Economist Intelligence Unit. (2017) World Industry Outlook: Financial Services. London, UK.
10. 2017 Investment Management M&A Outlook
11. 2016 Insurance M&A Outlook: https://www2.deloitte.com/content/dam/Deloitte/au/Documents/mergers-acqisitions/deloitte-us-fsi-2016-insurance-ma-outlook.pdf
    Banking and Securities M&A: Opportunities and Uncertainty
12. 2016 Financial Services M&A Predictions: https://www2.deloitte.com/content/dam/Deloitte/uk/Documents/financial-services/deloitte-uk-fs-ma-predictions-2016.pdf
13. 2017 Insurance M&A Outlook – Deloitte report
14. Banking and Securities M&A: Opportunities and Uncertainty
15. Appelbaum, Binyamin. "Yellen Treads Carefully on Regulatory Issues in Senate Panel Appearance." New York Times. July 13, 2017. https://www.nytimes.com/2017/07/13/us/politics/yellen-fed-banking-regulation-senate.html
16. Deloitte – Oil & Gas Mergers and Acquisitions Report – Year End 2016 (https://www2.deloitte.com/us/en/pages/energy-and-resources/articles/oil-and-gas-mergers-and-acquisitions-update.html)
17. Deloitte – Oil & Gas Mergers and Acquisitions Report – Mid-year 2017 (https://www2.deloitte.com/content/dam/Deloitte/us/Documents/energy-resources/us-oil-gas-m-n-a-report-midyear-2017.pdf)
18. Deloitte-WSJ (The Slow Road Back: Oil & Gas Industry Outlook for 2017 (http://deloitte.wsj.com/cfo/2017/01/04/the-slow-road-back-oil-gas-industry-outlook-for-2017/)
19. The Economist Intelligence Unit. (2016) World Industry Outlook: Energy. London, UK.
20. https://www2.deloitte.com/content/dam/Deloitte/us/Documents/energy-resources/us-deloitte-resources-2017-study-energy-management.pdf
21. EUI briefing, Deloitte sponsored: M&A Trends in LSHC: Growth at the global intersection of change
    https://www.theguardian.com/business/2016/apr/06/pfizer-allergan-tax-inversion-deal-merger
22. 2017 global life sciences outlook-https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Life-Sciences-Health-Care/gx-lshc-2017-life-sciences-outlook.pdf
23. 2017 global health care sector outlook (https://www2.deloitte.com/us/en/pages/life-sciences-and-health-care/articles/global-health-care-sector-outlook.html)
24. Deloitte M&A Index 2016: Opportunities amidst divergence
25. The Economist Intelligence Unit. (2016) World Industry Outlook: Healthcare and Pharmaceuticals. London, UK.
26. Market Trends: Prepare Now to Smooth the Inevitable Transition to a Subscription-Based Business Model
27. The Economist Intelligence Unit. (2016) World Industry Outlook: Telecommunications. London, UK.
28. The Convergence Of Technology, Media And Entertainment (http://mergermarketgroup.com/wp-content/uploads/2016/06/ReedSmith_Tech_MA_FINAL_LR.pdf) – This is a pretty generic statement and we do not have to quote as the such. Laying it here for ease of reference
29. Deloitte Artificial intelligence (AI) goes mainstream Revolutionizing businesses (https://www2.deloitte.com/us/en/pages/technology-media-and-telecommunications/articles/artificial-intelligence-disruption.html)
30. Deloitte Analysis: Spin Cycle – The Rise of Technology Sector "de-mergers"
31. http://www.marketwatch.com/story/tech-deals-market-shows-no-sign-of-slowing-2016-08-31
32. http://www.imf.org/en/Publications/REO/WH/Issues/2017/05/10/wreo0517
33. The Economist Intelligence Unit. (2017) Country Forecast: Global Outlook. London, UK.
34. http://mergermarketgroup.com/wp-content/uploads/2016/12/Firmex_Q4-2016_Newsletter_Final-LR1.pdf
35. M&A Insights Trends December 2016
36. M&A in Latin America – Deloitte Report
37. Mergermarket: Deal Drivers – Americas
38. http://www.factset.com/mergerstat_em/europe/Europe_Flashwire_Quarterly.pdf
39. https://www.ft.com/content/a14920aa-4a90-11e6-b387-64ab0a67014c
40. World Bank Group – http://pubdocs.worldbank.org/en/842861463605615468/Global-Economic-Prospects-June-2016-Divergences-and-risks.pdf
41. International Monetary Fund (2017) Regional Economic Outlook Update. http://www.imf.org/en/Publications/REO/MECA/Issues/2017/04/18/mreo0517
42. Deloitte Report: Investing in Sub-Saharan Africa http://www2.deloitte.com/xe/en/pages/about-deloitte/articles/manage-yourself/investing-in-sub-saharan-africa.html
43. Deloitte M&A Index 2017: Dealing with the Future
44. World Bank Group – http://pubdocs.worldbank.org/en/842861463605615468/Global-Economic-Prospects-June-2016-Divergences-and-risks.pdf
45. IMF Regional Economic Outlook – https://www.imf.org/external/pubs/ft/reo/2016/apd/eng/areo1016.htm
46. https://dupress.deloitte.com/dup-us-en/economy/global-economic-outlook/2017/q1-india.html
47. http://www.ibef.org/economy/indian-economy-overview
    https://dupress.deloitte.com/dup-us-en/economy/global-economic-outlook/2017/q1-china.html
48. https://dupress.deloitte.com/dup-us-en/economy/global-economic-outlook/2017/q1-japan.html

Deloitte.



Designed and produced by The Creative Studio at Deloitte, London. J13595