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The Deloitte

M&A Index H2 2013

Recovery in deal volumes expected in H2 as sentiment improves

Key points

- Deloitte predicts a 6% increase in global M&A deal volumes for H2 2013 compared to H1, with close to 30,000 deals globally by year-end.
- The strengthening economic outlook across the developed markets is the catalyst for M&A volumes to close higher in H2.
- The US tapering of QE is causing economic volatility across a number of asset classes, and may suppress emerging market outbound M&A activities; however, companies in these emerging markets could in turn become attractive targets.

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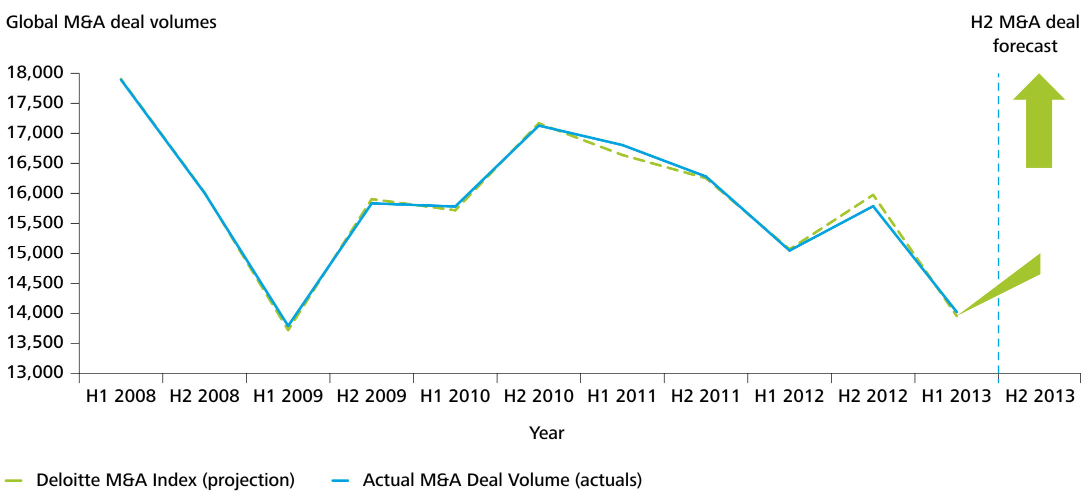
Figure 1. The Deloitte M&A Index



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 per cent dating back to Q1 2008.

H2 2013 M&A deal forecast: Up

A steady recovery, both in optimism and the economy, across the developed markets is expected to drive the uptick in M&A deal volumes.

North America

The overriding theme this year has been a return to growth for many of the world's advanced economies, with the US leading the way. All five of the mega deals (>US$10bn) seen in H1 2013 were carried out by US companies reflecting the returning confidence in the region. As the economy and investor sentiment continue to improve, we can expect the US-led resurgence to have a trickle-down effect on global dealmaking. Data from Q2 2013, shows that a North American company was involved as a buyer and/or seller in 37 per cent of all M&A transactions globally, the highest level since 2007. This underlines both the strength of the M&A market in the region and its importance to global M&A deal volumes.

Europe

The eurozone has finally come out of recession after a record 18-month contraction with two of the leading European deal making countries, Germany and France, both posting stronger-than-expected growth, expanding 0.7 per cent and 0.5 per cent respectively. The UK has also seen a wealth of positive data with GDP revised upwards to 0.7 per cent between April – June led by higher output across construction, manufacturing and parts of services. Recently released data also shows solid export growth, a rise in housing activity and better retail sales figures all pointing to increasing consumer confidence. Overall, Europe continued to see inbound deal activities throughout the economic downturn, and, if the recovery continues, we can expect European domestic and outbound M&A dealmaking to increase.

Emerging markets

The anticipated tapering of quantitative easing by the United States Federal Reserve has adversely impacted those emerging markets with fiscal and current account deficits as investors return to the US dollar. This has led to a rout of emerging market currencies, forcing respective central banks to intervene to halt the decline and shore up confidence. As a result, we expect outbound and domestic M&A deal volumes from these countries to fall. However, this could in turn present opportunities for developed market companies to pursue their growth agenda in the emerging markets by acquiring companies at attractive prices.

Corporate barometer

Company fundamentals of the S&P500 and FTSE100 companies have remained relatively unchanged in Q2 2013. Corporate cash reserves are still at or near record highs and companies are also generating increasing free cash flow for the firm (FCFF). However, in Q2 2013 there was a rise in average capital expenditure and average dividend payments. It appears these companies are pursuing organic growth and return earnings to shareholders. With the economic environment in the US and Europe improving, Deloitte expects corporate confidence to increase throughout H2 2013 and for companies to pursue growth through M&A.

Figure 2. Company fundamentals (FTSE100 and S&P500) (Q2 2013 v. Q1 2013 average)

Source: Bloomberg; Deloitte analysis

Factors influencing M&A in H2 2013

For H2 2013, the Deloitte M&A Index has highlighted a number of variables which have a significant statistical relationship and will impact M&A deal volumes:

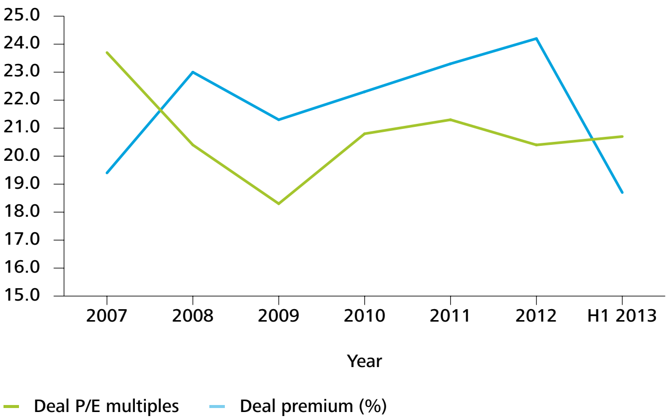
Premiums plummet

Despite volatility in equity markets, global P/E multiples have remained stable since 2010, however this year there has been a sharp decline in deal premiums. Having reached highs in 2012, deal premiums have now fallen to five year lows in H1 2013 suggesting that buyers are reluctant to 'sweeten' M&A deals. This may be the result of activist shareholders increasing their scrutiny of potential deals, adding pressure on CEOs to do the 'right deal'.

Changing trajectories

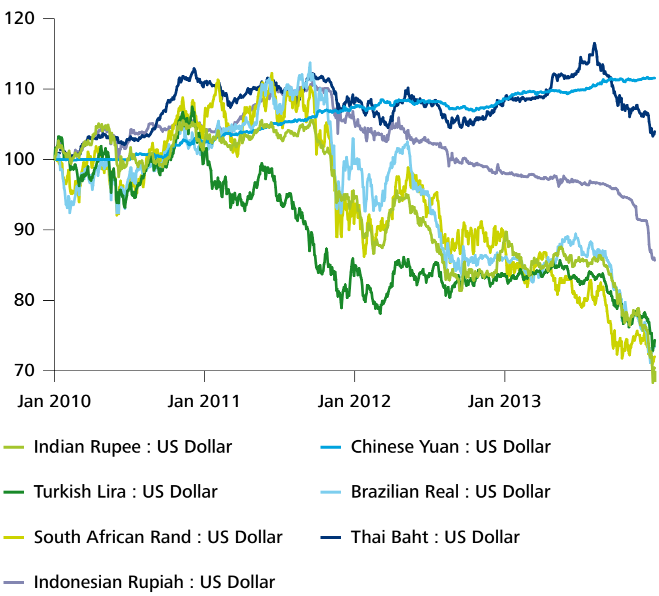
The accelerating recovery in the US and the Federal Reserves planned slowing of asset purchases has led to a destabilisation of many of the emerging market economies. Over the last few years, the Fed's quantitative easing programme led to credit inflation among many emerging markets helping to give a boost to their dealmaking activities, equity and IPO markets. The US Federal Reserves planned tapering of asset purchases is now causing investors to shun emerging market assets in favour of the US dollar, leading to a sharp decline in emerging market currencies and a fall in their foreign currency reserves. In the short term, Deloitte therefore expects outbound activity from the emerging markets to slow. However, the long-term economic and demographic upside of the emerging markets still remains and we expect developed market companies to use this opportunity to make strategic acquisitions.

Figure 3. Average deal P/E multiples v. average deal premium (%) (2007 – H1 2013)



Source: Thomson Reuters; Deloitte analysis

Figure 4. Emerging market currencies against US Dollar based to 100 (2010 to YTD2013)

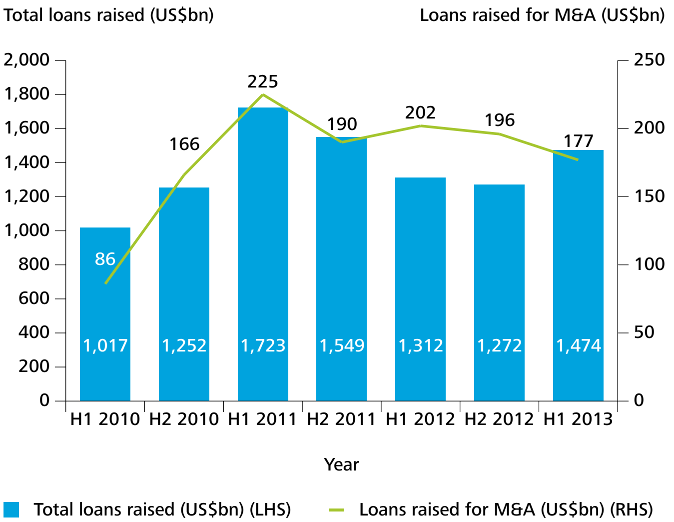


Source: Thomson Reuters; Deloitte analysis

Credit on tap

Markets are awash with credit as investors seek yield with the global corporate bond and loan markets showing continued strength in 2013. While bond issuance is down on 2011 and 2012 levels, loan issuance is on track to surpass 2012 levels this year. While most of the funds raised have been used to refinance debt to reduce interest payments and/or extend maturities, there has been a steady increase in funds earmarked for M&A activities, particularly by European companies. Deloitte expects companies to start using some of these funds for M&A activities.

Figure 5. Value of corporate loans raised globally (2008 – H1 2013)



Note: Figures do not include loans raised by financial companies, governments or agencies.

Source: Thomson Reuters; Deloitte analysis

Notes: In this publication, references to Deloitte are references to Deloitte LLP, the UK member firm of DTTL.

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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 (including world real GDP (YoY%) and the CBOE VIX Index)
- Funding and liquidity conditions (including global investment grade bond market volumes and global IPO volumes)
- Company fundamentals (including average cash in hand and average net debt/shareholder equity)
- Valuations (including trailing price/earnings and deal P/E multiples).

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 per cent dating back to Q1 2008.

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