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M&A Views

Deloitte M&A Views podcast: The state of the deal: M&A trends 2018

Transcript

Greg Jarrett: Welcome to Deloitte M&A Views, a Deloitte podcast series exploring the latest trends and topics in mergers and acquisitions (M&A). I'm Greg Jarrett, and today we are talking the state of the deal—M&A trends for 2018. Deloitte just published the fifth edition of this annual report, which asks more than 1,000 corporate and private equity executives to weigh in on the current year's M&A activities, and to share what they expect to see happen over the next 12 months. There are a number of revealing insights about what is driving entities to pursue deals, and what is making those deals more successful. Could companies really see more and bigger M&A deals in 2018 than anticipated?

Today, we're joined by Russell Thomson, partner with Deloitte & Touche LLP and National Managing Partner of Deloitte's Mergers & Acquisitions Services practice, who will walk us through the latest research and share his perspectives on what's trending for the coming year.

Russell, we appreciate you taking the time and sharing your perspectives today on what's happening in the M&A environment—upcoming in 2018 and what we can look forward to in the coming months. Now, according to Deloitte's latest M&A trends report, activity for 2018 is looking pretty strong. In fact, respondents are anticipating more and bigger deals. What's changed for corporate and private equity leaders since last year? Why is everybody so optimistic, Russell?

Russell Thomson: There is a strong sense of optimism. 68 percent of corporate executives and 76 percent of private equity leaders expect that the volume of deals will continue to increase over the next 12 months. And nearly two thirds of those expect, in addition to increases in volumes, the deal sizes of these transactions will continue to increase. And obviously this is in stark contrast to what we've seen over the last few months: We have actually seen a decline in both of those in the marketplace.

But you ask the question around what's changed, and what gives rise to that level of optimism. And it's a number of different things. Firstly, there's even more fire power. The amount of balance sheet cash that corporations have today is even larger than when we spoke a year ago.

And in addition to that, the stock market valuations—so the availability of stock as an additional currency and freely available debt financing just adds to that fire power. And if you look at some of the other fundamentals, inflation's under control, there’s low unemployment, low market volatility, and strong GDP growth rates. And all of that adds to the impetus. And then a couple other things that I would flag I think that fuel that level of optimism: One is tax reform and the pending clarity around the path forward is seen as a positive. If we end up with lower corporate tax rates and incentives to repatriate cash, this will only further accentuate the impetus to drive M&A activity.

And perhaps lastly—the one I would flag on the private equity side—is if you look back over the last 12 months, private equity fundraising has again been at record highs. Bigger amounts across fewer funds.

Greg Jarrett: Russell, there's certainly a lot going on worldwide, from North Korea to the United Kingdom leaving the European Union to Washington DC. So far, nothing seems to have put the brakes on for the markets or for M&A. Do you see anything on the horizon that could get in the way of pursuing deals of the magnitude in scale expected according to this report?

Russell Thomson: Absolutely, Greg. There remain some real potential headwinds. In fact, some would argue that uncertainty remains high and is underpriced in the market. And some of those potential obstacles, you mentioned a few, but I would say what comes through loud and clear is any delays in pro-business legislation such as tax reform could be a potential setback. Geopolitical concerns—we still read a lot in the media around what's going on in North Korea, Iran, the potential risk around trade wars.

Last year, we talked about valuation multiples and transactions being incredibly high. We've seen no moderation around that at all. So valuation multiples continue to be at record levels. And perhaps the last one I would flag, we’ve seen a lot of gain in the media over the last weeks around some of the antitrust considerations and the ability to close some of these really large transactions. So yes, there are potential headwinds. But in spite of those—we're taking all of those into account—the feedback coming out of this survey is still very optimistic as to the level and the size of transactions over the next 12 months.

Greg Jarrett: There are a lot of massive potential takeover targets out there, Russell. And there are a lot of very deep pockets, as we know. What's motivating companies to want to make bigger and more deals? Is navigating the change in these transactions worth it in the end?

Russell Thomson: If we look at the data from the survey, I'd say many feel that it's clearly worth it. And sometimes, it's an imperative to either grow or stay ahead of business disruption. And one key theme that came through loud and clear, that I'd highlight, is that companies are in it for the technology. And by this I mean—whether that's digital disruption, that's transformative shifts in customer buying habits, or, quite frankly, convergence across different industries and sectors. These are all examples of the driving forces, but they're all forcing companies to make bets on future technology—but make those bets now.

And in fact, if you look at the feedback for non-technology companies, technology acquisition was the number one driver that was cited for the pursuit of M&A transactions. And combined, if you look at the acquisition of technology assets and the pursuit of a digital strategy, that accounted for a third of all expected transactions going forward, which is a staggering amount. So all things considered, I would say there remains a very strong and healthy appetite for M&A, Greg.

Greg Jarrett: Russell, there are so many disruptors on the horizon. We can't ignore them—AI, autonomous vehicles, alternative energy expansion. How much of a driver are these disruptors? And do you see it leading to more cross-industry M&A?

Russell Thomson: Greg, absolutely. There are a tremendous number of disruptors. Obviously, that varies by industry and sector. I'll take us back to the point when we talked about some of the major drivers for M&A activity—yes, it's growth, but the other part is the strategic angle that people are either anticipating or trying to stay ahead of disruption or business competition. And so convergence across industries was another very strong theme that came through. And some of those acquisitions, particularly around the technologies and the digital platforms we talked about, are a clear response to some of the questions or the disruptors that you talked about.

Greg Jarrett: Well, the market is apparently strong for M&A activity. Everybody seems to be doing it now. But the market also has a tendency to put out some mixed signals. Have you seen anything surprising in the term of markets where we might see activity?

Russell Thomson: We are indeed. And one that comes to mind that I'd highlight is that the geographic field of potential targets appears to be narrowing. I mean if there are fewer US companies that are interested in looking to places like Asia, mainly China and Japan, and Brazil, Italy, and Spain. In fact, looking at the survey, the interest or the combined interest in these five countries dropped nearly a quarter over what they were last year.

Greg Jarrett: Russell, we've all heard stories about M&A gone wrong. Your own reporting indicates there are executives who admit having deals fall short of their expectations. Wouldn't that make companies more cautious going forward, especially with the suitors they choose and in their planning process, despite any favorable conditions?

Russell Thomson: Sure, Greg. Those are real concerns. But don't forget, as we spoke about earlier, companies still need to grow and some are facing disruptive forces and convergence across the industries that make M&A an imperative. That said, there are those whose deals did not deliver a return on their investment, and that is painful. But again, if we look at the data in the survey, there is a continuing improvement—or the number of deals that are cited as not achieving that return has continued to shrink.

And this year, only 12 percent of our corporate respondents said that more than half of their deals did not meet their expectation. And this was down 40 percent from the survey we did in the spring of 2016, so clearly an improvement. But if I look at one other data point, there are still more than half of those corporations that say approximately a quarter of their deals don't meet expectations. So although that is a significant improvement, not out of the woods yet.

And I look at two other things to highlight there. So deals are working better based on that input, but for the second straight year, the two most important factors for deals' success was cited as integration and accurate valuation. And this year, there were two new factors that jumped in importance, and they were speed of decision making and aligning the cultures of organizations. And I thought those were both very interesting observations.

Greg Jarrett: Russell, you've made a lot of compelling points here. So what's the takeaway for us in M&A for 2018? Are M&A transactions truly expanding and evolving?

Russell Thomson: Not yet, Greg. But that is clearly the market expectation. Here are some of the main points. We can anticipate a greater amount of M&A activity over the next 12 months, companies have the money in hand and are aiming for bigger targets.

And likewise on the private equity investor side, they have a record level of dry powder and are also expecting larger and more transactions. And with the new innovative technology tools and accelerators that are being pervasively used across transactions, the confidence in making deals work is way up.

And finally, if anticipated pro-business legislative changes take place that could lead to even greater deal activity. So in closing, I would say M&A transactions are here to stay and evolving in a very interesting and meaningful way.

Greg Jarrett: I'm Greg Jarrett, thanks for listening to Deloitte M&A Views, sponsored by Deloitte's M&A Institute. This podcast is provided by Deloitte and is intended to provide general information only. This podcast is not intended to constitute advice or services of any kind. To read the 2018 M&A Trends report, visit www.deloitte.com/us/ma/trends. For additional information about Deloitte, go to www.deloitte.com/about. We also release new podcasts regularly, and if you subscribe, you won't miss a single one. To stay connected and receive more information on Deloitte's M&A service offerings, visit www.deloitte.com/us/MAsubscribe and follow us on Twitter at @DeloitteMnA. Until next time ...