Capital Confidence Barometer

Dealmaking returns?

M&A outlook
Growth mandates and confidence spurring activity

Economic outlook
Global economic outlook has brightened

Access capital
Global credit conditions improving

Growth
Growth as the new imperative
Dealmaking returns?

Growth mandates – driven by increased confidence and credit availability – will spur M&A activity in the oil and gas sector

Key findings

71% view the global economy as improving, up strongly from April 2013

92% view credit availability as stable or improving

94% expect to grow or at least keep their current workforce in the next 12 months

66% view growth as their organization’s main focus

62% view investing as the dominant focus of their organization’s capital agenda

39% expect to pursue an acquisition in the next 12 months

79% view market share growth in existing markets as a main driver of planned acquisition activity
“Economic optimism and confidence are underpinning a revived growth agenda for oil and gas M&A activity”

A note from Andy Brogan, Global Oil & Gas Leader for Transaction Advisory Services

Our ninth Barometer shows a clear rebound in corporate confidence. After several years of conservative decision-making, executives are steadily moving toward investing and growth. Oil and gas M&A data over the last four quarters has been lower than expected, but we may be at an inflection point.

We are seeing increasing optimism and confidence in the underlying macro-economic conditions and a strengthening corporate focus on growth, but there is still some lingering conservatism and risk-aversion. Our respondents have shifted their capital agenda decisively toward investing, but appear to still be wedded to a cautious approach to growth, and still focused primarily on lower-risk forms of growth.

Nevertheless, the appetite for acquisitions is increasing as is the sector’s confidence in the deal environment. Our latest Barometer shows that 39% expect to pursue an acquisition in the next 12 months, higher than the global average. Valuations and sentiment suggest there is a window of opportunity to seize first-mover advantage in a market gaining momentum. History shows that first-movers can create differential value and position themselves for sustained market leadership. In this context, now is the time to invest and grow.

A note from Pip McCrostie, Global Vice Chair, Transaction Advisory Services

Confidence in the global economy is at a two-year high. Companies have weathered a prolonged period of uncertainty during which time they strengthened their balance sheets and optimized their capital structures. Having warehoused cash for a number of years and with a ready access to credit, leading corporates are in a strong financial position to do deals – they now have more confidence to pull the trigger.

This does not mean we will see a return to boom-time deal-making. That was unsustainable – but so is the M&A recession we have experienced since 2009. For many companies, operational efficiencies and a focus on cost cutting can no longer meet growth mandates. As a result, the signs are that M&A will once again be a preferred route to achieve growth.
Economic outlook

Global economic outlook has brightened

The global economy is stabilizing and economic optimism is increasing. While the slowdown has lingered in Europe, some rays of hope are emerging. Consumer and business confidence is rising in the US and Japan, and the emerging economies are generally recovering from their slowdown. Notably, the oil and gas companies in our survey are significantly more optimistic about the future of the global economy than they were six months ago, implying a positive environment for deal-making.

Optimism is increasing sharply

More than 71% of the oil and gas company respondents believe the global economic situation is improving, up from 44% in April 2013. There has also been a decrease in the number of companies who report declining sentiment, from 17% to 11%. Notably, oil and gas companies are also generally more optimistic than the broader global sample of respondents.

Rising confidence spurs expectations for higher growth

Sixty percent of our oil and gas respondents expect the global economy to grow between 1% and 3% over the next 12 months, down slightly from April 2013, but the same as the global sample. Additionally, 29% expect that growth will be higher than 3% over the next 12 months, up sharply from the April 2013 survey.

Optimism is increasing sharply but confidence is mixed

Confidence from our oil and gas companies was mixed however, across a broad range of economic indicators. More than half of the oil and gas respondents reported being positive about economic prospects in terms of economic growth and credit availability. But oil and gas respondents were less confident about employment growth, corporate earnings, equity valuation/stock market outlook and short-term market stability. Oil and gas respondents were generally more confident than the average global respondent in terms of economic growth, credit availability and employment growth, but were less confident for the other indicators.
**Revived optimism, but with caution**

Q. What is your perspective on the state of the global economy today?

<table>
<thead>
<tr>
<th>Perspective</th>
<th>Oct-12</th>
<th>Apr-13</th>
<th>Oct-13</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strongly improving</td>
<td>2%</td>
<td>3%</td>
<td>1%</td>
</tr>
<tr>
<td>Modestly improving</td>
<td>4%</td>
<td>16%</td>
<td>28%</td>
</tr>
<tr>
<td>Stable</td>
<td>35%</td>
<td>43%</td>
<td>60%</td>
</tr>
<tr>
<td>Modestly declining</td>
<td>11%</td>
<td>14%</td>
<td>21%</td>
</tr>
<tr>
<td>Strongly declining</td>
<td>0%</td>
<td>3%</td>
<td>2%</td>
</tr>
</tbody>
</table>

71% view the global economy as improving, up strongly from April 2013

Q. How much do you expect the global economy to grow over the next 12 months?

<table>
<thead>
<tr>
<th>Growth Rate</th>
<th>Oct-12</th>
<th>Apr-13</th>
<th>Oct-13</th>
</tr>
</thead>
<tbody>
<tr>
<td>More than 5%</td>
<td>1%</td>
<td>4%</td>
<td>10%</td>
</tr>
<tr>
<td>3%-5%</td>
<td>4%</td>
<td>16%</td>
<td>28%</td>
</tr>
<tr>
<td>1%-3%</td>
<td>29%</td>
<td>36%</td>
<td>60%</td>
</tr>
<tr>
<td>Zero growth</td>
<td>4%</td>
<td>5%</td>
<td>9%</td>
</tr>
<tr>
<td>Negative growth</td>
<td>1%</td>
<td>3%</td>
<td>1%</td>
</tr>
</tbody>
</table>

29% expect global economic growth to be more than 3%, up strongly from April 2013

Q. What is your level of confidence in the following economic indicators at the global level?

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Oct-12</th>
<th>Apr-13</th>
<th>Oct-13</th>
</tr>
</thead>
<tbody>
<tr>
<td>Economic growth</td>
<td>35%</td>
<td>10%</td>
<td>69%</td>
</tr>
<tr>
<td>Credit availability</td>
<td>27%</td>
<td>36%</td>
<td>57%</td>
</tr>
<tr>
<td>Employment growth</td>
<td>29%</td>
<td>36%</td>
<td>58%</td>
</tr>
<tr>
<td>Corporate earnings</td>
<td>29%</td>
<td>36%</td>
<td>51%</td>
</tr>
<tr>
<td>Equity valuations/Stock mkt outlook</td>
<td>19%</td>
<td>19%</td>
<td>38%</td>
</tr>
<tr>
<td>Short-term market stability</td>
<td>19%</td>
<td>17%</td>
<td>30%</td>
</tr>
</tbody>
</table>

74% had confidence in global economic growth
Economic outlook, cont’d.

Expectations increase for job creation

Local economic sentiment also strengthens
Oil and gas confidence in economic growth at the local level also increased in our October 2013 survey, with 86% of oil and gas respondents expecting the local economy to improve or be stable, with the majority (53%) expecting modest growth.

Local confidence is also mixed
As with the global sample, confidence in the indicators vary. While oil and gas confidence in economic growth at the local level increased in our October 2013 survey, confidence declined slightly at the local level for the other indicators.

Increasing economic confidence drives job creation
An overwhelming majority – more than 80% – of oil and gas respondents see business growth initiatives as an imperative, both at the global and local/domestic level. That perceived support and the increasing economic confidence is driving job creation.
Q. What is your perspective on the state of the local economy today?

86% expect that the local economy will grow or at least be stable

Q. What is your level of confidence in the following economic indicators at the home/local level?

71% had confidence in the growth of the local economy

Q. With regard to employment, which of the following does your organization expect to do over the next 12 months?

94% expect to grow or at least keep their current workforce in the next 12 months
Economic outlook, cont’d.

Risk and regulation top board agendas

**Boardroom agendas temper some of their optimism with conservatism**

Reflecting to some degree both the increasing optimism and a lingering streak of conservatism, oil and gas boardroom agendas are changing. Risk management has once again moved to the top of the agenda, and concern around regulatory issues has moved up to the second slot. Another conservative agenda item, corporate governance, also rose sharply to the third position. Capital allocation, which had topped the boardroom agenda in our April survey, dropped to fourth position. Interestingly, efficiency and cost control, which topped the agenda for the global sample and was the second-highest agenda item for oil and gas respondents in our April survey, dropped sharply to fifth position in our October survey.

**Boardroom agendas largely reflect local concerns**

As would be expected, risk prioritization is dominated by local concerns, with oil and gas respondents broadly split as to what the greatest economic risk was to their business. Political risks, which are often challenging to quantify and manage, generally outweighed near-term economic concerns. More than one-half of the oil and gas respondents saw increasing global political instability as the greatest economic risk over the next 6-12 months. Notably for our oil and gas respondents, concern over the Eurozone crisis has decreased markedly since the April 2013 survey.
Q. How has the boardroom agenda at your company changed from a year ago?

<table>
<thead>
<tr>
<th>Category</th>
<th>Greater focus today</th>
<th>Stayed the same</th>
<th>Less focus today</th>
</tr>
</thead>
<tbody>
<tr>
<td>Risk management</td>
<td>83%</td>
<td>13%</td>
<td>4%</td>
</tr>
<tr>
<td>Regulatory issues</td>
<td>79%</td>
<td>14%</td>
<td>7%</td>
</tr>
<tr>
<td>Corporate governance</td>
<td>77%</td>
<td>18%</td>
<td>5%</td>
</tr>
<tr>
<td>Capital allocation</td>
<td>77%</td>
<td>15%</td>
<td>8%</td>
</tr>
<tr>
<td>Efficiency and cost control</td>
<td>76%</td>
<td>19%</td>
<td>5%</td>
</tr>
<tr>
<td>Investor relations</td>
<td>74%</td>
<td>10%</td>
<td>6%</td>
</tr>
<tr>
<td>People (attracting retaining talent)</td>
<td>56%</td>
<td>20%</td>
<td>18%</td>
</tr>
<tr>
<td>Growth - new geographic markets</td>
<td>45%</td>
<td>32%</td>
<td>23%</td>
</tr>
<tr>
<td>Growth - innovation R&amp;D</td>
<td>33%</td>
<td>35%</td>
<td>32%</td>
</tr>
</tbody>
</table>

Q. What do you believe to be the greatest economic risk to your business over the next 6-12 months?

- Increased global political instability: 55%
- Failure to manage the withdrawal of US quantitative easing: 19%
- Continuation of the Eurozone crisis: 18%
- Continued slow growth in China: 8%

Oct-13
Access to capital

Global credit conditions improving

To advance their strategic imperatives, companies will take advantage of improving credit conditions. A willingness to use leverage and the view that credit availability is rising, signal a growing confidence in the long-term economic outlook. We are seeing some signs of a returning use of leverage, indicating a fundamental shift in the dealmaking environment, which has been previously dominated by conservatism and the reliance on cash for financing. This use of leverage will lead the way to larger, market-changing deals.

Credit conditions improving globally

While credit has remained broadly available, particularly to large-cap enterprises, our global respondents continue to see increased credit availability. Compared with two years ago, banks are on a stronger footing and better capitalized. Yet this healthier picture did not always translate into increased lending, as many banks tightened their lending standards, particularly for small-to-medium enterprise (SME) borrowers. The oil and gas respondents similarly believe that credit conditions generally continue to be improving, and compared with six months ago, the percentage of oil and gas companies seeing credit conditions loosening or at least stable has increased. Once again, oil and gas respondents also expressed generally more optimism than the broader global group of respondents.

Mixed global deleveraging trends

Over the past few years, many oil and gas companies have taken advantage of improved credit conditions and a favorable rate environment to strategically use additional leverage and reduce their cost of capital. But at the same time, over the last two years, more oil and gas companies have been looking to deleverage their balance sheets than companies looking to add leverage. The proportion of companies expecting to finance to further expand their operations and increase their debt-to-capital ratios decreased slightly in our October survey to 20%, down from 24% in April 2013 but up from 18% in October 2012. The proportion of oil and gas companies looking to take the opportunity to further deleverage (i.e., decrease their debt-to-capital ratios) increased from 45% to 48% from April to October 2013. In our April 2013 survey, more than 74% of the oil and gas respondents reported debt-to-capital ratios below 50%. In our October survey, that percentage increased to 78%, with 37% of the oil and gas respondents reporting ratios of less than 25%. Both of these percentages declined however, from our April 2013 survey. Clearly, some oil and gas companies, as well as companies in general, are choosing to shed some of their caution.
Loose credit conditions ease debt pressures

Q. What is your level of confidence in credit availability at the global level?

<table>
<thead>
<tr>
<th></th>
<th>Declining</th>
<th>Stable</th>
<th>Improving</th>
</tr>
</thead>
<tbody>
<tr>
<td>Oct-13</td>
<td>8%</td>
<td>39%</td>
<td>53%</td>
</tr>
<tr>
<td>Apr-13</td>
<td>15%</td>
<td>27%</td>
<td>58%</td>
</tr>
<tr>
<td>Oct-12</td>
<td>23%</td>
<td>50%</td>
<td>27%</td>
</tr>
</tbody>
</table>

92% view credit availability as stable or improving

Q. How do you expect your company’s debt-to-capital ratio to change over the next 12 months?

<table>
<thead>
<tr>
<th></th>
<th>Decrease</th>
<th>Remain constant</th>
<th>Increase</th>
</tr>
</thead>
<tbody>
<tr>
<td>Oct-13</td>
<td>48%</td>
<td>28%</td>
<td>24%</td>
</tr>
<tr>
<td>Apr-13</td>
<td>45%</td>
<td>27%</td>
<td>28%</td>
</tr>
<tr>
<td>Oct-12</td>
<td>31%</td>
<td>48%</td>
<td>21%</td>
</tr>
</tbody>
</table>

52% expect their debt-to-capital ratio to increase or at least remain constant
Access to capital, cont’d.

Cash still king, but debt expanding

Companies focusing on refinements
With large-scale changes to their capital structures now completed, oil and gas companies are focused on refinements – reducing interest costs, extending debt maturities and removing restrictive covenants. 38% of the oil and gas respondents were expecting to refinance loans or other debt obligations in the next 12 months, up from 30% in the April 2013 survey, and up from the 21% in the October 2012 survey.

Cash still the primary source of financing, but debt increasing again
Debt had been declining as the primary source of deal financing in the oil and gas sector, with debt seen as the primary source by 26% of oil and gas respondents in April 2013 survey, but rising sharply to 34% in our October 2013 survey. In contrast, cash remains the primary source of deal financing for the oil and gas sector, but the cash share declined slightly in October, compared with our April survey.
### Q. Does your company expect to refinance loans or other debt obligations in the next 12 months?

<table>
<thead>
<tr>
<th></th>
<th>Oct-13</th>
<th>April-13</th>
<th>Oct-12</th>
</tr>
</thead>
<tbody>
<tr>
<td>No</td>
<td>62%</td>
<td>70%</td>
<td>79%</td>
</tr>
<tr>
<td>Yes</td>
<td>38%</td>
<td>30%</td>
<td>21%</td>
</tr>
</tbody>
</table>

38% plan to refinance, with the majority of those intending to retire maturing debt.

### Q. What is your likely primary source of deal financing in the next 12 months?

<table>
<thead>
<tr>
<th></th>
<th>Oct-13</th>
<th>April-13</th>
<th>Oct-12</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity</td>
<td>16%</td>
<td>22%</td>
<td>22%</td>
</tr>
<tr>
<td>Debt</td>
<td>34%</td>
<td>26%</td>
<td>38%</td>
</tr>
<tr>
<td>Cash</td>
<td>48%</td>
<td>42%</td>
<td>40%</td>
</tr>
</tbody>
</table>

48% view cash as the primary source of deal financing in the next 12 months.
Growth

Growth as the new imperative

Growth is now a global imperative as almost two-thirds of oil and gas executives plan to accelerate their growth strategies over the next 12 months. Companies have weathered a prolonged period of uncertainty. During this time, they have strengthened their balance sheets and largely optimized their capital structures. Companies are now ready to capitalize on the improving global economy and credit markets to implement their growth agendas. Growth strategies will initially focus on the optimization of organic platforms (existing products and core channels and markets). This is driven by their enhanced focus on governance and fiscal discipline. The natural progression will then be to M&A. Coupled with positive leading indicators, the greater focus on growth points to a return of increased M&A activity and larger deals, globally.

Growth focus returns

Prioritization of growth had broadly declined for our global sample as companies in general became more focused on the fundamentals, but that decline has seemingly ended. Oil and gas companies’ focus on growth had similarly been declining, but turned up sharply in our April 2013 survey. Notably, our oil and gas respondents continue to be more focused on growth than the global sample of companies. Compared with 6 and 12 months ago, our respondents, both in the broader global sample as well as the oil and gas respondents, report an increased focus on growth, as well as on reducing costs, improving efficiency and optimizing capital. Notably, reflecting the broader economic optimism, both samples reported a decrease in a focus on just maintaining stability. Growth remains the number one objective for a majority of our oil and gas companies, with 66% reporting that growth is their primary focus, as compared to 28% whose primary focus was on cost reduction and operational efficiency, and only 5% whose focus was to maintain stability.

A cautious approach to growth: keeping shareholders happy

Despite an appetite for organic growth, intentions with regard to excess cash point to some lingering caution. Only 29% of the oil and gas respondents plan to deploy excess cash toward organic growth, while another 19% plan to deploy cash to inorganic growth. In contrast, returning cash to stakeholders — both shareholders and creditors — is the priority for 52% of the oil and gas respondents, up slightly from 49% in April 2013. Forty percent of oil and gas respondents expect that paying down debt will be their primary focus for excess cash over the next 12 months, thus providing further evidence that companies are focusing their attention on deleveraging and strengthening their balance sheets against a backdrop of ongoing uncertainty.
Growth strategies accelerating

Q. What best describes your organization’s focus over the next 12 months?

<table>
<thead>
<tr>
<th></th>
<th>Oct-12</th>
<th>Apr-13</th>
<th>Oct-13</th>
</tr>
</thead>
<tbody>
<tr>
<td>Survival</td>
<td>1%</td>
<td>5%</td>
<td>2%</td>
</tr>
<tr>
<td>Maintain stability</td>
<td>2%</td>
<td>17%</td>
<td>20%</td>
</tr>
<tr>
<td>Cost reduction and operational efficiency</td>
<td>2%</td>
<td>2%</td>
<td>27%</td>
</tr>
<tr>
<td>Growth</td>
<td>66%</td>
<td>61%</td>
<td>49%</td>
</tr>
</tbody>
</table>

66% are focused on growth, up from 61% in April 2013

Q. If you have excess cash to deploy, which of the following will be your focus over the next 12 months?

<table>
<thead>
<tr>
<th>Focus</th>
<th>Oct-12</th>
<th>Apr-13</th>
<th>Oct-13</th>
</tr>
</thead>
<tbody>
<tr>
<td>Organic growth (e.g., investing in products, capex, talent retention or R&amp;D)</td>
<td>14%</td>
<td>10%</td>
<td>14%</td>
</tr>
<tr>
<td>Inorganic growth (e.g., acquisitions, alliances or JVs)</td>
<td>25%</td>
<td>30%</td>
<td>39%</td>
</tr>
<tr>
<td>Pay down debt</td>
<td>25%</td>
<td>30%</td>
<td>40%</td>
</tr>
<tr>
<td>Paying dividends</td>
<td>8%</td>
<td>9%</td>
<td>11%</td>
</tr>
<tr>
<td>Buy back stock</td>
<td>4%</td>
<td>10%</td>
<td>14%</td>
</tr>
</tbody>
</table>

48% will deploy excess cash into growth, slightly less than in April 2013
But that growth will be cautious

A cautious approach to growth: shifting to a lower-risk growth path
Those companies focused on growth tend to prioritize lower-risk organic strategies that are within their comfort zone. Rather than pursuing ambitious, transformational deals, they are hoping to deliver growth through better execution in existing markets and identifying new sales channels. Companies are, however, also pursuing some riskier strategies, primarily developing new products and markets through the exploitation of technology, and changing the current mix of products and services.

Regulatory environment creating the biggest obstacles
In terms of deterrents to acquisitions, our oil and gas respondents are most likely to be deterred by the regulatory environment, and by insufficient acquisition opportunities. Conversely, the broader sample was more likely to be deterred by insufficient acquisition opportunities and by low confidence in the business environment. Notably, the regulatory environment and low confidence in the business environment were more important deterrents for our oil and gas sample than for the global sample. Each of the other deterrents was deemed more important by the global sample.
Q. What is the primary focus of your company's organic growth?

- More rigorous focus on core products/existing markets: 38%
- New sales channels: 20%
- Exploiting technology to develop new products/markets: 25%
- Changing mix of existing products and services: 12%
- Investing in new geographies/markets: 8%
- Increase R&D/product introductions: 3%

Q. What is the primary reason for not pursuing an acquisition in the next 12 months?

- Regulatory environment: 28%
- Insufficient acquisition opportunities: 12%
- Low confidence in business environment: 11%
- Funding availability: 11%
- Valuation gap: 23%
- Deal execution and integration capabilities: 16%
- Low board/shareholder confidence: 14%

58% will focus their organic growth in lower risk areas, whereas in April 2013, they favored higher risk areas.

41% saw the regulatory environment as being the primary reason for not pursuing an acquisition.
Growth, cont'd.

Capital Agenda

Q: Which statement best describes your organization's focus over the next 12 months?

**Raising:** A company's ability to raise capital is integral to achieving its growth imperatives and financial well-being. And with credit increasingly available and more attractive, companies now indicate a desire to take on more leverage, which signals that larger dealmaking will be done.

<table>
<thead>
<tr>
<th></th>
<th>Oct-12</th>
<th>Apr-13</th>
<th>Oct-13</th>
</tr>
</thead>
<tbody>
<tr>
<td>Raising</td>
<td>24%</td>
<td>23%</td>
<td>7%</td>
</tr>
</tbody>
</table>

**Preserving:** A company's ability to access liquidity, control costs and engage with key stakeholders is essential to preserving capital amid shifting market forces. Since most companies were forced to focus on preservation in order to survive, they are now able to concentrate on other areas of their Capital Agendas.

<table>
<thead>
<tr>
<th></th>
<th>Oct-12</th>
<th>Apr-13</th>
<th>Oct-13</th>
</tr>
</thead>
<tbody>
<tr>
<td>Preserving</td>
<td>13%</td>
<td>7%</td>
<td>3%</td>
</tr>
</tbody>
</table>
Oil and gas companies shift decisively to investing

Our latest Barometer survey shows a strong shift in the focus of the oil and gas capital agenda over the last year. “Investing” capital is by far the dominant dimension for the agenda, and it increased in importance from the April 2013 survey. “Optimizing” capital ranked second on the capital agenda, and was broadly flat from the last survey. “Raising” capital had moved up rather strongly on the agenda in the April 2012 survey, but has slid back sharply since then. “Preserving” capital also decreased once again in importance in our latest survey, and remained the least important part of the oil and gas capital agenda.

Investing: Executives’ sentiment indicates an investment climate is imminent, and as required levels of growth and returns increase, companies will look to M&A. Improving economic fundamentals will also enable more deal-powered growth.

<table>
<thead>
<tr>
<th></th>
<th>Oct-13</th>
<th>Apr-13</th>
<th>Oct-12</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>62%</td>
<td>42%</td>
<td>37%</td>
</tr>
</tbody>
</table>

Optimizing: Companies continue to employ a disciplined approach to capital optimization, with an enhanced focus on governance and fiscal rigor. And with capital structures largely optimized, executives today are primarily focused on refinancing to retire maturing debt and position themselves for more leverage.

<table>
<thead>
<tr>
<th></th>
<th>Oct-13</th>
<th>Apr-13</th>
<th>Oct-12</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>28%</td>
<td>28%</td>
<td>26%</td>
</tr>
</tbody>
</table>
Desire to make larger deals is now visible – as expectations for deals greater than $500m has increased sharply in the last six months. These expectations, along with the increased deal volumes, are clear indicators that a more robust dealing environment is on the horizon. They signal companies have confidence in their capital structures, deal fundamentals and in a real sustainable economic recovery. The anticipated narrowing of valuation gap can also be seen as a precursor to more dealmaking. As companies begin to act on their intentions for dealmaking and their imperative to grow, it will trigger deals of varying size across the global oil and gas marketplace.

**Appetite for M&A increases**

With reduced uncertainty about the global economic outlook, oil and gas companies are less wary of acquisitions and their perceived risks than they were over the last few years. Thirty-nine percent of oil and gas respondents now expect to pursue acquisitions over the next 12 months, up from 27% in April 2013 and 28% in October 2012, but still below the peak level of 48% in our October 2011 survey. Notably however, oil and gas respondents are more optimistic about the acquisition environment than is the global sample.

**Deal volumes are expected to increase**

Albeit with some conservatism, oil and gas respondents expect that global M&A deal volumes will increase over the next 12 months, with 77% expecting volumes to at least modestly improve. Expectations of the larger global sample were only slightly less. At the local level, oil and gas respondents were only slightly less optimistic, with 61% expecting volumes to at least be modestly better.

**Acquisition appetite increases as confidence improves**

Sharp increases in global confidence are underpinning an increased appetite for acquisition activity. That confidence includes the number and quality of opportunities as well as the likelihood of being able to close the deals. Confidence at the local level is also increasing, but slightly less than at the global level. Oil and gas respondents generally had more confidence than the broader sample in terms of positive views on the number of deals, the quality of deals and the likelihood of closing deals. Nevertheless, confidence levels are generally increasing, both for oil and gas respondents as well as for the broader sample.
Confidence driving deal making

Q. Do you expect your company to pursue acquisitions in the next 12 months?

- Diversified Industrial Products: 50%
- Life Sciences: 42%
- Oil & Gas: 39%
- Automotive: 38%
- Global: 35%
- Consumer Products: 33%
- Technology: 33%
- Financial Services: 28%
- Power & Utilities: 28%
- Mining & Metals: 24%

39% of oil and gas respondents expect to pursue an acquisition in the next 12 months.

Q. What is your expectation for global deal volumes in the next 12 months?

- Return to historic highs: 0%
- Strongly improve: 4%
- Modestly improve: 9%
- Remain the same: 21%
- Modestly decline: 2%
- Strongly decline: 3%

77% expect that deal volumes will increase in the next 12 months, up from 72% in April.

Q. What is your level of confidence at the global level in the next 12 months?

- Likelihood of closing acquisitions: 56%
- Quality of acquisition opportunities: 53%
- Number of acquisition opportunities: 75%

75% are confident in the number of acquisition opportunities in next 12 months.
Merger and acquisitions outlook, cont’d.

Smaller deals still dominant, but

Market share objectives driving acquisitions
In terms of the drivers of acquisition activity, increasing market share, both in existing markets and in new markets, dominated the responses, both for the broader global sample as well as the oil and gas companies. Particularly for the oil and gas respondents, the market share drivers have been strongly increasing in relative importance.

Bolt-on acquisitions favored over transformative deals
Among those oil and gas companies that do expect to engage in M&A, deal sizes remain fairly small, reflecting an ongoing aversion to risky, transformational transactions. More than 79% say that they will do deals worth less than US$500 million, and 18% say they will do deals under US$50 million. This suggests that, where deals are being considered, they will more likely extend existing businesses and fill strategic gaps, deals that are typically termed, bolt-on acquisitions. That said, however, the percentage of respondents expected to look at bigger deals (i.e., deals greater than $500 million) increased sharply in our October survey to 21%, as compared with 12% in April.

Pricing divergence reflects valuation uncertainty
Reflecting the divergence of opinion around the price/valuation of M&A assets over the next year, a plurality of oil and gas respondents expect prices/valuations to increase, but that percentage declined from the April survey. In contrast, only 13% of the oil and gas respondents expect prices/valuations to decrease, but that percentage was up from the April survey.
large-deal appetite is growing

Q. What are the main drivers of your company’s planned acquisition activity (select two)?


79% saw market share growth in existing markets as the main driver of acquisition activity.

Q. What is the expected deal size?


79% expect to pursue deals less than US$500 million in size.

Q. What do you expect the price/value of assets to do over the next 12 months?

- Oct-12: Decrease: 27%, Remain at current levels: 40%, Increase: 33%
- Apr-13: Decrease: 8%, Remain at current levels: 52%, Increase: 40%
- Oct-13: Decrease: 13%, Remain at current levels: 41%, Increase: 46%

87% expect the price/valuation of M&A assets to increase or at least stay the same over the next 12 months.
Valuation gaps expected to widen

The majority of oil and gas respondents believe that the current valuation gap between buyers and sellers is less than 20%, but that majority decreased from the April survey, while those believing that the current gap is greater than 20% increased in number. Notably, the percentage of respondents expecting the valuation gap to widen over the next year almost doubled from the April survey.

A cautious approach to emerging markets

Acquisition capital flows are expected to be allocated broadly by our oil and gas respondents, largely mirroring the allocation patterns of the global sample. Optimism around acquisitions in emerging markets remains relatively high, both for our broader sample and for our oil and gas respondents, but companies are exerting more caution, particularly in areas where growth has slowed. Notably, political and regulatory risk and a lack of local infrastructure are the principal obstacles to emerging market deals, particularly for oil and gas companies.

Unforeseen liabilities as biggest threat to deal expectations

Among companies that have recently completed acquisitions, unforeseen liabilities (e.g., taxes and human resources or pension issues) were the leading reason for deals not meeting expectations. Notably, strategic value over-estimation, which was the top reason for deals not meeting expectations in our April 2013 survey, declined in importance.
82% expect the valuation gap between buyer and sellers to widen or stay the same over the next 12 months.

Q. Which statement best describes your approach to M&A in those emerging markets that are experiencing slower growth:

- We remain optimistic about opportunities and have not changed our approach to assessing deals in emerging markets: 17% Oct-13, 40% Apr-13, 40% Oct-12
- We remain optimistic but will apply further rigor when assessing deal opportunities in emerging markets: 11% Oct-13, 12% Apr-13, 11% Oct-12
- We are less optimistic and are reconsidering our emerging markets strategy: 5% Oct-13, 6% Apr-13, 5% Oct-12
- We are less optimistic and have already turned attention more toward developed market deal opportunities: 2% Oct-13, 2% Apr-13, 2% Oct-12
- We have discontinued our emerging markets strategy for now: 2% Oct-13, 2% Apr-13, 2% Oct-12

82% remain optimistic about M&A opportunities in emerging markets, even if those emerging markets are experiencing slower growth.

Q. For acquisitions recently completed, what was the most significant issue that contributed to deals not meeting expectations?

- Unforeseen liabilities (tax, HR, pension etc.): 21% Oct-13, 21% Apr-13, 21% Oct-12
- Sales volume declines/ Loss of customers: 23% Oct-13, 23% Apr-13, 23% Oct-12
- Poor operating cost assumptions: 19% Oct-13, 19% Apr-13, 19% Oct-12
- Strategic value overestimated/ purchase price multiple too high: 32% Oct-13, 32% Apr-13, 32% Oct-12
- Poor execution of integration: 18% Oct-13, 18% Apr-13, 18% Oct-12
- Product/Sales price and margin deterioration: 16% Oct-13, 16% Apr-13, 16% Oct-12

26% see unforeseen liabilities as the most significant reason for deals not meeting expectations.
Divesting declining, but still driven

Divesting activity shifts down
Since our April 2012 survey, there has been a sharp decline in the number of companies planning to make divestments in the next 12 months, particularly in the case of oil and gas respondents. Many companies have gone through the process of optimizing their portfolios and offloading those assets that did not fit their overall strategic objectives. Focusing on core assets is still the primary driver of divestment activity, but it did decline in relative importance in our recent survey, while rising shareholder value increased sharply in relative importance. Notably, however, reflecting the increased optimism, raising cash to compensate for underperformance elsewhere in the organization declined sharply in importance.

Optimization moves to the forefront
Following an active period of divestment activity over the past 18 months, oil and gas companies have now shifted their focus to optimizing capital allocation and improving performance. For oil and gas companies expecting to make divestments over the next year, a sale or spin-off/IPO of an existing business unit were seen as the most-likely forms of divestment.

Execution risks and business disruptions were the big deterrents to divestments
For our oil and gas respondents, the most-often cited deterrents to making divestitures were execution concerns and the fears of disruptions to core business activities. As in the case of acquisition activity, the inability to realize the price/value expectations (i.e., the “valuation gap”) has decreased in importance as a deterrent to divestment activity.
by core focus and optimization

**Q. What are the main drivers of your company's planned divestment activity? (select two)**

- Focus on core assets: 47% Oct-13, 61% Apr-13, 59% Oct-12
- Enhance shareholder value: 21% Oct-13, 37% Apr-13, 37% Oct-12
- Fund inorganic/M&A growth plans: 14% Oct-13, 21% Apr-13, 36% Oct-12
- Shed underperforming business unit: 4% Oct-13, 16% Apr-13, 43% Oct-12
- Raise cash to compensate for underperformance of aggregate business: 14% Oct-13, 16% Apr-13, 43% Oct-12

**Q. What form of divestments do you expect to make?**

- Sale of business unit: 32% Oct-13, 42% Apr-13
- Spin/IPO of business unit: 26% Oct-13, 43% Apr-13
- Contribution of business unit to joint venture: 11% Oct-13, 21% Apr-13
- Sale of entire business: 11% Oct-13, 14% Apr-13

**Q. What is the main reason for you to not pursue a divestment?**

- Execution risk leading to disruption to core/ongoing business: 71%
- Exposure to adverse market reaction: 65%
- Ability to realize price/value expectations: 16%

---

16% expect to use divestments as a way to raise cash to compensate for underperformance elsewhere in the organization, down substantially from the April survey.

42% expect to divest in the form of a sale of a business unit.

71% see execution risks and disruptions to business operations as the main reason to not pursue a divestment.
About this survey

The Global Capital Confidence Barometer gauges corporate confidence in the economic outlook, and identifies boardroom trends and practices in the way companies manage their capital agenda – EY’s framework for strategically managing capital. It is a regular survey of senior executives from large companies around the world, conducted by the Economist Intelligence Unit (EIU). Our panel comprises select global EY clients and contacts and regular EIU contributors.

Profile of respondents:

- Panel of more than 1,600 executives surveyed in September 2013, including 169 oil and gas executives
- Companies from 72 countries
- 792 CEO, CFO and other C-level respondents
- More than 900 companies would qualify for the Fortune 500 based on revenues