Crowe Horwath

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The Global Corporate Advisor

The Corporate Finance newsletter of Crowe Horwath International

Welcome to the January edition of the Global Corporate Advisor (GCA) newsletter

As the new Chairman of Crowe Horwath International's Global Corporate Advisors, I'm delighted to introduce the first edition of our newsletter for 2013.

To tell you a little bit about myself, I'm based in London and have almost 25 years of experience working with clients on a range of due diligence and investigation matters, including pre-acquisition due diligence; pre-lending and viability reviews for banks; pre-investment due diligence for financial institutions; and initial public offerings and other public company transactions.

My team and I have worked on cross-border transactions involving companies with operations in multiple territories. I look forward to sharing M&A insights and information that we have gained from this experience, and as we develop content for GCA in the future.

This year, we'll introduce you to a different regional GCA leader in each issue. This will give you the opportunity to learn more about our team and our expertise within each region.

In this month's issue, we provide a wrap-up of the 2012 M&A market around the world, along with our predictions for 2013. With the ongoing debt crisis in Europe and slow growth in the United States, the economic outlook is uncertain. However, this year we should see a healthier global M&A market.

We expect 2013 to be a turning point for Western Europe, with an increase in M&A activity. But the region will not be without its financial challenges and economic recovery may not be realistic. Elsewhere in the world, M&A activity should steady in the United States, remain strong in China, and grow in India and the Middle East.

As ever, the GCA team is here to respond to your needs relating to M&A transaction support, valuations and M&A advisory services. If there is a topic you would like us to cover in future issues of the GCA newsletter, don't hesitate to contact me or a member of the team to discuss your ideas.

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Inside This Issue:

The Global M&A Landscape

Uncertainty surrounds the global economic outlook for 2013. The International Monetary Fund and the Organisation for Economic Co-operation and Development (OECD) have downbeat expectations for 2013, primarily due to concerns about the ongoing debt crisis in Europe and sluggish growth in the United States. While emerging economies forge ahead, their growth rates remain below pre-2008 levels. In this article, we provide our team's observations on how the global landscape is affecting M&A activity in a number of major markets.

China

Despite the continued global economic downturn in 2012, M&A activities in China remained robust over the year, fueled by domestic activity. In addition, private equity firms are increasingly using M&A to exit their investments as interest in initial public offerings (traditionally private equity's main exit route) has dried up.

According to industry data published by China Venture Investment Consulting Group, total reported M&A deal values increased by 37% in 2012 to reach a record high of US$308 billion, up from US$225 billion in 2011. There was also a substantial increase in the average deal size in 2012 (US$105 million) from 2011 (US$60 million), mainly due to the focus on deals in the energy and mining sectors.

However, over the same period, the total number of deals fell by 28%. In 2012, 3,555 deals were completed compared to 4,595 in 2011. The greatest number of deals in 2012 took place in the manufacturing sector.

In 2012, the energy and mining sectors accounted for nearly 30% of the value of all M&A deals in China. The internet sector, finance sector and manufacturing sector each contributed around 10% of the value of all M&A deals in 2012.

During 2013, Crowe Horwath forecasts that the total number of deals and total deal value will continue to grow in China. We expect that Chinese companies looking for M&A targets with low valuations will focus on Western countries that are struggling economically. We believe these targets will come from the energy and mining, engineering and infrastructure sectors. Further, M&A activity will remain strong in Chinese markets, powered by domestic growth.

Association of Southeast Asian Nations (ASEAN)

Malaysia

During 2012, M&A transactions in Malaysia totaled US$26.13 billion compared with US$22.54 billion in 2011. The largest transaction was Petronas' US$5.4 billion acquisition of Progress Energy Resources Corporation. Other notable transactions above the US$1 billion mark included the acquisition of Tanjong Energy Holdings Sdn by 1Malaysia Development; the AIA Group's acquisition of ING Management Holdings Sdn; and the merger of Kencana Petroleum and Sapura Crest Petroleum.

Malaysian M&A transactions largely took place in the energy sector (namely oil and gas), financial services, infrastructure, manufacturing, property and healthcare. These transactions were mostly undertaken by Malaysian companies and government-linked private equity firms.

In 2012, the Malaysian M&A market was characterized by contrasts. We witnessed the listing of Felda Global Venture Holdings, Astro Malaysia Holdings and IHH Healthcare, which raised a combined US$6.872 billion during their respective initial public offerings (IPOs). These listings marked Malaysia as one of the top IPO markets in the world. Aside from Facebook, no other companies worldwide have raised more money than Malaysian IPOs in 2012.

Simultaneously, Malaysia experienced a number of companies that have withdrawn from the public listings which wiped US$2.8 million off the market capitalization of the Bursa Securities Malaysia (formerly known as the Kuala Lumpur Stock Exchange). The recent announcement of the de-listing of Tradewinds (M) will likely wipe another US$800 million off the value of Bursa Securities Malaysia. We believe de-listing is an emerging trend that will likely continue.

Singapore

As consumer demand falls in sluggish markets such as Europe, we are witnessing companies seeking growth through mergers and acquisitions in fast-growing Asian economies including Singapore.

Notable M&A transactions in the Singapore market during 2012 included DBS Group Holdings Ltd's proposed S$6.85 billion acquisition of PT Bank Danamon Indonesia; Heineken's S$5.6 billion acquisition of a 40% stake in Singapore-listed Asia Pacific Breweries; PTT Plc's (Singapore's national oil conglomerate) S$1.2 billion offer to acquire Singapore-listed Sakari Resources; and Suntory's S$364.8 million acquisition of Singapore-listed tonic maker Cerebos Pacific.

In 2013, Crowe Horwath believes M&A activity will be strong in Singapore's real estate, energy and resources, life sciences and healthcare sectors.

India, Middle East and Africa

Crowe Horwath expects M&A activity to grow in India and the Middle East during 2013.

India

In India, recent government reforms have boosted market sentiment around M&A activity, including the Indian Government's moves to postpone the introduction of General Anti-Avoidance Rules until 2016.

However, other reforms may have a mixed impact on M&A activity. For instance, the Government's approval of changes to India's foreign direct investment (FDI) regime for retail multinationals may not generate investment flows into India, as opposition political parties vow to overturn the changes if they gain power in 2014. On the other hand, FDI reforms in civil aviation could see foreign carriers invest into at least one – and possibly three – Indian airlines.

During 2013, we also expect to see growing M&A activity in the pharmaceutical, fast moving consumer goods (FMCG), information technology enabled services, engineering and property sectors. Our analysts believe buyers will take strategic and opportunistic approaches as they work through the process of acquiring distressed assets. Further, we may see some M&A activity in the telecommunications sector linked to pricing and auction timetables.

In addition, the granting of new banking licenses by the Indian Government could drive investment in the sector. Crowe Horwath also believes that regulatory changes permitting the wider use of external commercial borrowing (ECB) funds for local projects will encourage Indian companies to tap overseas funding for new projects or to refinance expensive Rupee debt. We expect that the attractiveness of overseas funding will remain during 2013, as the Reserve Bank of India will likely cut rates only to a limited extent. Indian investors looking for investment opportunities outside their nation will continue to search for resource, engineering and FMCG assets, and also businesses in the services and knowledge sectors.

Middle East

In spite of ongoing political turbulence in the Middle East, M&A activity remained robust across the region in 2012. For example, M&A transactions involving target companies from the Middle East doubled in value in 2012 up to US$20 billion, compared with US$9.8 billion 2011, recording their largest increase in deal values since 2008.[1]

In the Middle East, the telecommunications sector emerged as the most in-demand sector among investors. Qatar and the United Arab Emirates were among the main players in the region in 2012, with Egyptian companies the most in-demand among investors. The oil and gas sectors are likely to generate more M&A activity in 2013.

Our analysts expect that M&A activity in the Middle East will increase over the course of 2013, driven by global investors that want to take advantage of the opportunities in the region, and local companies looking to consolidate their global presence.

Africa

Africa continues to attract global investor interest, particularly in the resources sector. However, the high cost of debt and labor issues have hurt sentiment. We believe that restoring investor confidence is crucial in attracting investments into places such as South Africa. If this confidence boost does not occur, M&A transactions will likely remain concentrated in the small- to midcap-sectors and among unlisted entities.

Sources

1. Thomson Reuters, *Middle Eastern IB Analysis,* (2013).

Eastern Europe

In 2012, the number of M&A deals declined by 19% across Eastern Europe compared with 2011. This decrease took place despite a near 46% increase in the median deal value in 2012, which was boosted by spin-offs in the energy and telecommunications sectors.

From Crowe Horwath's perspective, we see buyers becoming more conservative in the current market. They are increasingly including measures such as 'earn-out' arrangements during M&A deals to ensure the acquisition represents good value. Under earn-out mechanisms, payment of the full purchase price by buyers is dependent on the business achieving future earnings targets. In our experience, putting earn-out provisions in place can add hurdles to M&A deals and it may be difficult to have sellers agree to these conditions.

During 2012, companies found it more time-consuming to close deals. Depending on the complexity of the deal, it appears that many are taking several weeks or months extra to close. This is partly due to buyers undertaking more comprehensive due diligence of potential targets, including legal and environmental aspects.

We expect M&A activity in Eastern Europe will improve slightly during 2013. However, the level of improvement will depend on economic conditions in the Eurozone. Further, M&A activity will be affected by the success (or failure) of owners to hand over their businesses, and investors' ongoing demand for large spin-off companies in the energy sector.

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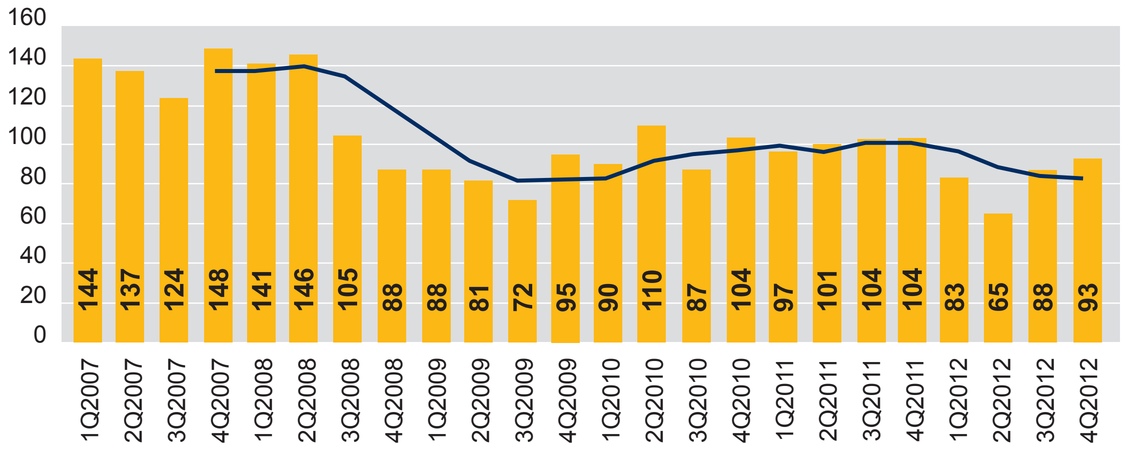
M&A trends in Eastern Europe



Source: TPA Horwath Corporate Finance s.r.o.

Notes:

- There was a 19% year-on-year decline in the number of transactions in 2012.
- Median deal values were €33.5 million in 2012 compared with €23 million in 2011.
- The line above refers to the moving average for four quarters. Eastern Europe is defined as the following countries: Albania, Austria, Bulgaria, Croatia, Czech Republic, Hungary, Poland, Romania, Serbia, Slovakia and Slovenia.

Western Europe

The European M&A market was less active in 2012 than in 2011 – in terms of values and volumes. The market was affected by economic woes ranging from threats of a double-dip recession to challenges in managing the ongoing Eurozone crisis. Traders also watched nervously as political landscapes changed in the US, France and China.

Looking ahead, we expect that 2013 will be a turning point for growth. Crowe Horwath forecasts that M&A activity in Western Europe will increase in 2013. Just as in 2012, the United Kingdom, France and Germany will dominate M&A activity in the region. In 2013, we believe Switzerland, Belgium, the Netherlands and Luxemburg (Benelux), and countries in Northern Europe such as Denmark, Norway and Sweden will also present attractive M&A opportunities.

However, there are a number of challenges in 2013. Similar to 2012, there is a lot riding on policy makers to fuel growth, re-invigorate risk appetites, quell sovereign debt fears and restore confidence in the markets. Politically, elections will take place in countries such as Germany and Italy. The outcome of these polls will affect the economic environment in the region in 2013.

We believe Eurozone nations will attempt to return to positive GDP growth in 2013. But with high unemployment rates and debt burdens across the region, the question remains whether a meaningful recovery can be achieved in 2013.

In the current environment, Crowe Horwath sees numerous M&A opportunities among distressed European companies for investors with cash reserves who are comfortable taking on risk. We believe the majority of corporate debt restructurings are more likely to take place in Southern Europe than Western Europe, with the crises in Greece, Spain, Portugal and Italy still taking the spotlight.

There is also the possibility that strategic buyers (who are looking to build long-term shareholder value) may outbid financial buyers in the M&A market, as corporates look to grow through M&A activity given current constraints on achieving organic growth.

Our analysts expect that corporates that have weathered recent economic storms by restructuring their operations and strengthening their balance sheets will be well placed to take advantage of a promising M&A environment in 2013.

In addition, there is a lot of pressure mounting on private equity firms from investors looking to realize returns. On the sell-side, we can expect to see more activity from private equity players looking for the right time to exit their respective portfolio companies.

In 2013 Crowe Horwath expects heightened M&A activity across Western Europe in areas such as energy, financial services, consumer and retail brands, industrial and chemical, technology, and pharmaceutical and healthcare.

The M&A environment in 2013 will favor businesses with strong brands that are experiencing growing demand from middle-class consumers in emerging markets. This trend is likely to continue in 2013 among Brazil, Russia, India and China (the BRIC countries) and MIST countries – Mexico, Indonesia, South Korea and Turkey. For example, Bright Food, a Chinese food business, acquired controlling stakes in Weetabix in the UK and Diva Bordeux in France in 2012. US businesses are also keen to seek growth opportunities by acquiring European brands and benefit from any potential upturn in European growth.

Since the GFC, the European banking sector has undergone significant change. Banks are still keen to dispose of risky assets and shed capital-hungry businesses – especially ahead of proposed regulations under the Basel III banking regime. We expect these trends will drive M&A activity in the banking sector; however, there are only a small number of buyers with strong enough balance sheets to make acquisitions. The few strategic buyers will likely come from Canada, Japan, China, Russia, Poland and Turkey. On the other hand, asset management and private banking businesses will be more attractive to private equity and sovereign wealth funds.

Germany

The German M&A market experienced steady growth in 2012.[1] Deal values rose by 28% to reach €140 billion in 2012 compared to €109 billion in 2011. The number of transactions rose by 0.7% to 1,340 in 2012 compared to 1,331 in the previous year. M&A activity grew strongly in the first half of 2012, lost momentum in Q3, but then increased in Q4 again.

Over the period from 2006 to 2012, the German M&A market grew by 35% based on the number of deals. Deal value amounted to €150 billion in 2006 and peaked in 2007 at €180 billion. It fell to a low of €79 billion in 2009 and recovered slightly in 2010 and 2011, and showed strong growth in 2012.

However, since 2009, the number of M&A transactions involving German targets and acquirers has declined continuously to 40% in 2012 from approximately 53%. At the same time, M&A transactions involving foreign buyers rose steadily to 34% in 2012 from approximately 23% in 2009. A foreign seller was involved in 26% of all M&A transactions in Germany in 2012 compared with approximately 24% in 2009.

Demand among overseas investors for German assets reached record levels in 2012, according to InterFinanz, a leading German M&A advisor.[2] However, due to the European financial crisis, many owners chose not to sell their well-running businesses as they saw a lack of safe investment alternatives for their sales proceeds. As a result, the demand for quality targets was several times higher than the number of companies for sale.

In 2012, the largest M&A transaction in Germany was the €5 billion takeover of Porsche AG by Volkswagen AG. Another nine transactions in 2012 had a deal value exceeding €1 billion. The value of the next 90 transactions by deal value increased by 51% in 2012 over 2011, and the average deal value was €546 million.

Another trend we witnessed in 2012 was the return of private equity firms as investors in the German market. Private equity firms were involved in 95 deals in 2012 – a 12% increase over 2011. The largest deal involving a private equity firm was Advent International's €1.7 billion takeover of retail group Douglas AG.

In addition, our analysts saw a change in focus among Chinese investors in 2012. While Chinese investors mainly acquired distressed German companies in the past, they competed for many quality targets in 2012 – particularly in the mechanical engineering and automotive industries.

Crowe Horwath has a positive outlook for M&A activity in the German market during 2013. We expect deal activity to increase, despite the lack of quality targets. This will most likely result in rising transaction multiples. We also believe companies will find it easier to secure finance in 2013, but that 40% to 50% of the purchase price will still need to be financed with equity.

Germany will hold a government election in September 2013, and there are looming changes that may increase tax rates when owners transfer business ownership. These changes have been put forward due to a lawsuit in the Federal Finance Court, where the claimant argues that the current generous exemption amounts for inheritance tax relating to business transfers are a violation of the equality principle. This may encourage owners to sell their companies prior to the election, resulting in an increase in quality targets on the market and higher German M&A activity in 2013.

Sources

1. *FAZ Frankfurter Allgemeine Zeitung fuer Deutschland,* (27 December 2012) page 15.
2. InterFinanz, *54th Annual Report,* (2012), page 4.

North America

United States

In the US, favorable conditions such as low interest rates boosted M&A activity during the second half of 2012. Crowe Horwath expects these factors will underpin robust deal activity in 2013. The positive impact of these factors was muted during the fourth quarter of 2012 due to uncertainty surrounding the Presidential election and the ongoing impact of the 'fiscal cliff'.

Middle-market transaction volume in the US remained strong during 2012. We saw an increase in activity during Q4 as sellers worked to finalize transactions ahead of potential capital gains tax rate increases in 2013. Marc Shaffer of Crowe Horwath's US team expects that attractive debt pricing, continued stabilization of corporate earnings and increased competition for quality assets will help narrow differences in valuation expectations between buyers and sellers in 2013. This will create a supportive transaction environment. We also expect that the healthcare, energy and technology sectors will be major areas of middle-market activity during 2013.

During 2012 in the US, private equity was the most acquisitive industry, accounting for US$133 billion in deal value over the course of the year. The second most active industry was oil and gas exploration and production, which completed transactions worth US$79 billion.

Overall, the funds raised by private equity firms increased by 20.3% to US$160 billion in 2012, from US$133 billion in 2011. This increase in capital raisings will fuel competition among buyers for available targets in 2013.

We also expect that the cost of borrowing will remain relatively low in 2013. Debt is tipped to remain cheap due to lower risk-free interest rates and increased competition among lenders in credit markets.

In addition, we have seen buyers reduce their equity contributions during acquisitions. For example, financial buyers (buyers looking to realize a return on their investment) reduced their equity contributions to 33% of the total purchase price during the second half of 2012, compared to an average of 42% of the total purchase price over the past five years. Lower equity contributions have increased the universe of targets with attractive return potential. This results when buyers can acquire more expensive assets by increasing the use of debt rather than their equity contribution.

Turning to the corporate sector, US corporations maintain record levels of cash on their balance sheets. Corporate cash balances reported by S&P 500 companies rose 5.8% at the end of Q3 2012 compared to the same quarter a year earlier. Given the tepid economic recovery, in our view, managers that were previously seeking organic growth will instead look to acquisitions to improve their earnings.

Crowe Horwath expects transaction volumes in the US banking sector to increase in 2013 as stronger banks (institutions that cut costs) will look to acquire less-efficient competitors. Further, we believe that transactions in the healthcare industry will be a driver of US deal activity in 2013, with health funds looking to achieve scale through consolidations in an increasingly competitive landscape.

Canada

According to our analysts, US and Canadian transaction volumes should benefit from continued activity in the energy sector, particularly acquisitions of operations working in Canadian oil sands. However, Canada's mining industry, which contributed significantly to deal volumes in 2012, is expected to slow due to lower commodity prices stemming from reduced demand among Chinese operators. During 2012, foreign acquisitions of Canadian energy and mining operators were a major source of deal volume. In 2013, increasing local political opposition to resource transactions involving state-owned reserves threatens to curtail similar foreign investment in Canada.

Latin America

According to the OECD, M&A activity in South America fell by 30% in 2012 compared to 2011, to US$60 billion. In 2011, M&A activity totaled US$87 billion, following the record level of US$91 billion recorded in 2010.

However, the decrease in M&A activity in South America (30%) is lower than the global fall in M&A activity in 2012 (36%), making the region one of the most attractive globally. In Crowe Horwath's view, this appeal is mainly due to the current economic and business uncertainty among advanced economies.

M&A activity varied substantially among Latin American economies in 2012. During the year, nations such as Brazil, Chile, Argentina and Panama experienced decreases in M&A activity, while Colombia and Mexico recorded increased levels of M&A activity.

Mexico

During 2012, Mexico was one of the most prolific Latin American countries for M&A activity, with over US$40 million in completed transactions. The largest single M&A deal was Belgian group AB Inbev's US$20.1 million acquisition of 50% of Grupo Modelo.

Peru

Peru was another country that experienced a relatively large number of M&A deals in 2012. Between January and October, the quantity and volume of M&A transactions surpassed the values recorded over the same period in 2011. Peru is among the leading M&A destinations in South America due to its favorable investment climate, low inflation, record levels of international reserves, and reductions in public debt. Further, the country has an open investment policy, with a solid, stable and transparent legal framework that treats national and foreign investors equally.

Crowe Horwath expects that 2013 will be a good year for M&A activity in South America. Our analysts believe the economic declines in the Eurozone and US won't have a large impact on emerging economies. In fact, we believe that the complicated economic situation among developed countries makes South America more attractive.

Further, the region is forecast to grow strongly in 2013. According to the International Monetary Fund, South America will grow by 3.9% in 2013 compared with 3.2% in 2012. While this lags behind the forecast growth of 6.8% for emerging Asian economies in 2013, South America remains an attractive global M&A destination.

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