June 2012

The Global Corporate Advisor

The Corporate Finance newsletter of Crowe Horwath International

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

Halfway through the year, economic instability across Europe, the United States and Asia continues to rattle investors. This month, we take a look at the United States M&A market, and the domestic and global issues threatening the country's economic recovery. With the European sovereign-debt crisis weighing on US capital markets, what can we expect from the American M&A market in the second half of 2012?

Other financial markets are on the up. After facing default in 2009, Dubai's economy looks to be recovering steadily, with several major corporations repaying debts, the Islamic banking sector strong and tourism booming.

Elsewhere in this edition, we provide an overview of worldwide M&A activity in the renewable energy industry, including an analysis of the renewable energy M&A market in the EMEA region during the first quarter of 2012. This sector continues to present an attractive investment opportunity, although potentially substantial returns can be affected by unpredictable political climates.

If you'd like to discuss anything in this issue, or if you have any needs relating to M&A transaction support, valuations, M&A advisory or related services, please don't hesitate to contact me or the team.

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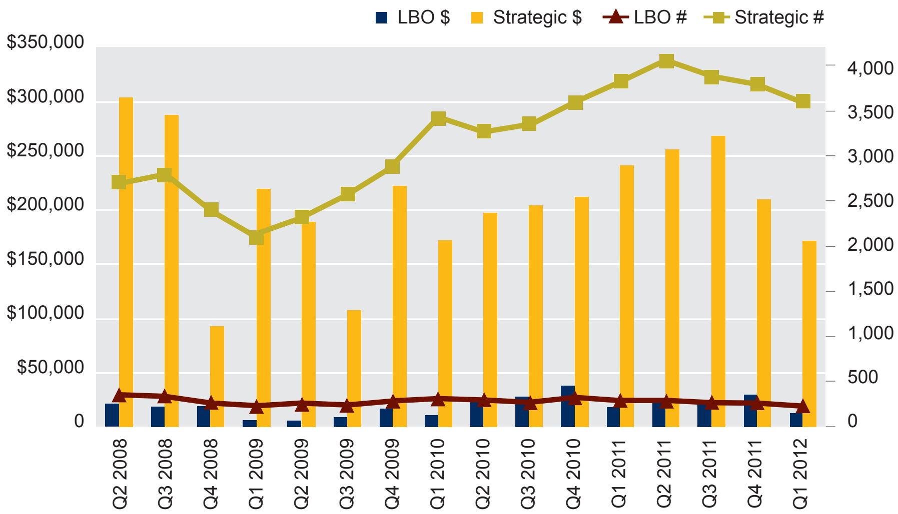
United States M&A Market Steadies Despite Sluggish Economy

By Paul Kreidler, Chicago

Uncertainty in the global and domestic financial markets is causing delays in investment decisions, and has contributed to a disappointing first quarter in terms of M&A activity. But as the US economy continues its slow road to recovery, will we see a boost in M&A activity?

In this article, we examine the North American M&A market and what we can expect for the second half of 2012. We also take a look at the factors contributing to economic and investor uncertainty in the US, including the European sovereign-debt crisis, China's economic slowdown, and domestic issues such as political unrest, unemployment, housing sales and a possible third round of quantitative easing.

Figure 1: Strategic versus financial buyer M&A (North American targets) ($ millions)



Source: S&P Capital IQ

North America M&A market update

Compared to M&A activity in 2011, 2012 got off to a slow start, as summarized in Figure 1.

Total M&A transactions in North America were down 11.5% in Q1 2012 from the peak of 4,328 in Q2 2011 and transaction value was down 36.9% from the peak of $288,167M in Q3 2011. There is a trend of increased transaction counts and decreased transaction dollar volumes in the US. According to the research firm Robert W. Baird & Company, the number of deals in April 2012 was up on a year-over-year basis for the tenth straight month, while the transaction dollar volume decreased for the sixth straight month.

Although M&A activity declined in Q1 2012 from 2011, it remains strong compared to 2009 and 2010. Investor financing is widely available and corporate cash levels are historically high. The way a number of global and domestic issues play out this year will determine how quickly the US economy can recover and to what extent investor sentiment improves.

Global economic slowdown threatens US markets

Europe's sovereign-debt crisis is weighing heavily on US capital markets, although the magnitude of its impact is still unclear. Since early May, US stock prices have dropped sharply, mainly due to concerns about Europe. Investors are focused on whether Spain or Italy will need additional bailout funds, the consequences if Greece leaves the euro currency union, and how US banks and other companies would be affected by a sustained European recession.

In Greece, the "New Democracy" party escaped with a narrow victory on June 17th, which should lessen the chances of an exit from the European Union and debt default for now. However, the Greek government remains in deadlock and a default may be imminent. A Greek default could increase the likelihood that Portugal, Ireland, Italy and Spain also default. Spain and Italy's 2011 gross domestic products (GDPs) were 8.9% and 11.7%, respectively, of the European Union's total GDP in purchasing power parity (PPP) terms; Greece was only 1.9%.[1] Both Italy's and Spain's borrowing costs continue to rise while bond values are falling, and the Madrid stock market hit a nine-year low at the end of May.

As the European debt crisis escalates, falling consumer confidence is likely to hurt demand for China's exports. In the first quarter of 2012, China's annual rate of GDP growth slowed to 8.1% from 8.9% in the previous three months – its slowest growth rate in nearly three years. However, government stimulus spending led to a 30.3% increase in capital spending from March 2011 to March 2012, which should result in higher GDP growth towards the second half of 2012. China's GDP growth is forecast to be 8.7% for 2012.[2]

1 International Monetary Fund
2 The World Bank

US domestic economy shaky

Despite recent optimism, US housing sales are weak after falling unexpectedly in April to a four-month low, and unemployment remains high at 8.1%. However, these numbers are significantly better than they were a year ago.

The country's disappointing May employment figures increased prospects for a third round of central bank asset purchases or quantitative easing, known as QE3. This would see the Federal Reserve purchase additional bonds to combat the slowing economy, but some financial analysts and Federal Reserve officials are questioning whether such additional easing would work.

Fading employment prospects are also contributing to weak consumer confidence. According to a survey released by research group The Conference Board at the end of May, consumer confidence fell in May to a five-month low. A decline in oil prices – crude oil dropped from $105 a barrel at the start of May to below $90 at month's end – also failed to brighten spirits.

Political standstill contributes to uncertainty

It's unlikely that financial reform will happen before the November 2012 presidential election, or in the two months following the elections, which is a historically slow period for legislations. The elections could coincide with the federal government reaching its borrowing limit of US$16.4 trillion, which is likely to happen towards the end of the year. To raise the limit, legislators must pass a separate law. Congress failed to do this in 2011 and it almost derailed economic recovery; another impasse would almost certainly push the US economy into deep recession.

The US is also facing the so-called fiscal cliff: separate legislation is in place that will both raise taxes and force a dramatic cut in government spending at the end of the year – tipping the economy over the proverbial fiscal cliff – unless Congress acts to postpone it.

Outlook for US M&A market

These challenges have slowed the US economic recovery considerably and left the country in a delicate state, but there is evidence that things are picking up. A stabilization and recovery in the eurozone would help the US to improve its economy, so we'll be keeping a close eye on how Europe manages its debt crisis.

With accessible and cheap financing, and record corporate cash balances, conditions are ripe for M&A activity. US credit markets showed no signs of slowing down in April, as high-yield issuances during the first four months of 2012 were roughly double the volume in Q3 and Q4 of 2011, according to Robert W. Baird & Company. The Federal Reserve indicated that interest rates will likely remain low until 2014, which should lead to an increase in historically low equity valuations.

The window will soon be closing for private equity firms to invest a significant portion of older, unspent capital, which makes up a large part of the country's US$425 billion capital overhang.[3] As companies work through this build-up of so-called dry powder, there should be an increase in investment activity. Taking into account this influx, as well as other aspects of the industry that remain strong such as exits and the middle market, we expect to see a stronger M&A market in the second half of the year.

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3 Merrill Datasite Pitchbook

Is Dubai's Economy On the Road to Recovery?

By Saad Maniar, Dubai

In the years following the global financial crisis, Dubai's economic growth slowed dramatically. The emirate was on the brink of default in 2009 after Dubai World – one of the emirate's biggest conglomerates – sought a standstill on debt repayments.

In late 2009, the Dubai Government issued Islamic bonds worth US$1.93 billion, which were several times oversubscribed. This was an early indication that investor sentiment was beginning to improve, especially toward government-backed entities as issuers.

Today, with tourism booming and several debt restructuring deals taking place, investor confidence is the highest it's been in several years, and it looks like 2012 could be a bumper year for Dubai.

Debt restructuring boosts investor confidence

Jebel Ali Free Zone (JAFZ) – one of the world's largest free trade zones and an important driver of Dubai's economy – received shareholder approval in May this year to repay its AED7.5 billion (approximately US$2 billion) sukuk (Islamic bond) ahead of schedule. It was reported that the government-owned entity (owned through Dubai World) plans to repay the sukuk by means of a loan, a sukuk and its internal cash resources.

The free zone has mandated seven leading banks to arrange an Islamic bond, including Citigroup, Standard Chartered and Emirates NBD.

Earlier this year, the Dubai Holding Commercial Operations group repaid a US$500 million bond that was due in February. DIB also repaid its US$750 million, five-year Islamic bond, which matured in March 2012, with its own resources. In addition, we have received reports that DIFC Investments, associated with the Dubai International Financial Centre, has secured a loan of more than US$ 1 billion from a syndicate of banks to refinance a sukuk that matures in the second week of June.

Optimism remains cautious

While the signs are positive, JAFZ's and DIFC Investments' ability to repay their debts is being closely watched by investors worldwide.

These deals happened just months after Standard & Poor's issued a report in December 2011 titled 'Dubai Government-Related Entities (GREs) Face Debt Maturities and Refinancing Issues in 2012'. The report provided a negative outlook of JAFZ's and DIFC Investments' ability to refinance their debts, saying: "Even though Dubai's economy has shown signs of recovery this year, we believe regional GREs face broader risks linked to the weakening global economic outlook, the Arab Spring, and, since August 2011, the volatile equity and bond markets. In particular, we believe issuers in the 'B' category and below that carry large short-term debt maturities, such as DIFC Investments and JAFZ, will likely struggle to refinance without some form of government support."

However, evidence is mounting that Dubai can expect a strong year. In April 2012, the Government of Dubai issued a US$1.25 billion sukuk. JAFZ reported a 2011 net profit of AED242 million (approximately US$66 million), which was significantly higher than its 2010 profit. DIFC Investments is also confident about its refinancing plan.

Contributing to Dubai's recovery is the strong growth of Islamic banking in international financial markets. In the coming decades, with around 80% of Middle Eastern banks expected to convert fully to Islamic banking models, it looks as if Dubai's economic recovery is well underway.

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Overview of Recent M&A Activity in the Renewable Energy Industry

By Gerald Hespelt, Frankfurt, with contributions from Chulanga Jayawardana and Leo Malkin, London, and Gerd Marxer, Munich

Crowe Horwath continues to advise cleantech businesses on due diligence, valuation and structuring matters around the world. In this article, we examine M&A activity in the renewable energy industry, focusing on 2011 and Q1 2012 in the EMEA (Europe, Middle East and Africa) region. In 2011, the EMEA region was the most active market with the highest number of closed deals and highest deal value for renewables, followed by North America and the Asia-Pacific region.

Renewable energy industry sectors examined in this article include the biofuel, biomass, energy efficiency, geothermal, hydroelectric, solar and wind sectors, as well as technology and service sector organizations that work with companies in the renewable energy industry.

Growing global demand for renewable energy

Growing concern over the scarcity of the world's natural resources, coupled with increasing energy demands, is driving market development in renewable energy. The March 2011 earthquake in Japan destroyed the Fukushima Daiichi Nuclear Power Plant and increased worldwide awareness of the vulnerability of our planet. Incidents like this reinforce the need for renewable energy, and countries around the globe are developing different solutions.

Following the Fukushima nuclear disaster, the German Government announced it would close all the country's nuclear power plants by 2022 and fuel Germany's energy demands using alternative sources. As a result, we expect to see significant investment in the solar, wind, water and biomass energy sectors in Germany, and the development of a new smart grid electricity supply system. Other countries are taking similar action, although the focus and intensity of investments varies from country to country.

Investing in renewable energy sectors is regarded by private and institutional investors as a worthwhile strategy with potentially attractive returns. However, this asset class is also seen as one of the most difficult in which to achieve financial success. Unpredictable political decisions and interventions often have a major impact on the rationale of underlying business models, making strategic and financial planning very challenging.

Renewable energy M&A activity in the EMEA region

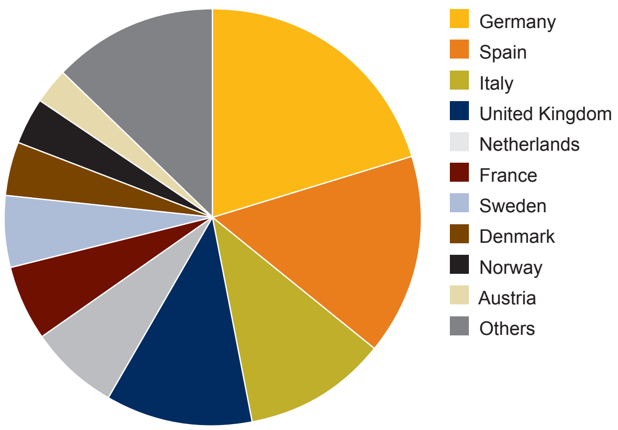
In this section, we highlight the countries in the EMEA region that are the most attractive to investors, countries with the biggest investment appetite, and the renewable energy industry sectors that saw the most investment activity in 2011 and Q1 2012.

2011 M&A deals by EMEA target country

In 2011, there were 142 renewables-related M&A transactions in the EMEA region. Germany topped the list for the most M&A transactions in both the target and bidder categories. Spain outperformed other countries on deal value by target due to Iberdrola's €2.6 billion repurchase of a 20% stake in Iberdrola Renovables. Deal value for France was increased by the EDF Group's €1.5 billion share buyback of its subsidiary, EDF Energies Nouvelles.

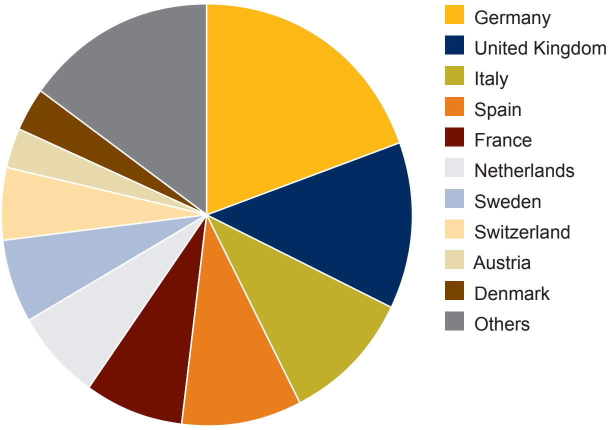
Total deal value outside these large transactions was evenly spread between Germany, Italy and the UK. In Germany, the €272 million acquisition of Roth & Rau AG, a provider of plasma processing systems to the photovoltaics industry, by Swiss-based Meyer Burger AG was one of the major deals closed in 2011. In the UK, the €387 million acquisition of PowerHouse Energy Group Plc, an energy company specializing in the sale of waste to energy systems, by UK-based Bidtimes Plc was the highest-value disclosed deal in 2011.

Figure 1: EMEA region – 2011 top ten target countries by number of renewables M&A transactions



Source: mergermarket

Figure 2: EMEA region – 2011 top ten bidder countries by number of renewables transactions



Source: mergermarket

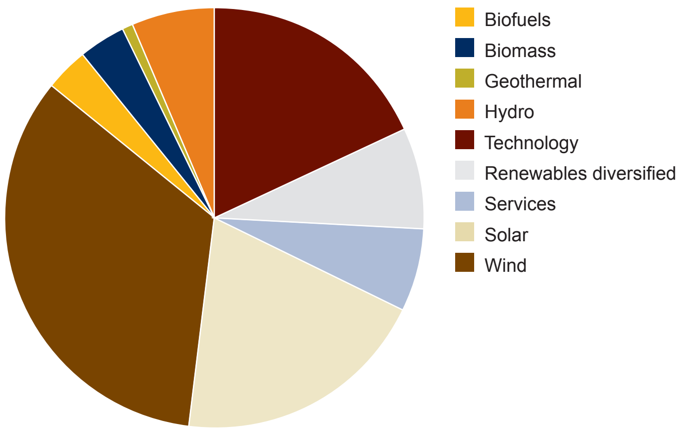
Italy saw two significant deals close in 2011. The first involved the €250 million purchase by Rete Rinnovabile S.r.l. – a portfolio company of UK-based Terra Firma Capital Partners Limited – of 10 photovoltaic plants with an installed 78MWp owned by Terna S.p.A., the Italy-based operator and principal owner of high-voltage grids. The second deal saw the purchase of five wind farms operated by IVPC Power 3 S.r.l. by ERG S.p.A., a listed Italian oil company, with a disclosed deal value of €235 million.

2011 EMEA M&A deals by bidder country

The UK generated the second highest number – after Germany – of renewable energy transactions by bidder in 2011, followed by Italy, Spain and France, which each had a similar number of transactions. About one-third of UK and Italian bidders were asset managers or private equity firms while two-thirds were strategic investors. In France, around half the bidders were financial investors and half were strategic investors. The picture was quite different in Germany, where a vast majority of bidders were strategic investors.

The USA, China and Brazil were the most active bidders outside the EMEA region, being involved in 15 transactions in the EMEA region. These deals were valued at more than €1 billion in total with 12 involving US bidders. About half of US investors were financial, whereas both of the two Chinese investors involved were strategic. The largest investment from a non-EMEA bidder involved the acquisition of Jantus S.L., a Spanish operator of wind power plants, by Brazil's CPFL Comercializacao Brasil S.A., for €680 million.

Figure 3: EMEA region – 2011 deals by renewable energy industry sector



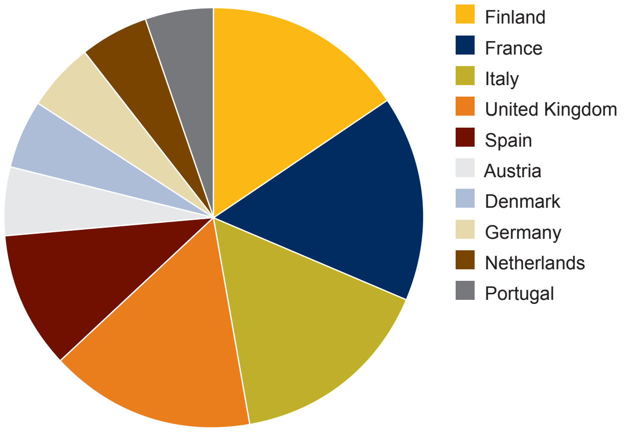
Source: mergermarket

2011 M&A activity by industry sector in the EMEA region

In 2011, the wind, solar and technology sectors were the most active and accounted for 72% of the number of M&A deals in the EMEA region. Technology deals included transactions with manufacturing companies. Eleven deals were closed in the 'renewables diversified' sub-sector, which comprises project developers, investment companies and energy producers that are active across various renewable energy sectors.

The largest disclosed wind sector transaction was the abovementioned €680 million acquisition of Jantus S.L. by Brazil's CPFL Comercializacao Brasil S.A. The largest solar sector deal was the acquisition of a 90% stake in Andasol 1 and 2, a Spanish thermal solar power plant, with a deal value of €747 million, by a consortium of financial investors from France, Germany and the UK. The largest technology sector deal was the abovementioned public takeover of the German company Roth & Rau AG by the Swiss-based Meyer Burger AG.

Figure 4: EMEA region – Q1/2012 M&A deals by target country



Source: mergermarket

Q1 2012 M&A deals by EMEA target country

In Q1 2012 the number of completed M&A transactions dropped by 43% from 34 in Q1 2011 to 19 in Q1 2012. This decline was mirrored in the disclosed deal value, which fell from €4.8 billion in Q1 2011 to €2.7 billion in Q1 2012. This was mainly due to uncertainty about the euro crisis, difficult financing conditions and the cutback of government subsidies in a number of countries.

In Q1 2011, Germany and Spain were the two most active markets, with six completed transactions in Germany and five in Spain. In Q1 2012 Germany and Spain were replaced by Finland, France, Italy and the UK, which completed three transactions each. In the same period, only one transaction was closed in Germany and two in Spain. However, Germany shows the most potential to regain its top position, with four deals currently in negotiation.

Major deals in Q1 2012 included the acquisition of a 70% stake in Edipower S.p.A., an Italian company that owns and operates thermal, hydroelectric and photovoltaic power plants, by the Italian company Delmi S.p.A., with a deal value close to €2 billion. The second largest deal, with a disclosed deal value of €642 million, was the acquisition of UK company Seajacks International Ltd – owner and manager of self-propelled jack-up vessels that are used in offshore wind power installations – by the Japan-based Marubeni Corporation and Innovation Network Corporation of Japan.

Q1 2012 EMEA M&A deals by bidder country

In Q1 2011 France had the largest number of investors (six deals). In Q1 2012, Finnish investors were the most active with four completed deals, followed by investors in France, Italy, Switzerland and the UK with two completed transactions each. Two of the four Finnish investors were power generation companies, while the other two were an investment manager and a manufacturing company.

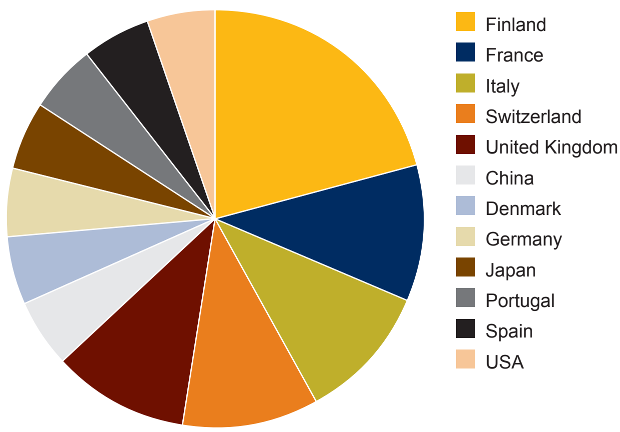
Investors from China, Japan and the United Arab Emirates were largely absent in Q1 2011. However, in Q1 2012 they closed two deals and another three are in negotiation. China, Japan and the United Arab Emirates mainly focused on technology deals, especially with German- and Swiss-based photovoltaic module and equipment manufacturers. Several of these manufacturers were in a distressed state due to strong competition from China and a sharp reduction of feed-in tariffs in many European countries.

In contrast to Q1 2011, more investors from non-EMEA countries were involved in M&A transactions in Q1 2012. However, US investors were much less involved in M&A deals, and overall financial investor activity in this asset class slowed significantly. In Q1 2012, financial investors successfully bid for only three out of the 19 deals closed.

Q1 2012 M&A deals by renewable energy industry sector

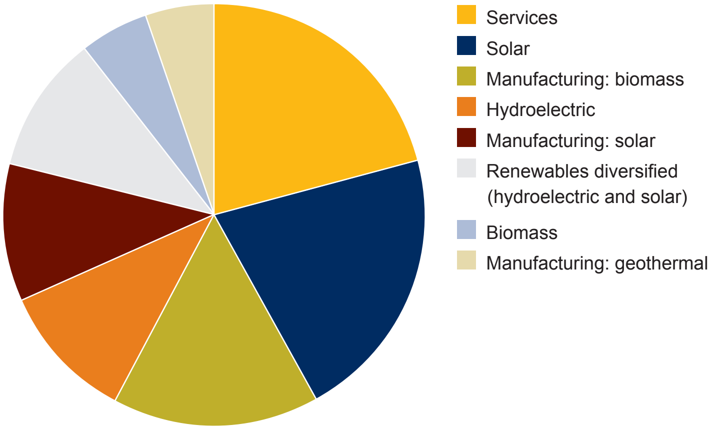
In Q1 2011, the photovoltaic technology and wind sectors were the most active, with seven deals completed in the photovoltaic technology sector and six deals completed in the wind sector. Q1 2012 saw investor activity shift between renewable energy industry sectors in the EMEA region.

Figure 5: EMEA region – Q1/2012 M&A deals by bidder country



Source: mergermarket

Figure 6: EMEA region – Q1 2012 M&A deals by sector



Source: mergermarket

In Q1 2012, transactions were spread more evenly between sectors, with four solar deals and four services deals completed. Overall, the number of technology deals finalized in Q1 2012 increased slightly to almost one-third of total renewable energy industry deals. The acquisition of UK company Seajacks International Ltd. was the largest services sector deal. No deals with a major deal value were disclosed in the solar sector.

In Q1 2012, three deals in the technology sector with a deal value between €160 million and €250 million were in negotiation, as was a deal involving a German wind farm with a deal value of €632 million. This indicates that some major deals could be closed later in the year in the EMEA region.

Private equity

Overall, private equity companies were involved as bidders in approximately 20% of all completed renewables-related deals in the EMEA region in 2011. They were more active on the buy side than the sell side. In Q1 2012, their involvement as buy-side investors dropped to about 5% of all deals closed.

There are encouraging signs of activity in the UK. In early 2012, a new UK Government initiative included the launch of an £80 million (approximately €98.8 million) investment fund aimed at promoting green infrastructure. Greensphere Capital and the Foresight Group will lead this new fund. Sub-sectors to be targeted by the fund include waste recycling and reprocessing facilities, pre-treatment projects and energy-from-waste projects.

A close look at UK capital markets

Given the current negative investor sentiment, raising capital through an IPO on the London Stock Exchange (LSE) continues to be challenging. In 2011, there were only two IPOs and one introduction of an alternative energy company to the LSE's AIM exchange. In contrast to many other European stock markets, where there was no IPO activity in renewables companies, there was one IPO at the LSE's AIM exchange in Q1 2012.

Auhua Clean Energy Plc (Auhua) was admitted to the LSE's AIM exchange on April 2 2012. Crowe Clark Whitehill was appointed as reporting accountant on the IPO transaction, which saw Auhua raise £1 million (approximately €1.2 million) at a market valuation of £25 million (approximately €30.9 million). As at June 7 2012, Auhua was trading at a market capitalization of £27 million (approximately €33.3 million), which is 6.3% above its market valuation at IPO.

Auhua and its subsidiaries (the group) operate in the renewable energy industry in the Shandong Province of China, specializing in the development and application of green energy and energy-efficient solutions. The group's principal business is the design, manufacture and sale of advanced split solar-powered water heating systems, designed to be cost-effective systems for generating hot water for domestic households. The sector that Auhua operates in is supported by government policies. China has committed to ambitious targets for reducing its carbon emissions, and some local governments have made the installation of solar power systems mandatory.

Crowe Clark Whitehill also acted as reporting accountant to China New Energy Limited in 2011 on its admission to AIM. The Chinese group provides technology, process and engineering solutions for bioethanol and biobutanol projects.

Outlook for 2012 and beyond

After several years of high M&A and IPO activity, the EMEA region will see a much lower level of deal activity in 2012. The solar industry is suffering from oversupply and very strong competition from Asia, which has resulted in equipment manufacturers facing declining demand.

The wind industry is also struggling with overcapacity, but to a lesser degree than the solar industry. The biomass industry shows slow growth, but is still far from becoming a major source of renewable energy production in most EMEA countries.

The inability or unwillingness of many banks to finance large-scale renewable energy projects, and the steep cut in feed-in tariffs in many countries (in some cases even retrospectively) has driven away investors – or at least made them cautious about investing in renewables. In this negative environment, distressed deals will most likely increase and gain a large share of M&A activity in renewables in 2012. Some distressed deals had already closed in Q1 2012 when investors from Asia and the Middle East acquired insolvent renewables technology companies. We expect many more deals of this type to follow in 2012.

In the medium term, when solar power reaches grid parity in many markets and becomes less dependent on government funding, a new wave of growth in the renewables industry can be expected. This will lead to increased M&A and IPO activity in this area.

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