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The Global Corporate Advisor

August 2012

The Corporate Finance newsletter of Crowe Horwath International

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

As 2012 progresses, conditions in the global M&A market remain turbulent. The last few months offered a brief respite from plunging deal values, but there are few signs of sustained optimism, and we're on track for one of the worst years for M&A activity since 2004.

Europe remains mired in uncertainty, with ongoing worries about its debt crisis. However, over the first half of this year, Europe made up the largest share of global M&A activity of any region. The United States has few positives to boast about, accounting for a diminishing share of global M&A dealings.

Further, Asian markets remain soft. Falling commodity prices hit the Australian economy hard, and the nation registered the largest year-on-year decline in M&A activity of any country in the Asia-Pacific region. In a sign of the times, China showcased its robust economy by posting only a modest decline in deal values. While in India, ongoing regulatory uncertainty is driving a 'wait and watch' attitude in the field of M&A.

Yet, despite this backdrop of negative sentiment and sluggish economic conditions, deals are still being done. Chinese firms remain hungry for acquisitions, bolstered by the strength of the local currency, and are seeking resources plays in Brazil and Canada. We've also seen strong interest between Turkish and German companies, with deals flowing both ways.

The GCA team is here to assist with M&A transaction support, valuations, M&A advisory and related services. If there is something you'd like to see covered in future editions of this newsletter, don't hesitate to contact me or a member of the team to discuss your ideas.

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Driving a Better Deal: Giving Your Potential Acquisition the Best Chance of Success

By Andrew Fressl, Sydney and Mike Lux, Chicago

Failing to prepare

Deals often begin with unbridled optimism, with expectations that it will be relatively easy to realize the combined benefits of the companies involved. However, in the haste to make the deals happen, many complex areas are often overlooked or only superficially explored, including market trends, quality of earnings, integration challenges and cultural issues.

In our experience, many acquirers underestimate the costs of integration, overestimate the synergies between the two organisations and run into cultural barriers. The end result can be a failed acquisition. We're often reminded of the quote: "more than 70% of all acquisitions fail to live up to expectations or fail".

Making your deal count

To give your deal the best possible chance of success, it is crucial to:

- put in place an advisory team
- conduct a valuation and pricing analysis
- undertake pre-deal due diligence
- decide on the best deal structure
- complete integration planning.

Putting in place an advisory team

To run an effective transaction process, you need access to advisors with the necessary skills and experience across critical functions, such as business valuations, due diligence, deal and taxation strategy, and deal integration.

With these skilled advisors in place, a company has a network of experts who can quickly resolve problems. In addition, they can ensure that issues such as tax are dealt with effectively, and any tax liabilities stemming from acquisitions are minimised.

Valuing the target and its underlying assets and liabilities

Companies can benefit from valuation services before, during and after an acquisition.

A comprehensive pre-deal valuation analysis is an essential step in ensuring the right price underpins your transaction. The valuation process identifies key value drivers, and considers market conditions, alternative deal structures, the combined benefits of the new entity and competing opportunities.

In addition to pricing and structuring a deal, valuations are required to allocate the purchase price to the assets and liabilities acquired – known as a purchase price allocation (PPA) – for both financial reporting and taxation purposes. Intellectual property is often a significant component of the purchase price.

PPAs have wide ranging benefits, enabling acquirers to understand and plan for future accounting and taxation treatments related to:

- the recognition of certain classes of assets and liabilities
- the quantum and timing of upfront and deferred tax deductions
- the quantum and timing of depreciation and amortisation charges
- potential impairment charges.

Understanding these factors enables a business to:

- forecast future earnings more accurately
- position itself to optimize the quantum and timing of tax deductions and post-tax cash flows
- position itself to generate higher profits and pay more dividends
- reduce uncertainty and manage risk
- manage banking covenants (both leverage and debt service).

Pre-deal PPAs can be an important planning tool and are based on information available prior to completion of the deal. Post-deal PPAs generally benefit from greater access to information and support the creation of financial reports and taxation positions.

Pre-deal due diligence

When you're evaluating the affordability and attractiveness of a transaction, it is important to evaluate the target's value drivers, and identify its major risks and weaknesses. This requires quite detailed analysis, covering quality of earnings, working capital and operational issues.

This thorough due diligence process begins with an inspection of financial statements, analyzes operational factors and technology infrastructure, and explores people and culture. This latter point is the most intangible aspect, but is often the most vital factor in determining long-term value. At this stage, as you seek to uncover hidden concerns in target companies, it may also be prudent to engage IT and human resources specialists.

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Deciding on the best deal structure

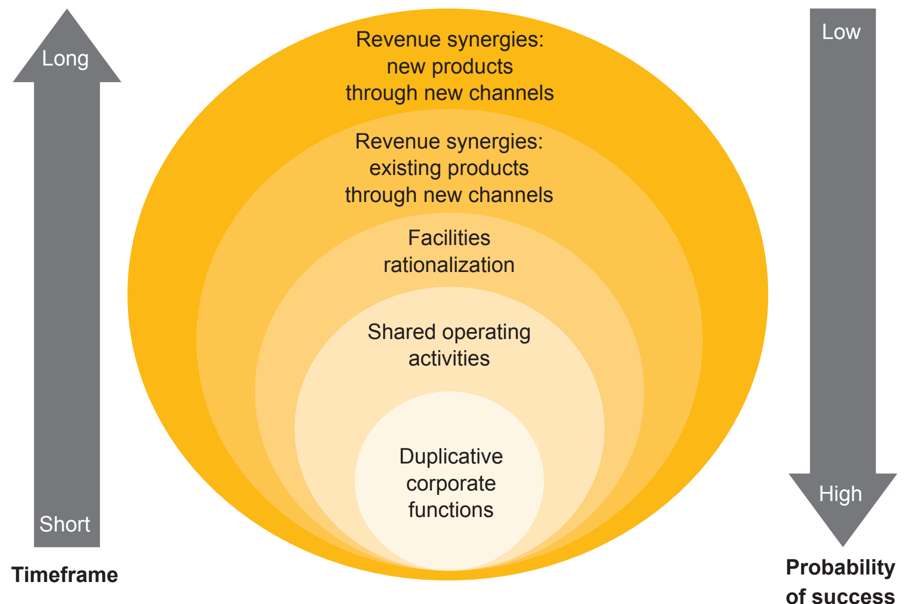
A blend of tax, accounting and capital considerations will determine the optimal deal structure. In terms of tax concerns, the purchase of shares or assets must be considered, along with issues relating to capital structure and future tax liabilities.

Completing integration planning

To unlock value from merger and acquisition opportunities, you need to identify and realize the unique benefits that will arise when your company and the target combine. These benefits include removing duplicated corporate functions and shared operating activities, as well as consolidating facilities. Integration planning should begin as soon as the deal is confirmed, and assess any potential issues identified during the due diligence process.

The following diagram outlines the common benefits arising from deals and the timeframes over which they tend to occur.

Figure 1: Deal benefits and timeframes



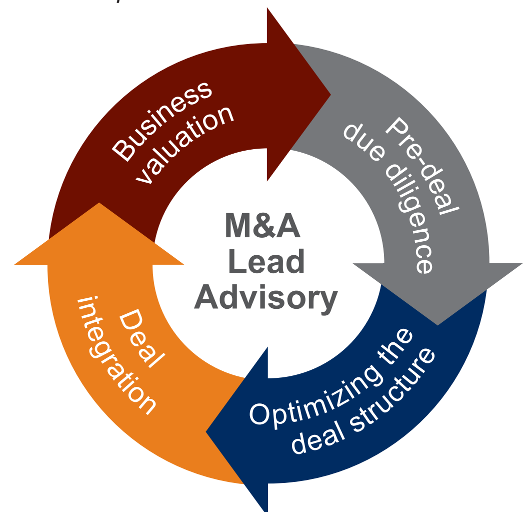
Crowe Horwath's experienced team

M&A can be a complicated process. Our team of experienced M&A advisors can help you plan for and close the potential gaps in a merger or acquisition. Our Transaction Support and Valuation professionals have specialized industry experience and knowledge in assisting, evaluating and helping to execute M&A deals, as well as providing advice to corporates, private equity firms, lending institutions and other professional investors.

Our fully integrated services approach helps you identify deal breakers, realise opportunities to increase profit, manage risks and optimize transactions. This approach can also help simplify project management by having a single point of contact, backed up by a unified team, with everyone working off a shared project plan that ensures issues don't fall through the cracks.

Crowe Horwath's integrated service offering can be seen in Figure 2.

Figure 2: Crowe Horwath's integrated M&A process



Your next steps:

If you require assistance with a potential transaction, please contact one of the authors of this paper below at Crowe Horwath:

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The Global M&A Landscape

Worldwide

The decline in global M&A values paused in the second quarter of calendar year 2012, with an increase of 13.9% over Q1/2012. This reversed five consecutive quarters of falls in global M&A totals, according to mergermarket's *M&A Round-up* for the first half of 2012.

However, the overall M&A picture remains uncertain. The value of deals done in the first half of 2012 was a near 22% decline on the same period in 2011. On current form, full-year 2012 is set to post the second lowest yearly total for M&A activity since 2004.

Asia-Pacific

Introduction

Despite recent instability in financial markets, there are some signs of optimism regarding M&A activity in 2012. According to Bloomberg's *2012 Asia Pacific M&A Outlook*, 70% of respondents expect an increase in M&A deal count over the course of this year compared to 2011. But investors see slow economic growth and ongoing market volatility as the most significant obstacles to closing M&A deals in 2012.

Further, survey respondents expect deal premiums to rise during 2012 compared to the previous year. Distressed companies are seen as the most frequent M&A targets, followed by public mid-cap companies and corporate divestitures. There are also expectations that the number of management buyouts will increase.

So far this year, the most popular deal types are company takeovers and private equity deals. Survey respondents believe the latter will increase in importance during the second half of this year.

In addition, the survey found that Japan and China continue to be the most frequent acquirers and targets for the Asia-Pacific region. For calendar year 2011, Japan was the most acquisitive by volume with US$160 billion in deal volumes in the region, while China came in second with US$126 billion worth of deals in the region. However, China outpaced Japan in terms of frequency with 2,275 regional deals compared to Japan's 1,811 deals.

China

The European debt crisis, and its subsequent drag on global growth, has only had a limited impact on China. This is because the Chinese economy is principally driven by internal demand, and the country's M&A market has remained highly active despite the global slowdown.

According to the Bloomberg survey, Chinese firms announced US$157 billion worth of global M&A transactions in calendar year 2011 – a 7.3% fall from 2010. Average deal values dropped to US$72.58 million in calendar year 2011 compared with US$77.86 million the year prior.

Deals in the region were dominated by oil companies. The largest transaction involved the acquisition of Petrogal Brasil Ltd by China Petroleum & Chemical Corp for US$4.8 billion.

The mining and energy sector is China's highest value M&A market, followed by the banking and finance and manufacturing sectors. However, according to the ChinaVenture Investment Consulting Group, the largest number of deals took place in the manufacturing sector.

Investors have high expectations for M&A activity in China in the second half of 2012. ChinaVenture Investment Consulting Group predicts that the poor performance of China's stock markets and the slowing down of its IPO market are expected to favor buyout investments and lift the number of M&A deals.

Further, the strength of China's currency will make foreign investments very attractive. Chinese enterprises are seeking investment opportunities overseas in the energy and manufacturing sectors, particularly among debt-laden companies.

Australia

Australia has experienced a challenging period for M&A activity in the first half of 2012. According to mergermarket, Australia recorded the largest year-on-year decline during this period of any country in the Asia-Pacific region. Impacted by falling commodity prices, the value of M&A deals totalled US$23.2 billion in the first half of this year – a 22% drop from the same period in the prior year. The number of deals decreased 30% to 305, according to Capital IQ.

The resources and energy sector continues to dominate Australian M&A activity, accounting for nearly 50% of the total number of transactions according to a study conducted by Clayton Utz. Prominent deals conducted over the first six months of 2012 include:

- Yancoal Australia's (whose majority shareholder is China's Yanzhou Coal Mining Company Ltd) US$8.4 billion acquisition of Gloucester Coal
- Whitehaven Coal's takeover of Aston Resources (US$2.4 billion) and Boardwalk Resources ($US738 million)
- Exxaro's takeover of African Iron (US$280 million)
- St Barbara's proposed acquisition of Allied Gold (US$633 million)
- Sumitomo's acquisition of a 50% interest in Isaac Plains operations from Aquila Resources Ltd (US$454 million).

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Foreign investment remains the biggest driver of Australian M&A activity, accounting for 73% of announced deals in the first half of this year according to Clayton Utz. This investment is driven largely by Australia's natural resources, as well as its standing as a stable economy with a transparent regulatory environment.

Key foreign investors into Australia include China, with its investment in resources (for example, Yancoal's acquisition of Gloucester) and agriculture (including COFCO Group's takeover of Tully Sugar). India is also involved in M&A activity in Australia, with resources acquisitions by GVK, Adani and Lanco, largely driven by India's need for resources and energy sources – including thermal coal.

Given the current volatility in equity markets, and an increase in foreign bidders, cash deals have represented close to 82% of all Australian M&A transactions in the first half of 2012, according to Bloomberg.

Australia continues to experience a two-speed economy, where the mining and energy sectors are thriving, while the manufacturing and retail sectors struggle and experience significant foreign competitive pressures. Corporate boards remain highly cautious at present and matching the price expectations of buyers and sellers will prove difficult in the current environment.

Japan

Over the first half of 2012, Japanese companies completed 912 M&A deals worth US$71.6 billion (¥5,622 billion), according to Recof. Underpinning this M&A activity was the Japanese Government's decision to inject US$12.74 billion (¥1,000 billion) into the Tokyo Electric Power Company, in response to the Fukushima nuclear disaster.

At the same time, the number of cross-border M&A deals between Japanese and international firms reached its highest level in 22 years over the first half of 2012. According to Recof, 262 deals were completed worth US$44.45 billion (¥3,490 billion). This M&A activity has been focused around the food and energy sectors.

Since the Fukushima disaster, Japanese companies have increasingly sought out opportunities in overseas markets, anxious about the possibility of local electricity supply shortages. For that reason, large companies and small to medium enterprises now actively participate in global M&A deals, which has helped boost the number of deals being undertaken.

Some analysts have forecast that Europe's unstable financial situation will lead to an ongoing appreciation of the Japanese Yen this year. A higher currency will push up the price of exports, and will hinder an export-led recovery.

According to economists, population increases and economic growth in emerging markets will ensure global M&A transactions involving Japanese companies continue to grow into the future.

Middle East, Africa and India

Introduction

M&A activity in the Middle East and Africa went up in the first two quarters of 2012 based on deal value, according to mergermarket's *M&A Round-up*. However, when compared to the same period in 2011, overall M&A activity in the first half of 2012 was down by US$22.1 billion, a 16% drop.

The telecommunications and financial services sectors recorded increases in both deal numbers and values in the first half of 2012.The largest deal completed in this period was France Telecom SA's US$3.3 billion acquisition of a 63.64% stake in the Egyptian Co. for Mobile Services.

Turning to India, the domestic M&A sector remained robust over the first six months of 2012. This was despite a drop in overall M&A activity. In addition, ongoing legal and regulatory uncertainty may lead some companies to reconsider or delay M&A plans.

Turkey

The Turkish economy has been one of the world's fastest growing in recent years. Shrugging off the effects of the global financial crisis, the country has mounted a strong recovery, with gross domestic product increasing by 8.5% in 2011. Turkey is now viewed as an emerging market and an increasingly attractive investment destination.

At present, Turkey is in the middle of a major privatization program, involving infrastructure and power projects, in addition to the national lottery. And the increasing power needs of the economy are expected to underpin an increase in M&A deals in coming years.

In the first half of 2012, major M&A activity focused on the financial services, energy and manufacturing sectors. These deals involved a mix of local enterprises and companies from Russia, France and the United Kingdom.

However, the nation's economy does face a number of headwinds. These include the current account deficit, exchange rate risk and the fallout from the ongoing debt crisis in Europe.

In a developing trend, Turkish companies have increasingly pursued M&A deals with their German counterparts – and vice versa. During the first six months of 2012, six M&A deals have been completed between companies from these countries – with five of the deals involving target companies in Turkey.

Based on published deal values, the largest deal announced over this period was the acquisition of Turkey-based distributor of imaging, graphic and medical products, Filmat Dis Ticaret A.S. by Fujifilm Europe GmbH for €21 million.

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In 2011, 11 deals were completed between companies from these countries, up from seven in 2010. German investors were involved in six completed deals with target Turkish companies in 2011, compared with three a year earlier. Turkish investors completed five deals with target German companies in 2011, a slight increase over the four completed in the previous year.

While only a few deal values were announced, based on published deal values, approximately €26 million was invested in deals between German and Turkish companies in 2011 – less than half the total in 2010.

However, the deal values disclosed in 2010 were influenced by a major media transaction. Germany's Stroeer Out of Home Media AG, one the world's biggest outdoor media companies, paid €55 million to increase its stake in Turkey's Stroeer Kentvizyon Reklam Pazarlama A.S. to 90% from 50%.

In 2011, the largest disclosed transaction was Germany's Doehler GmbH paying €22 million to purchase 100% of the shares in Aroma Karaman Konsantre Tesisleri in Turkey. The shares were sold by Aroma Bursa Meyve Sulari ve Gida A.S.

We expect the number of deals between German and Turkish companies to increase in 2012, underpinned by robust economic conditions in Turkey. With stable economic growth, investment-friendly legislation and structural economic incentives for companies, Turkey is a nation of growing economic importance.

Further, the country has a workforce of over 25 million people, and acts a strategic hub and important bridge between Europe and Asia, offering a cost-effective logistics hub for companies.

India

Indian M&A activity in the first half of 2012 was dominated by domestic deals, which accounted for 86% of all deals completed. Overall, the value of transactions finalised over this period is estimated at US$18.1 billion – around 35% lower than the corresponding period for 2011. The drop in activity levels was particularly sharp in Q2/2012, with the value of deals done plummeting by 57.2% compared to Q2/2011, to US$5.4 billion. The value of transactions undertaken in Q1/2012 was estimated at US$12.7 billion according to the Reuters and Dealogic reports.

Despite these figures, we have seen strong activity in the domestic M&A sector. The value of domestic deals done in the first half of 2012 is estimated at US$7 billion. The merger and restructuring of Sesa Goa, Vedanta Resources, Sterlite Industries, Cairn India and Madras Aluminium, with a valuation of US$4.1 billion was the single largest deal over the first half of 2012.

Domestic sector transactions were focused around the financial and telecommunications sectors, health care, media and entertainment, technology, and real estate and hotels. As a whole, the domestic sector is seeking access to cheaper capital, with several companies feeling the combined stress of rising operating and interest costs, and lower demand. This environment presents opportunities for companies that have conserved their cash holdings. These opportunities will arise across a variety of sectors, including manufacturing, health care and pharmaceuticals, services and retail, real estate, finance, aviation and IT.

At present, India's M&A market is being affected by uncertainty over the taxation environment and exchange rate movements. This has led companies to take a 'wait and watch' attitude towards deals, or abandon them altogether.

There had been optimism in the market following the Indian Supreme Court's ruling in the landmark Vodafone tax case. This decision was expected to support deal-making in a market that needs more sources of external funding. However, the Indian Government's ill-advised move to retrospectively amend the law and tax the capital gains earned by Vodafone and other companies caused a severe backlash and curbed the optimistic sentiment.

Without getting into the merits of seeking to tax such gains – some other countries are doing so – it is the retrospective nature of the amendment that has hurt sentiment. Businesses have enough uncertainty to deal with and no one wants to worry about amendments that change the rules after the game has been played.

Further, the proposed introduction of General Anti-Avoidance Rules (GAAR) was viewed as causing additional challenges for foreign investors and foreign institutional investor (FII) transactions. FIIs feared there would be insufficient time to plan investment and exit strategies. However, this fear was partially allayed by the Indian Government's postponement of the matter, although the need for greater certainty will return once the GAAR panel makes it recommendations.

In other policy-level challenges, the Government has been unable to bring in foreign direct investment (FDI) in multi-brand retail and civil aviation, sectors that were expected to generate strong inbound investment interest. In addition, pricing and regulatory uncertainties linked to the telecommunications sector – previously an area of strong investment interest – caused a drag on sentiment. The depreciation of the rupee continued to create risk fears in the minds of foreign investors, many of whom saw a dilution of their dollar-based gains.

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On the other hand, some recent Government decisions have been positive:

- Indian retail brands can now secure FDI without government approval, so long as ownership of the brands remains with companies that are locally owned and controlled. This is expected to lead to greater private equity investment interest in Indian brands
- regulations for external commercial borrowings have been frequently eased
- FDI by Pakistan nationals and Pakistan-based entities is now permitted, except in some specified sectors.

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