Crowe Horwath

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# The Global Corporate Advisor

## The Corporate Finance newsletter of Crowe Horwath International

**Dan Cotton**
*GCA Regional Leader*
*Oceania*

Welcome to the October issue of *Global Corporate Advisor*, brought to you by the GCA Oceania team.

In this month's issue, we provide an in-depth snapshot of current changes in the global tire industry, with a special focus on production in Asia, care of Sanjay Bansal, Founder and Managing Partner of Aurum Equity Partners LLP, India, a Crowe Horwath International business associate.

This issue also contains a detailed update of M&A activity in Korea, delivered by Eui-Young Hwang, a Senior Analyst at Crowe Horwath Choongjung in South Korea.

Rounding out this edition is a comprehensive investigation into some of Poland's most promising investments, written by Krzysztof Horodko and Krzysztof Kajetanowicz, of TPA Horwath Poland. We believe the country is a growing power on the global economic stage, and presents some exceptional opportunities for investors.

## Oceania Markets

Meanwhile, in Australia and New Zealand, deal volumes are gradually improving. There has been US$78 billion of deal volume so far this year. This is still subdued compared to pre-GFC levels. However, contested takeovers are increasing. For example, strategic agricultural sector businesses such as dairy-product processing play to the theme of food security and a growing Asian middle class. We have also seen significant Chinese interest in Australia's real estate sector.

Institutional investors are reported to be pushing corporate boards more actively to raise debt levels and spend more on capital expenditures and deals. Australia's top 200 listed companies

## Inside This Issue:



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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 Peter Varley, Chairman of GCA at peter.varley@crowecw.co.uk. Alternatively, please contact your local member of the GCA team to discuss your ideas.

have accumulated about US$69 billion of cash reserves. An example, is Hills Holdings using its cash reserves in its September deal to acquire Merlon Healthcare Communications and Hospital Television Rentals (HTR) for approximately US$30 million.

Andrew Fressl, who leads Crowe Horwath's Transaction Services team in Sydney and who advised Hills on these deals, comments "These acquisitions are in line with the aggressive transformation strategy embarked on by Hills and gives Hills the number 1 and 2 positions in its respective market segments. Merlon provides communications and nurse call systems to hospitals and aged-care facilities, while HTR does exactly as its name suggests. The acquisitions will be funded from Hills' cash 'war chest', which is expected to swell to around US$285 million by year-end."

At the same time, corporate lending by non-European foreign banks in Australia is up 25% over the last year, catalyzing greater deal flow.

As we noted in a private equity article in the GCA September 2013 newsletter, private equity firms in Australia have performed well. 'Survival of the fittest' has played out, with strong local funds dominating the buyside and sellside market.

Equity capital markets deals have increased to US$13.2 billion, up 6.5% year-on-year. This year's top Australian IPOs have all shown positive returns of between 36–57% since listing. This is encouraging vendors to consider IPOs in greater volumes than they have for many years. Equity capital markets windows can close as quickly as they open. However, there is a good pipeline of flotations expected to come to market before the end of the year in sectors as varied as entertainment, electrical retail and packaging.

Thank you to our global GCA colleagues for sharing these valuable insights. As always, if you have any ideas for contributions to the newsletter, please get in touch – we'd love to hear your perspective.

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# South Korea – M&A Market Overview

**By Eui-Young Hwang, Seoul**

Over the past three years, merger and acquisition (M&A) activity by South Korean companies has been relatively sluggish. In 2010, 280 M&A deals were completed, worth around US$39 billion; in 2012, 237 deals were closed, worth over US$28 billion (Figure 1).

However, Korean M&A activity has begun to creep up again. For instance, in 2012, inbound M&A deal values increased by 37.5%, and outbound M&A deal values grew by 14.3%, compared with 2011 (Figure 2).

In 2012, the largest growth in deal volumes were in the chemical and industrial, consumer, and financial services sectors (see Figure 3).

## Looking ahead

According to Bloomberg, citing major local newspapers, more than US$17 billion of M&A deals are expected to be closed in the South Korean market in 2H 2013, due to a number of mega deals. These include the privatization of Woori Financial Holdings, which is projected to be valued at between US$9.2 and $9.5 billion.

This deal is attracting the interest of major financial companies, global private funds and sovereign wealth funds. Furthermore, Tong Yang Group, STX Group and other conglomerates are currently experiencing liquidity challenges, which could create M&A opportunities in the market.

Foreign funds are more enthusiastic than they have been in the past, and we are seeing a surge of interest among Chinese investors for opportunities in the South Korean market. For example, in 2013 the Industrial and Commercial Bank of China made a bid to purchase a Korean commercial bank.

Biotech and healthcare companies in Europe and the United States are also exploring potential acquisitions in South Korea.

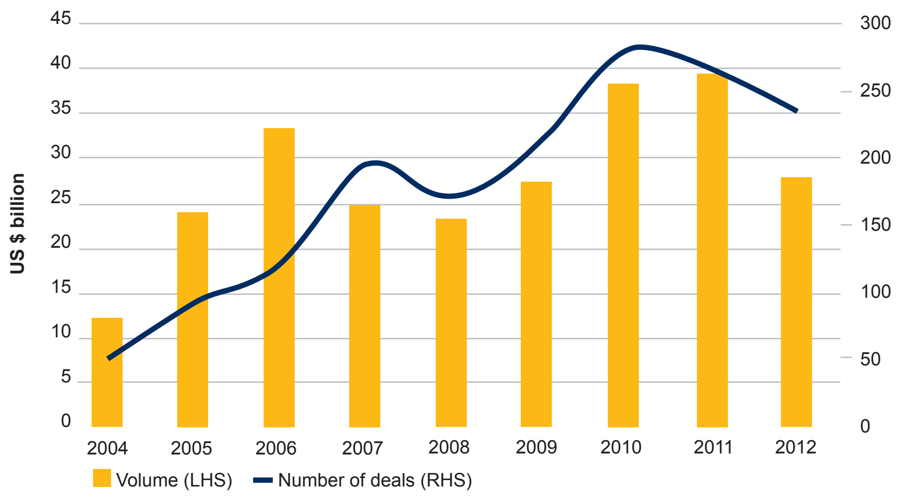


*Figure 1: South Korean M&A deal volumes – trend (FY04–FY12)*
*Source: Bloomberg*

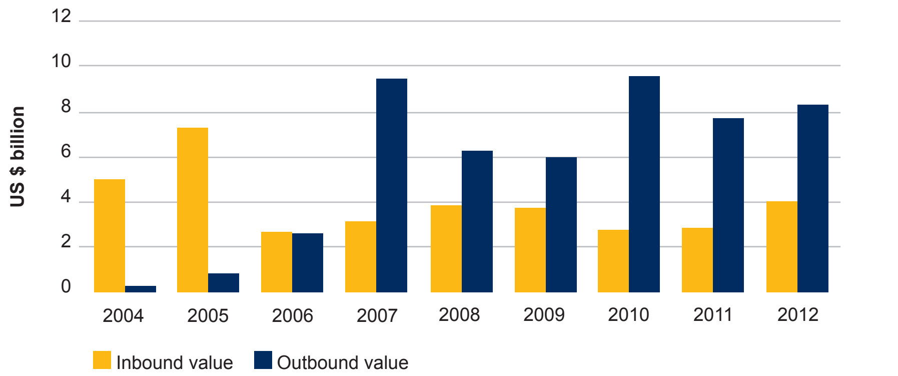


*Figure 2: South Korean M&A deals – inbound versus outbound by value*
*Source: Bloomberg*

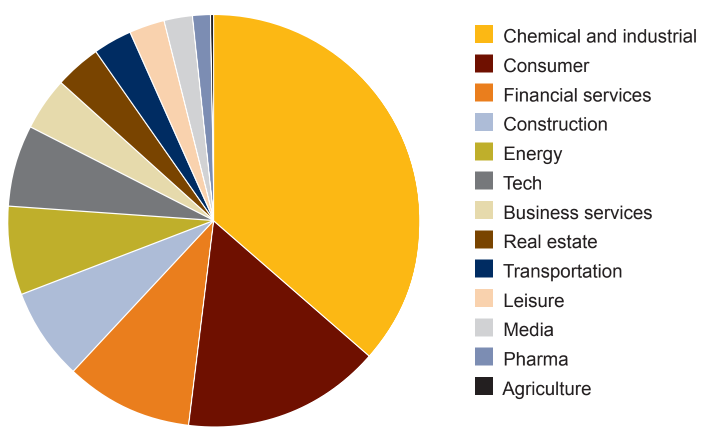


*Figure 3: South Korean M&A deal value breakdown by sector, 2012 (%)*
*Source: Bloomberg*

During M&A deals, foreign private equity funds are typically taking a financial rather than a strategic approach to investing. For instance, funds such as the Carlyle Group and Kohlberg Kravis Roberts have taken this approach in their bid to acquire Woori F&I, a subsidiary of Woori Financial Holdings.

***For more information***

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# Poles Apart: Identifying Promising Investment Opportunities in Poland

**By Krzysztof Horodko and Krzysztof Kajetanowicz, Poland**

Poland has shrugged off its Communist past to become an increasingly attractive destination for foreign investors. However, there are a number of potential challenges investors should be aware of before they direct funds into this emerging economy.

## Poland's growth story

Poland is a growing economic power on the world stage. The nation is the largest of the 11 former Communist economies that have joined the European Union (EU) since 2004, and over the last decade its economic growth has exceeded average growth rates across the EU.

According to the Polish Central Statistical Office, Poland's real gross domestic product (GDP) continued to grow in 2012, increasing by 1.9% after a 4.5% advance in 2011, up from 3.9% in 2010 and 1.6% in 2009[1]. The country has also steadily reduced government deficits from 7.9% of GDP in 2010 to 3.9% of GDP in 2012[2]. Inflows of foreign investment have increased from US$5.5 billion in 2010 to US$5.9 billion in 2011[3].

The nation's currency, the Polish zloty, now floats without major intervention from the central bank. Poland has also been a major beneficiary of the EU's Cohesion Fund, with about €106 billion allocated in 2014–20 to drive economic activity[4]. This amount is equivalent to about 3.5% of GDP over this period, seeing as the 2012 output was the equivalent of €380 billion[5].

## Sending mixed signals

Authorities boast that Poland is the EU's 'green island' – the only country to have avoided recession after the global financial crisis – and is underpinned by a robust banking sector. According to the National Bank of Poland's Financial Sector Stability Report in July 2013, during a period of financial stress – such as a 30% depreciation in the local currency – the nation's banks would only require around US$1.4 billion in capital and US$10 billion in liquidity.

However, some investors have a different point of view, and consider Poland to be a relatively uncertain investment destination and, like Ukraine, vulnerable to the fallout from the debt crisis still gripping Western Europe. These concerns are evidenced by a decline in foreign direct investment in Poland from €17.2 billion in 2007 to €13.57 billion in 2011[6].

Investors remain concerned by Poland's relatively high unemployment rate of 10% and the fact that only 56% of the population is in the labor force. They are also worried that Poland may not be able to finance its credit markets should foreign banks scale back their operations. This risk of 'capital flight' is adding to currency volatility and putting a strain on Poland's capital account.

In Q3 2013, foreign capital outflows drove up the 10-year bond yield by exactly half from the 3% low in May. This rise in yields may have been fueled by investor uncertainty over how the Polish Government would manage public debt levels approaching the constitutional limit of 60% of GDP. In addition, despite the government's inability to get fiscal deficits below 3% of GDP, sovereign bond yields are low. In 2004, investors could secure returns of over 7% for 10-year Polish Government bonds. At present, 10-year bonds offer returns of little more than 4%. This is an unusual situation, as investors would usually require relatively higher returns to invest in a developing economy rather than a developed one.

## Recent M&A activity

Merger and acquisition (M&A) activity plunged in 2012. The value of M&A deals fell by 60% to €6.5 billion in 2012 from a record high of €16 billion in 2011. The number of major private equity deals decreased from 30 to 15. Also, the value of initial public offerings declined from €2.2 billion in 2011 to €730 million in 2012.

While this weakness has generally continued during 2013, there have been two major deals of note:

- PKO Bank Polski's purchase of Nordea for €700 million
- Danish Dong and Spanish Iberdrola exiting their investment in the Polish wind energy market. The assets were purchased by state-owned utilities for €440 million.

1 Polish Central Statistical Office (GUS), 2013 *Concise Statistical Yearbook of Poland*, www.stat.gov.pl/cps/rde/xbcr/gus/RS_maly_rocznik_statystyczny_2013.pdf, page 486
2 Polish Central Statistical Office, as above, page 492
3 OECD, *Country statistical profile: Poland 2013*, www.oecd-ilibrary.org/economics/country-statistical-profile-poland_20752288-table-pol.
4 Polish Ministry of Treasury, www.msp.gov.pl/portal/en/88/4015/Poland_to_get_nearly_EUR_106_bln_from_20142020_EU_budget_pool__expected_impact_o.html
5 Polish Central Statistical Office, op cit, page 483
6 National Bank of Poland, http://www.nbp.pl/publikacje/ib_raporty/raport_ib_2011.pdf

In Poland, average M&A deal sizes have been growing over the last decade, thanks to large-scale privatizations and major transactions in the banking and telecommunication sectors. In the absence of major deals in coming years, we see greater potential in the middle market where private equity has been circling potential targets.

# Chasing returns

Despite these challenges, Poland offers several potential opportunities for investors in the export and infrastructure sectors.

Poland's export growth is being driven by a growing number of lucrative partnerships with countries such as Russia, Slovakia and Ukraine, and nations in Asia and North Africa. These relationships are particularly important as the demand from France, Italy and the Netherlands wanes due to macro-economic weakness in the eurozone.

Given these trends, we see potential opportunities for chemical companies, furniture and machinery manufacturers, and metallurgy companies. Chemicals is a special case in that the sector is still partially state-owned, raising hopes for eventual privatization and scope for deals with domestic and foreign investors.

The Polish Government has also vowed to allocate fresh funds – possibly EU-backed – to improve the nation's ailing roads, complete freeways, deliver high-speed rail and upgrade the energy grid. Given EU elections are slated for 2014 and a Polish national election is due in 2015, the government may feel pressure to meet its infrastructure commitments. This could be good news for investors in the energy and construction sectors.

Looking to the future, we have identified a number of promising areas for investors, including:

- private healthcare and aged care
- telecommunications infrastructure, particularly wireless technology
- retail, given the sector's ongoing consolidation
- private equity company investor exits from investments they made during the post–EU accession boom incited in 2004, and exits from middle-market investments.

# Managing risks

While Poland has become a more attractive investment destination, investors need to manage a number of key risks in areas including tax, financial reporting, the legal system and compliance arrangements.

## Taxing times

In recent years, businesses have complained about a lack of clarity in Poland's tax laws. This led the creation of a system of binding rulings to offer certainty on tax issues. However, there is still a risk that tax authorities will impose rulings that require additional tax payments – even when their interpretation of contentious legal provisions contradicts the spirit of tax law and/or previous rulings. In this situation, investors must consider the pros and cons of going to court to defend their position.

To avoid these situations, we recommend investors seek professional local tax advice, especially in areas such as transaction taxes, VAT on asset transfers and carry-forward losses.

## Getting reporting right

Reporting standards in Poland are generally sound and local companies are gradually adopting International Financial Reporting Standards. But enforcement arrangements and corporate governance frameworks vary markedly across the country, as they do in many emerging markets.

In addition, the amount and quality of data available during due diligence can be highly variable. For example, during a due diligence engagement on a Polish company, we discovered that the target company had made no provisions for doubtful receivables, and it had an outdated accounting system that made simple mistakes in corporate tax reporting. As a result, we adjusted our valuation to virtually zero and the client decided not to acquire the company.

## Steering clear of the courts

While Poland's legal system is fair, justice can be slow and difficult to enforce. For this reason, we recommend investors to do all they can to avoid legal proceedings, including using promissory notes and arbitrage clauses. Investors should also be particularly wary about acquiring plots of land – particularly in city centers – that don't have a verified legal status.

## Managing compliance requirements

In Poland, investors may have to respond to unpredictable demands from government officials. Unless the market is completely unregulated (such as social networking sites), investors should be aware that obtaining permits to perform routine activities, for example trading natural gas, can take months to secure. This is because many public officials only respond to permit requests through formal letters.

To manage this situation, it can be invaluable to seek professional advice. For instance, in Poland it is easier to buy a small bank rather than try to obtain a banking license and commence operations from scratch.

On a positive note, Poland's labor market is generally more flexible than many other European nations. While social security contributions that weigh on labor costs can be substantial, there is very little union presence in the private sector.

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***For more information***

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# Eastward Bound: How Global Tire Makers are Looking to the East to Drive Sustainable Growth

**By Sanjay Bansal, New Delhi**

Historically, the global tire industry has been dominated by major players from Japan, Europe, and the United States. For instance, Bridgestone (Japan), Michelin (France) and Goodyear (US) account for more than 40% of global tire sales. However, the rise of tire manufacturers in emerging Asian economies poses a threat to the existing order.

## A new orientation

The major global brands listed above have built their position over decades on the back of booming global automotive sales, using this situation to create comprehensive distribution networks to satisfy the ongoing demand for replacement tires (see Figure 1).

Around 70% of global tire demand is driven by the replacement tire market, while the remaining 30% of sales come from automobile manufacturers. This entrenched position has created prohibitive barriers to entry for new players. Few smaller tire manufacturers have the resources or economies of scale to carve out a competitive position and claim market share. It has also given leading tire producers pricing power and enhanced profitability.

But as the landscape for automotive demand has changed, so have patterns in the global tire market. In response to growing demand for vehicles in Asian markets and the cheaper cost of production, car makers have increasingly shifted production to emerging Asian economies (such as China and Korea) over traditional markets in Europe and North America (see Figure 2). This trend has increased the strength of tire makers in emerging markets.

For instance, in June 2013, India's Apollo Tyres announced it would acquire US-based Cooper Tires in a proposed deal that would create the world's seventh-largest tire company.

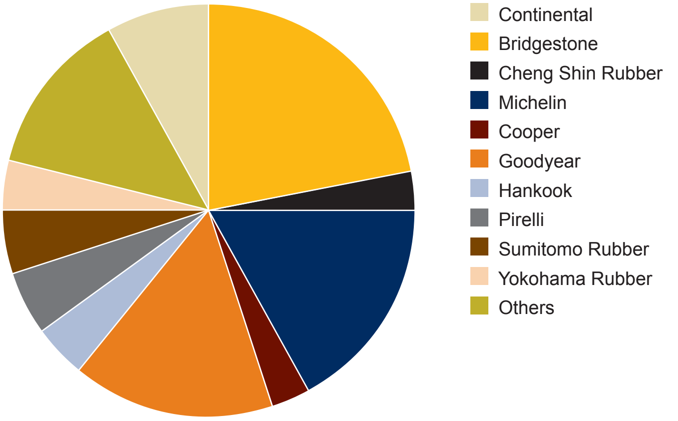


*Figure 1: Global market share by sales (USD), 2011*

*Source: Bloomberg, March 2013*

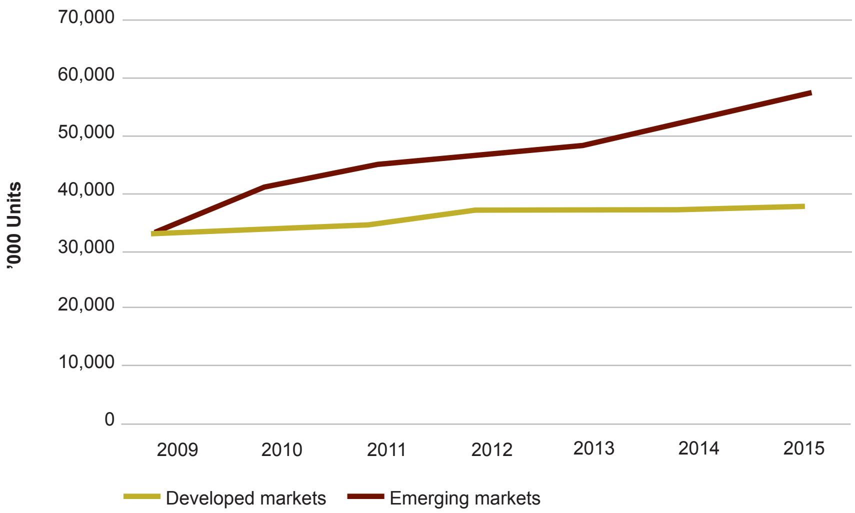


*Figure 2: Vehicle sales in developed vs. emerging markets (2009–2015)*

*Source: JADMA (Japan Direct Marketing Association), JADA (Japan Automotive Dealers Association), KAMA (Korean Automobile Manufacturers Association), SIAM (Society of Indian Automobile Manufacturers), FENABRAVE (Brazil's National Federation of Motor Vehicle Distribution), CAAM (China Association of Automobile Manufacturers), ACEA (European Automobile Manufacturers' Association, Autodata, LMC Automotive, March 2013).*

As of October 2013, the deal remains incomplete and both parties have commenced litigation. However, the announcement of the deal boosted the value of Apollo stock and demonstrates the shifting balance of power in the global tire market.

## Going east

At present, 60% of global tire sales take place in developed markets, whereas more than 50% of global tire production occurs in Asia (excluding Japan). The majority of production occurs in South-East Asia thanks to relatively cheap labor costs and an abundance of natural and synthetic rubber (see Figure 3).

We estimate that demand in developed economies will soon lag that in emerging markets. According to Macquarie Bank estimates, the global tire market will grow between 3–4% annually between 2012 and 2020, compared with 10% annual growth in China over this timeframe.

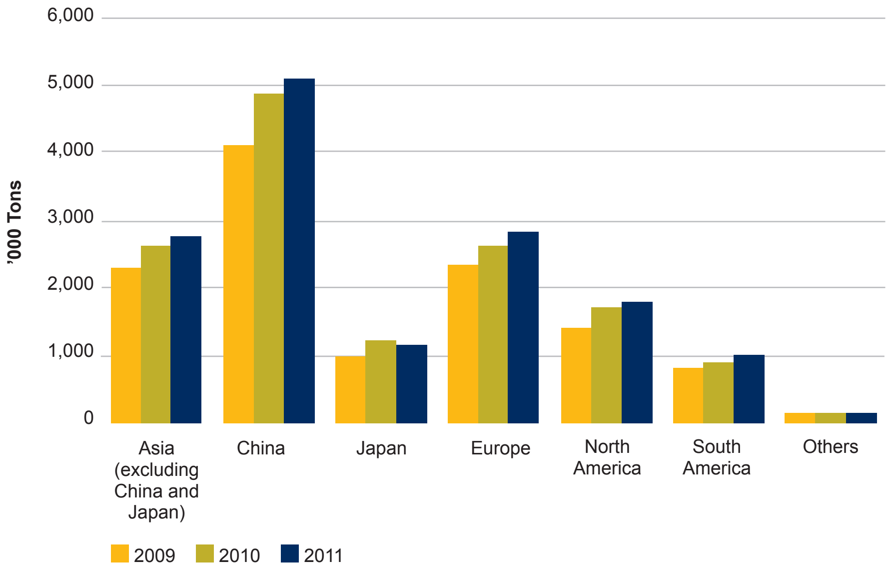


*Figure 3: Global tire production by region*

*Source: International Rubber Study Group, March 2013*

Does this shift spell doomsday for traditional tire manufacturers? We don't think so. Tire makers in emerging economies face challenges in meeting the stringent demands of consumers in developed markets, in terms of safety standards and enabling fuel efficiency. Instead, global tire companies are setting up manufacturing bases in growth markets such as China and India to capitalize on lower production costs and high domestic demand.

In line with this trend, we anticipate cross-border deals between tire makers will accelerate. These transactions will boost the capabilities of emerging market players – for example, through access to cutting-edge technology – and give established companies entry to more lucrative markets. In this way, the global tire market truly is eastward bound.

***For more information***

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