



AM&AA GLOBAL

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A Message from the Publisher

As our International Symposium: "the New Economics of the Private Market" is about to open in London, our AM&AA Global Newsletter explores one of the major "black swans" facing the global economies and businesses, i.e. the turmoil in the Middle East and the likely impact of the 2011 oil price shock on a still tentative global economic recovery. In an invited article by AM&AA down-under member Paul Hawkins of Merge Co, we explore the challenges and opportunities facing middle market M&A in Australia.

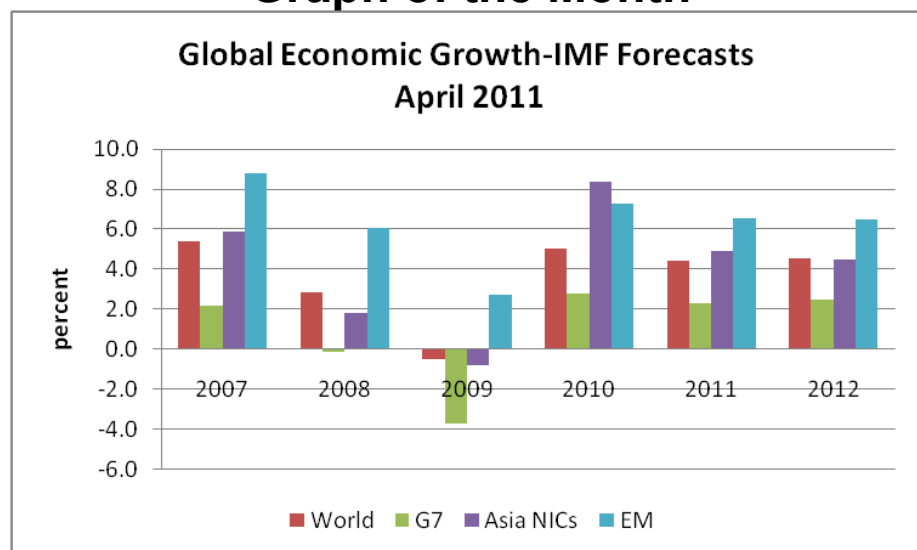
Mike Nall, Founder

OF NOTE:

M&A activity is off to a very strong start in 2011 as global corporations are redeploying some of the estimated \$3.3 trillion of their cash reserves in stock buy-backs and acquisitions. The global M&A market has seen \$567 billion in deals in the first quarter of 2011— multiples have also increased to an average of 9.2 times EBITDA. If present trends continue, we should see an increase of 15-20% in deal volumes for the year, on top off a 27.1% rise in 2010. We have also seen a pick-up in corporate IPOs, \$19.5 billion in 1Q11, in part due to the rapid rise in private equity fund exits. We expect this trend to continue in the coming quarters.

- Karim Pakravan

Graph of the Month



Source: IMF April 2011 World Economic Outlook



Editor's Macro Color: Black Swans and Geopolitical Risks: The Arab Spring

Global risk is back big time, in particular geopolitical risk. Since early 2011, the global economy has been hit by a series of so-called “black swans”¹. What was known as “tail risk” seems to be the norm today, in a world that has been lurching from one crisis to another since 2008: First, we had the financial meltdown that followed the collapse of Lehman in September 2008. The slow-burning eurozone sovereign debt crisis came to a head in early 2010, and has been brewing ever since, moving from Greece to Ireland, and now Portugal. The first months of 2011 saw the collapse of the existing Arab order, the devastating Sendai earthquake and tsunami and the Fukushima nuclear power plant disaster, and finally a third military conflict involving the United States. All of these come against a background of surging in oil prices and rising global inflation. Moreover, these tail risks are being activated at a time when the major powers’ ability to react is constrained by massive fiscal deficits and debt problems, political disunity and stretched resources.

What did the analysts and the policy-makers miss? Excluding the natural disaster in Japan, what the analyses missed were geopolitical risks, which came back with a vengeance, and not just in its traditional realm of emerging markets. Today, the world is seeing the impact of convergence of two major crises, one originating in the Arab world (but also beyond) and the second in Europe. Political crises lead to political transformation and strategic change. The challenge for the decision-makers is to move pro-actively to adapt and even benefit from these changes.

To analyze the impact of these unprecedented events, we must look at the intersection of three sets of parameters: identifying the risks; assessing their potential economic/political/business impact; and finally assessing the mitigating factors and countervailing forces and policies that can contain their negative impact. In what follows, I will focus on impact of one of the “black swans” on the global economy—the Middle East turmoil.

The Arab Spring and the Price of Oil: The first black swan was the so-called “Arab Spring”. The wave of change in the Arab world, which came out of nowhere, spread initially with lightning speed, overthrowing the existing orders in Tunisia and Egypt, then jumping to Yemen, Bahrain and Libya, and now Syria. Pushback and brutal repression by the regimes may have temporarily contained the protests, but profound political transformations are inevitable as ossified authoritarian regimes are confronted by continuing unrest.

How will the regional situation impact the global economy? Outside oil, the region does not have significant direct economic linkages to the rest of the world. Nevertheless, regional turmoil can have an indirect impact through several channels—the consumer’s pocketbook, regional financial flows and asset allocation, as well as changes in global risk aversion.

The oil price shock of 2011 came at a time of strong upward pressures on oil prices, which had already been on the rise since mid-August, with WTI up by 28% at the end of 2010 from its low-point on 8/24/10 as a result of strong demand growth. The overthrow of authoritarian regimes in Tunisia and Egypt in early 2011 had little impact on oil markets—neither are oil exporters. However, the violent turn of events in Libya made it the first major oil producer under siege—the country pumped about 1.6 millions of barrels per day (mbd) of high quality light crude (about 2% of global supplies), and is key supplier to Europe, which takes 85% of Libyan crude exports. This resulted in a 24% spike in oil prices between mid-February and mid-April, pushing WTI to around \$110/bbl. Nevertheless, the markets remain well-supplied. OPEC production has recovered from its low of 1Q09, reaching 29.5 mbd in January. Additionally, OPEC excess capacity is estimated by the International Energy Agency (IEA) to be at 4.7 mbd, with Saudi Arabia accounting for 75% of that number. Moreover, apart from Libya, other oil exporters are producing normally, the Persian Gulf is open to tanker shipping, and so are the Suez Canal and the TransMed pipeline. Therefore, the oil price surge is largely driven by fear of the unknown and the “What-ifs”, such as continued unrest in Iran that could escalate in an oil workers’ strike, or trouble in the Eastern Province of Saudi Arabia that could disrupt production and tanker loading.

¹ Black Swans are defined by author Nassim Taleb as an event with the following three attributes: rarity, extreme impact, and retrospective (though not prospective) predictability.

In the past forty years, oil price spikes have been followed by recessions in the United States (1973, 1979, and 1990). Will it be different this time and can the governments act to counteract the dampening impact of soaring oil prices? While the major economies have little room to act counter-cyclically on either the fiscal or the monetary side, the rise of China and the emerging markets and the resilience of their economies (which in large part explain the rise in oil and commodity prices) provide an important dynamic factor in the global economy. Moreover, the recovery in global equity markets, which have sustained one of their strongest historical performances of the past two decades in the last year, provide another prop for the global economy. Another important consequence of the regional turmoil has been a sharp increase in capital flows from the Middle East region to the financial markets of the West, which has been another element in financial resiliency. Nevertheless, it is premature to declare victory. The oil price shock of 2011 has hit us just as the US economy recovery was taking root, and is likely to have some impact, shaving up to ¼ point from US growth this year. We face considerable uncertainties with respect to oil prices. Ultimately, however, it will come down to supply and demand, and as long as the big players, in particular Saudi Arabia and Iran continue to pump the crude, the oil price shock should be manageable.

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Global Business Analysis: Australasian M&A: *Sell-Side Tsunami*

by Paul Hawkins 14th April 2011

There is a supply-side tsunami swelling up in Australia. It consists of pent-up exits that cannot be absorbed by the relatively much smaller group of eligible generation X business buyers, who are still in challenging times for acquisition finance.

Consider the Australian business profile:

- There are just over 2 million Small and Medium Sized Enterprises (SME's) in Australia, making up 99.4% of Australian businesses.
- They account for 60% of the national economy and employ nearly 50% of the Australian workforce.
- Two thirds of ASX-listed businesses are SME's.
- 80% of Australian businesses are family owned and these have been valued by some experts at approximately \$1.6 trillion.

Almost a third (> 28%) of Australian business operators are now over 55 years of age and when CPA Australia surveyed a sample of these in 2004, it reported that 40% were planning to retire in the following 5 years through to 2009. These exits have been delayed by the advent of the Global Financial Crisis (GFC) which dampened the ability of prospective buyers to finance these changes of ownership.

Australia also shares a demographic profile that resembles other Western countries involved in the Second World War, in the sense that it will (for the first time in 2011) have more baby boomers exiting the workforce than generation Y's entering it. As this all-time demographic anomaly combines with the exit desires of current private business owners, it will greatly exceed the ability of the market to absorb it. The relative scarcity of financing and eligible generation X successors is creating some challenging business continuity and economic issues.

A Broader Asian Perspective

According to a Global mergermarket survey commissioned by Mercer and Kroll in August 2010, Greater China and North America have become key targets for Asian acquirers with Greater China as the most popular target market for future Asian-cross border M&A, with 49% of respondents indicating that they would be likely to make an acquisition in Greater China over the next 18 months. North America came in at second place, with 29% of respondents signalling that they would be likely to undertake an acquisition there, while South East Asia, India and Australasia followed, with 27%, 22% and 15% respectively. Less than 10% of respondents were planning to acquire in Africa (6%), the Middle East (6%), South America (5%), and Western Europe (3%). Japan was the least popular market for Asian buyers, with only 1% of respondents planning to acquire assets there.

Respondents remain positive on Asian cross-border deal making in the foreseeable future with 83% of respondents expecting Asian cross-border acquisitions to increase over the next 18 months and organisations based in Greater China are also investing locally. Mainland Chinese respondents indicated that they would be likely to target Hong Kong, Taiwan & Macau (68%), North America (28%), India (24%), South East Asia (24%), Africa (8%), Australasia (8%), Eastern Europe & Russia (8%) in 2011.

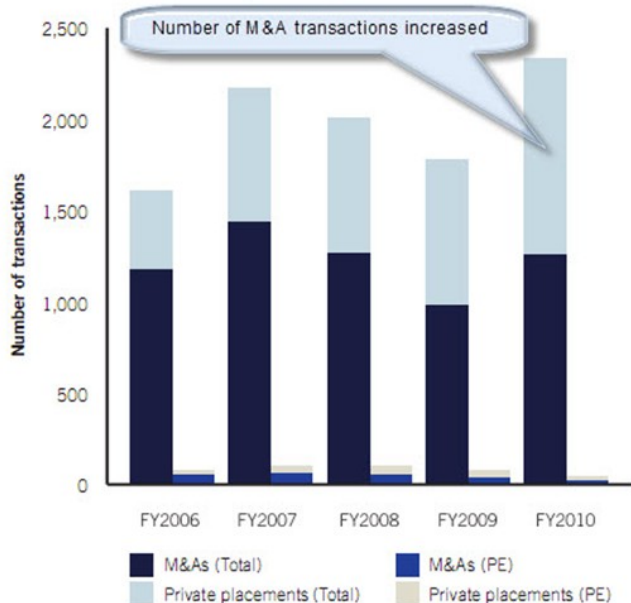
By contrast, Indian respondents were looking to target North America (50%), South America (25%), Pakistan & Sri Lanka (25%), Africa (17%), Australasia (17%), Eastern Europe & Russia (17%), Greater China (17%), Middle East (17%), and Western Europe (8%). Australian companies continue to invest in North America (40%) and South East Asia (33%).

The Australian M&A Market

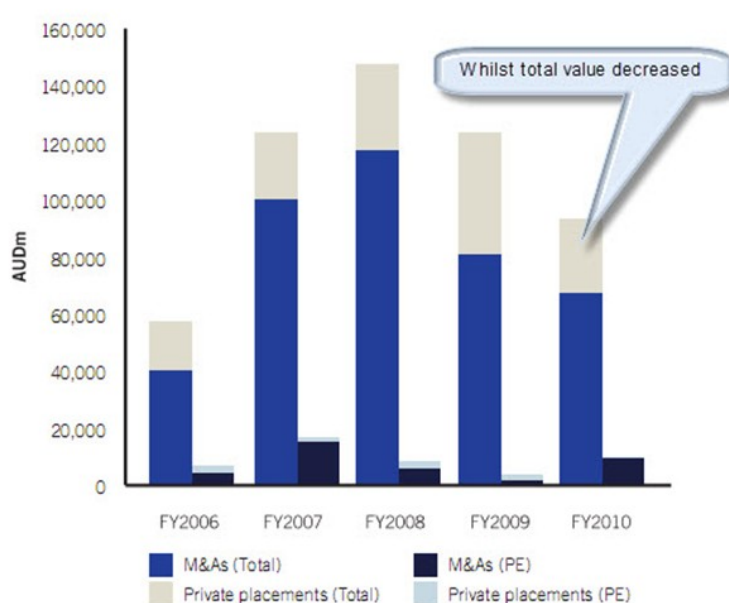
Australian Private Equity and Venture Capital Limited (AVCAL) produces an annual report in conjunction with Capital IQ which tracks trends and developments in M&A and private placements in Australia and New Zealand over the last five years, and the contribution of private equity (PE) in this context.

According to AVCAL, the total value of Australian M&A and private placements fell by 27% year on year in FY10. However, the small- and mid-market segment continued to anchor overall transaction activity, which meant that the decline in deal levels was not as sharp as it otherwise might have been. In addition, a number of significant transactions in recent years (including bank mergers and resources/energy deals) ensured Australia remained a major centre for M&A in the region. Notably, many of the largest deals during this period involved offshore buyers, confirming the continued attractiveness of Australian companies as long-term investment propositions.

Number of M&As and private placements (Australia)



Value of M&As and private placements (Australia)



Source of Data: Capital IQ, as referenced in AVCAL's Market Observations – Australia and New Zealand – September 2010

About MergeCo

MergeCo Pty Ltd is the newest antipodean member of the AM&AA. It is a boutique corporate advisory firm with offices in Sydney and New York. MergeCo assists buy-side clients with proprietary sourcing of acquisitions in Australia and South East Asia, acting as an extension the corporate development function (or on behalf of private equity) to coordinate due diligence, deal making and post-merger integration activities on the ground.

MergeCo also works with buy-side clients to review M&A practices against its M&AVal® benchmark and in subsequent implementation of the SETUP4Success® leading practices. On the sell-side, MergeCo acts for valuable Australian and regional private companies seeking global strategic purchasers.

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