



# AM&AA GLOBAL

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Karim Pakravan, PhD  
International Committee

If you would like to submit an article to be considered for this newsletter, please email it to: [karim.pakravan@sbcglobal.net](mailto:karim.pakravan@sbcglobal.net)

## A Message from the Publisher

As we start 2011, we see a world that is more hopeful, yet beset by financial and economic countercurrents. Germany, the largest European economy, is experiencing its strongest economic growth in two decades, France is on a positive path, all this while the European sovereign debt crisis is still in full swing. Speaking of two-speed growth, commodity prices are surging and emerging markets continue to be buoyant, the concern there being overheating and inflation. This issue of the AM&AA International Newsletter addresses some of these issues and tries to put them in perspective.

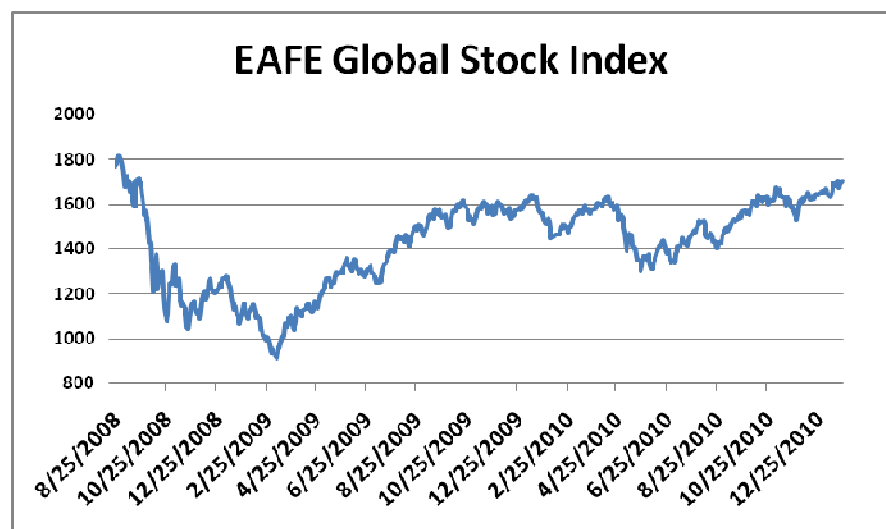
Mike Nall, Founder  
Alliance of M&A Advisors

## OF NOTE:

The IMF has revised its global growth forecast upwards, although it also notes that the two-speed recovery is likely to continue. Global economic growth accelerated in 3Q10, and is forecast to rise by 4.4% in 2011 from 5% in 2010. However, economic prospects of the G-7 economies will be subdued, with high unemployment and continued sovereign debt-related stress in the European periphery exerting downward pressure. In addition, high commodity prices will contribute to rising inflationary pressures in major emerging markets.

- Karim Pakravan

## Graph of the Month



Note: EAFE is an MSCI global equities index covering developed countries outside North America



## Editor's Macro Color: Europe has to stop kicking the can down the road in the eurozone

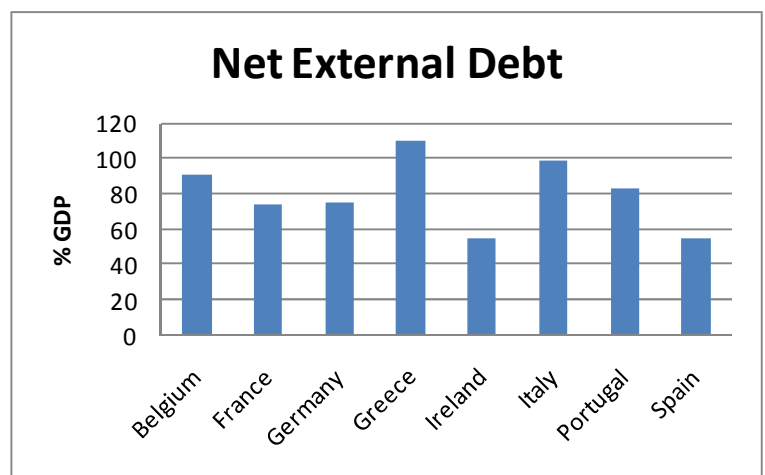
**Running in place:** As we enter another year of financial crisis on Europe's periphery—a region that Jamie Dimon, CEO of JPMorgan has elegantly christened the GIPSI , Greece, Ireland, Portugal, Spain and Italy—European economic policies continue to be mired in incoherence and inconsistencies, and structural solutions to the GIPSI problems continue to be postponed. The Greek and Irish financial crises have been viewed so far as illiquidity crises rather than the insolvency ones they really are. Let's look at the results so far. Europe set up the €440 billion European Financial Stability Fund (EFSF). At the same time, the European Central Bank (ECB) offered indirect fiscal support by stepping up its purchases of European government debt and continuing to accept sovereign bonds from the affected states as collateral for discount loans to the banking system, thus indirectly propping up troubled sovereign debt. Greece was bailed out with a €110 billion IMF/EU financial package and Ireland with a €67.5 billion one, both in exchange for drastic austerity programs. Both Spain and Portugal, which have been punished by the bond market with a sharp increase in financing costs, have also introduced highly unpopular belt-tightening measures. None of these actions have quieted the financial markets, which continue to demand sky-high spreads for the distressed countries—effectively reflecting a non-trivial probability of default. Deep disagreements among the key players on how to proceed also delayed any structural solution, with the problem essentially being kicked down the road for the time being.

From the fog of indecision, several unpleasant truths have emerged:

- The evolving financial crisis is not going to be resolved by the mixture of draconian economic austerity measures at the periphery and generous liquidity support from the center. Even if the affected countries could emerge from their deep recession after a couple of years, the population is unlikely to support a prolonged recession so that foreign creditors can be paid. Already, the Irish government is tottering at the edge of collapse and new elections in those two countries and Spain are likely to lead to a victory for the opposition parties
- To paraphrase Tolstoy, happy countries are alike, but unhappy countries are each unhappy in their own way. The roots of the crisis are different in each country, and there is no "once-size-fits-all" solution. For one thing, Spain and Ireland have low levels of actual sovereign debt—actually lower than that of Germany or France- but face huge contingent sovereign liabilities tied to the bail-out of their banking systems. Italy, which is not in crisis, has a very high sovereign debt, but it is almost entirely financed internally. Regardless of the roots of the crisis, the end result has been a massive debt burden for the governments concerned,
- While the crisis has left the major core countries (France and Germany in particular) scrambling for a way out of the crisis, there have been only short-term fixes so far. Any long-term solution has to recognize the fact that creditors (in this case mostly French and German, but also other European banks) will have to take a major hit, either ultimately through a default or an orderly restructuring of the GIPSI sovereign debt.

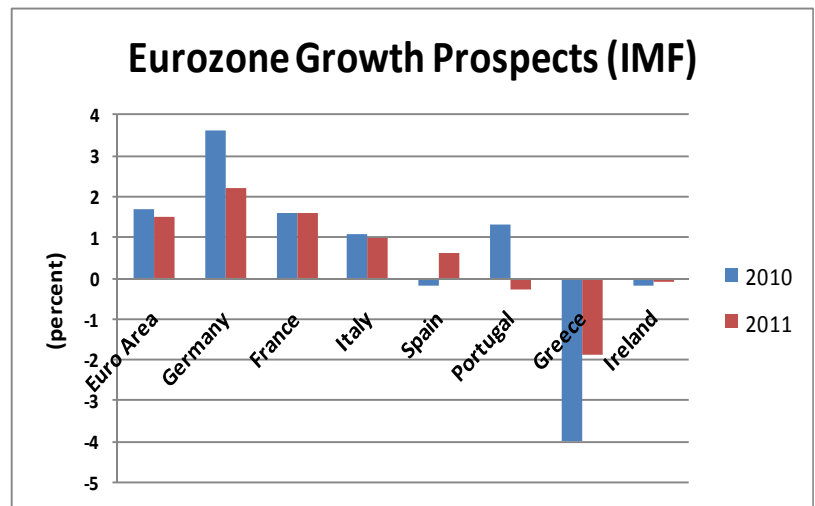
Europe needs to do some serious thinking and stop delaying the inevitable. Neither Europe nor the world can afford another sovereign debt crisis—in particular if it originates from one of the heavyweights, Spain or Italy. Such a crisis could once again lead to financial market tensions, derail the equity markets momentum and deal another blow to the fragile US recovery. More ominously, it could undermine the euro, and potentially lead to a breakup in the eurozone, with incalculable consequences.

Fig. 1: Europe's Sovereign Debt



**Thinking the unthinkable:** The unmanageable European sovereign debt crisis has broken a taboo, one that stated that advanced countries' sovereign debt would never default or be restructured—that was so Argentina! In fact, the European Stabilization Mechanism (ESM) proposed by Germany, which is supposed to come into effect in 2013 when the EFSF expires, has a built-in restructuring mechanism. As proposed, the ESM would be a permanent institutional arrangement within the Eurozone, providing financial support to distressed member countries. Moreover, the so-called “collective action clauses” would allow market-driven negotiated debt restructuring between governments and bondholders. Furthermore, the ESM would strengthen the existing (and unenforced) macroeconomic policy responsibility regime. Overall, it would go a long way to remove moral hazard from the European financial markets and provide ‘adult supervision’ to the sovereign debt markets.

Fig. 2: Eurozone Economic Growth



Source: International Monetary Fund

The debt relief obtained from debt rescheduling would reduce the fiscal burden on distressed countries and break the vicious circle of recession and financial crisis. While such an outcome would require a significant write-off by European banks—which have built up a strong capital base—it is certainly better than the alternative, default and financial chaos.

Remarkably, growth has continued to decouple between the European core and the periphery, with Germany and France on a strong rebound, in contrast with the on-going recession in the distressed countries.

Karim Pakravan is an international strategist and a senior faculty member of the Finance Department at DePaul University.  
**Contact:** karim.pakravan@sbcglobal.net

## GLOBAL BUSINESS ANALYSIS: BRIC 2011 Prospects? **Adeodato Volpi Netto, Senior Partner at Open Point Partners**

Here we are at the beginning of a new year. Far enough (not far away) from the heart of the financial crisis, with some important signs of recovery on major economies but still far from where we all wanted to be. Recently I've called BRIC as “Best Rated and Interesting Companies”. I stand with this. Not coincidentally the highest growth rates, EBITDA and cash generation companies are based today on emerging markets. Being based in Brazil allows me to provide some analysis and making some peculiar comparison to “first world countries”.

Brazil has dropped its unemployment rate to the lowest level in more than 100 years – 6.75% in most regions. This amount of people engaged in the economy makes the wheel of fortune spin at incredible speeds. What are the main differences? Why is this country that a couple of decades ago had an inflation of more than 1000% a year performing so well now? Basically I would say because Brazil has an economy fully based on adding value, production and consumption. The contagion from places such as Wall Street and super-leveraged groups, peoples, brokers, banks and all those institutions and factors that drained the liquidity from world's economy did not affect Brazil.

Brazil has one of the most developed and well regulated banking systems of the world. Why is that? Where did this come from? Well, having lived for decades in constant crisis, the country was driven into this direction and most of all,

the most committed people in the nation joined efforts for a desperate way to find stability. It is quite hard for North Americans, Europeans or even Japanese financial executives and analysts to understand how come a country could make an adjustment to its currency from one day to another, transforming what was R\$1000 yesterday into R\$ 1 today.

What Brazil has the most today – liquidity – was never available before. When you have no money available, or when you do, the costs are so high that makes any funding operation impossible to handle, the only alternative is investing in production. That's what this emerging world power has done over the past decades... now it is starting the harvest season.

Brazil leads in innovation in a huge and clean energy matrix, renewable sources and other types of fuel. It is the worldwide biggest market for ethanol in automobiles. In Brazil Ethanol is made from sugar cane and not corn. Brazil has got megacities such as São Paulo and Rio de Janeiro, as well as quality of life and urban planning in places such as Curitiba.

The B from the BRIC (Goldman Sachs BRIC) is becoming international reference for healthcare in various areas, including AIDS treatment, which is an example of government commitment when the patents were broken. No pharma is allowed to sell the "cocktail" treatment for a AIDS. These are free medicines for every Brazilian citizen.

And what is still to come? This country is going through a high level of consolidation between companies in its internal market, and at the same time moving fast towards a global position in all major segments. Steel, Oil & Gas, Aircraft industries, consumer goods. Some important examples of companies that has Brazilian capital in control and that are strong global players are: Petrobras (Oil & Gas – BOVESPA: PETR4), Vale SA (Mining Industry – BOVESPA: VALE5), Gerdau SA (Steel – BOVESPA: GGBR4) and its subsidiaries Gerdau Ameristeel, Gerdau Macsteel and others. Budweiser, Burger King, Itaú Unibanco SA (Banking – BOVESPA: ITUB4).

Brazil is not an adolescent anymore. Brazil can be responsible with foreign investors and capital. Brazil learned about sharing. The country opened borders, stock markets and gained "liquidity". This is a country where middle-market players can take the chance and grow. There is no industry or niche that is not willing to receive options, brands, investments, employment and profits.

Mature economies have high level of opportunities for investments and M&A movements. This is certainly the path that Brazil is going through and the companies are growing on some amazing rates and this is why the snapshot of this environment brought the BRIC – "best rated and interesting companies".

Brazil has learned and deeply got engaged with environment responsibility and sustainable actions. Programs that take care of Amazon forest, which is world's lung, along with regulation policies are some of the most important moves. Responsibility and respect to international protocols and sustainability projects being financed by government initiatives together with private capital.

The new year 2011 is heralding some important achievements for Brazil. Three years after receiving the investment grade, this country is fighting against the same "ghosts" as USA, UK, Germany and all other international players. Undervaluation and artificial exchange rates, commodities volatility and foreign relations are the same issues. Therefore, dealing with the same problems, we may be close to rise an international effort towards "adding value"... and that's exactly why Brazil can (and will) become a global reference. Let's keep watching...

**Adeodato Volpi Netto, is Senior Partner at Open Point Partners. Specialist in Mergers and Acquisitions by De Paul University – Chicago, USA. Head of Market Development, intangible assets as deal structuring at OPP. Worked for 17 years with Foreign Trade and Automotive Markets. Main executive positions at Volvo Cars, Cotia Trading and United Auto Brasil.**  
[www.oppbrasil.com](http://www.oppbrasil.com)  
[adeodatonetto@oppbrasil.com](mailto:adeodatonetto@oppbrasil.com)

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