



AM&AA GLOBAL

AM&AA's International Newsletter

June 2010 Vol. 1, Issue 5



The AM&AA is the acknowledged leading association and credentialing body for Merger & Acquisition Professionals.

Publisher:

The Alliance of
M&A Advisors

Editor:

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International Committee

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A Message from the Publisher

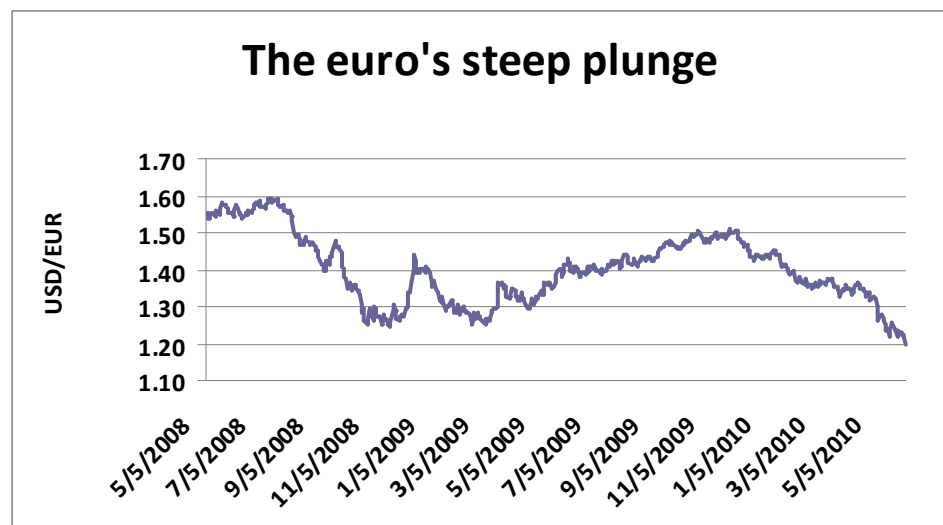
After a period of relative calm, the global economy is once again under stress, risk aversion is on the rise and market and currencies volatility is back. In such times, it is important to keep a steady hand and focus on fundamentals. The latest issue of the International Newsletter focuses on on-going issues of particular interest to our membership—Europe and Asia from both the macroeconomic and business points of view. We hope you find it useful. Have a great summer and see you at our July Summer Conference in Chicago!

Mike Nall, Founder

OF NOTE:

The president of the People's Bank of China (central bank) has recently stated that the government is keeping a close eye on the economy, trying to balance fears of overheating with the negative impact of the European crisis. Concerns over an overheating real estate sector led the central bank to introduce measures to tighten monetary policy. At the same time, the European financial crisis and the sharp devaluation of the euro against the Chinese yuan (which has a de facto peg to the US dollar) is causing some concerns that the Chinese economy could slow down from its double-digit rate of growth. Overall, the expectation is that the government will delay any moves to revalue the yuan relative to the US dollar and continue to pump stimulus in the economy to maintain a steady rate of growth of 8-10%.

Graph of the Month





Editor's Macro Color: TOP KILL

Europe is facing its most severe test since the birth of the euro in 1999. The sovereign debt crisis has revealed the deep structural flaws in the single currency construct. Structural flaws are magnified by a lack of a collective political will, and the fact that the EU does not have a credible enforcement mechanism to harmonize economic policies. The Economic and Monetary Union envisaged in 1992 is under strong attack, and one of the bitter lessons learned is that the EMU is only as strong as its weakest member. Over the medium term, the eurozone faces two equally unpalatable outcomes: deflation or sovereign defaults. While the euro is expected to survive, it could well move to parity with the US dollar by the end of the year.

In response to the markets' deepening concerns over the Greek sovereign debt crisis, the eurozone financial and economic policy-makers proposed a massive financial package totaling \$1 trillion to support the most vulnerable eurozone countries—Greece, Spain and Portugal. At the same time, in a series of steps reminiscent of the Fed's actions in 2008 and 2009, the ECB took a number of steps to provide liquidity to the European banking system, while the Fed reopened its dollar swap facility to prevent a dollar-funding shortage in the European money markets. However, the markets were not impressed, and both the equity markets across the globe and the euro continued their rapid slide, which accelerated with the loss of its AAA Fitch rating by Spain.

The global financial markets were correct in perceiving that the European leaders continue to see the Greek sovereign problem as one of illiquidity, whereas it is one of insolvency. Lessons from emerging market debt crises of the past three decades have not been learned. In contrast with the earlier emerging market sovereign debt crises, the crisis-stricken eurozone members do not have any currency flexibility. Thus, Greece is in a situation which is very similar to Argentina prior to its default, where severe austerity measures without the ability to devalue the currency eventually led to an impasse as the economy went into a deflationary spiral and ended in default. In contrast, the crisis-stricken Asian countries were able to let their currencies depreciate, leading to a relatively rapid rebound. The choices for Greece are clear, either an orderly rescheduling or a chaotic default, and one or the other is likely to happen in the next 6-12 months, and the greater the delay, the more costly the result.

The crisis will affect Europe's economic recovery. The eurozone had been emerging from recession in the last two quarters. However, the draconian austerity measures introduced by the three target countries (Greece, Spain and Portugal) will push those economies into a deep recession. The main risk to Europe's short and medium-term growth prospects come from the exposure of European banks to southern European sovereign obligors and banks alike. Even discounting the current situation, the European banks have yet to fully recover from the financial crisis, and the ECB estimates that they still need to write off €195 billion in non-performing assets. Nevertheless, the European banks are in as strong position, having built up their capital position to approximately \$900 billion in the past two years. However, this does not mean that they will be willing to lend, and the current crisis will nevertheless lead to in a sharp tightening of credit—which is particularly important in Europe, where 75% of corporate financing comes from the banking system. Coming on top of a significant fiscal tightening, this will worsen the deflationary pressures, which could push the whole eurozone back into recession. While the initial response to the crisis was disorganized and insufficient, there is a sense of urgency at the top levels of the major European countries and institutions.

The eurozone financial crisis can impact the US economy through three potential avenues: direct and indirect trade impact, a global credit crunch, or wealth destruction. First, slower growth in Europe will impact negatively US exports—directly, as well as indirectly, through its impact on Asian growth. Second, a rise in global risk aversion and the need for significantly higher bank capital will result in tighter credit. While US banks have limited direct exposure to Greek and other shakier European sovereign obligors, they would be impacted through their exposure to European banks. Finally, the negative impact of US equity markets could shake the fragile recovery in business and consumer confidence.



The New New Safe Havens

By Ravi Bhagavan

The recently conducted assessment by A.T. Kearney of senior executive sentiment at the world's largest companies provided some striking conclusions. A staggering 72% of corporate investors believe that the Asia-Pacific region will lead the world out of recession. In terms of outlook for Foreign Direct Investments (FDI), China, India and Brazil earned spots in the *Top-5* ranking of most favored destinations by global investors.

In periods of economic crisis, investors flee regions of uncertainty to countries that offer solid fundamentals, low market volatility and benign economic environment. While there was indeed an exodus of foreign institutional investors from emerging economies at the height of the global crisis in 2009, the sentiments have shifted quite convincingly, suggesting that the withdrawal of capital from the leading developing economies may have been a short-sighted knee-jerk reaction.

In specific, the placement of China, India and Brazil in the top five indicates a strong vote of confidence in the fundamental strengths of these economies and the optimism in their secular growth outlook. Investors view these emerging giants as indispensable in maintaining competitiveness in the global marketplace in the long term.

China's 8.5% GDP growth in 2009 placed it at the top of the list, distancing it further from the United States. The economic juggernaut continues to be driven by government-supported and bank-sponsored investments in the real economy, a huge domestic market and infrastructure frameworks such as the mega SEZs in the Guangdong and Hainan provinces facilitating FDI from all over the world. The Indian growth story (GDP growth of 6.9% in 2009) continues to be one leveraged off the entrepreneurship and gutsy risk-taking of business leaders, a mentality for innovation that just works ("*jugaad*") and an immense and productive young population driven by Bollywood movie-sized ambitions. Brazil's strong natural resource base, favorable political leadership and a global business mindset will continue to drive rapid economic expansion for many years to come.

Country	2010 Rank	2007 Rank
China	1	1
United States	2	3
India	3	2
Brazil	4	6
Germany	5	10
Poland	6	22
Australia	7	11
Mexico	8	19
Canada	9	14
United Kingdom	10	4

China's success in attracting FDI can be largely attributed to its strategic policy initiatives targeted at growth involving a four-fold approach: providing economic freedom, opening up the economy, attracting diaspora and creating flexible labor laws. Its investment strategy in basic infrastructure focused on hinterland connectivity to join mainland China with coastal areas has been very well received by foreign investors. In comparison, India's infrastructure is decades behind; it demands hundreds of billions of investment dollars that can only be achieved by allowing free capital inflows. It is also essential for India to adopt a policy of greater openness – beginning with greater liberalization of the financial services sector and privatizations in the oil, steel, air travel and cement manufacturing sectors.

2009 was one of the worst years in recent history for foreign direct investments. Global FDI inflows fell by 39% from US\$ 1.7 trillion in 2008 to just over US\$ 1.0 trillion in 2009. The sharp decline was widespread across all major economic groups, with developed nations taking it on the chin more than emerging economies, ending the latter's uninterrupted 6-year growth. In comparison to the global average, China's FDI inflow fell only 2.6% and India's FDI decreased 19% in 2009. Global cross-border M&A took a breather as well, dropping 66% in volume in 2009 as compared to 2008.

We at Galileo Global Advisors expect to see a moderate turnaround in global FDI in 2010. There is significant investment potential in China, India, the Middle East and certain Latin American economies such as Brazil, Colombia, Peru and Chile. The IMF predicts a 3.1% growth in world GDP for 2010, as against -1.1% in 2009. Improving economic conditions will encourage strategic and financial investors to scale up their international investment plans and direct capital towards the most attractive investment destinations alluded to above. Please contact us directly for additional information on the markets and investment opportunities in these regions.

Ravi Bhagavan, Partner, Galileo Global Advisors, LLC. Cross-border M&A, private placements, fund placements and corporate advisory services with a focus on India, China, Europe and North America. Galileo Global Securities, LLC is a FINRA-registered broker dealer.

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