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Resetting the compass

Navigating success in deal-making for mature market sellers and high growth market buyers

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How high growth market buyers are moving M&A in a new direction

pwc

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Ready to reset your compass?

The geography of deal-making is changing fast. Over the last five years we have seen more deal value flow from the largest high growth markets (HGM) to mature market economies than in the other direction. Between 2008 and 2012 HGM companies invested US$161 billion into mature market companies, outstripping the opposite flow of US$151 billion. In 2012 alone, HGM companies closed deals for mature market targets worth US$32.6 billion, almost three times the amount they invested in 2005. We see this shift in dealflow direction as the start of something bigger, that will not just bring a much needed boost to the global M&A market but that can stimulate growth for both mature and HGM market companies alike. In this report, we look at how dealflows are changing and we also consider how new types of HGM investors are turning to M&A and the factors driving their investment choices. Large and mid-sized private companies have now joined the state-backed investors who were among the first to acquire mature market targets. HGM investors' scope is also widening, with HGM to mature market M&A activity ranging from energy, raw materials and engineering to media, retail and consumer goods companies.

From outsourcing to deal-sourcing

Looking ahead, we believe that European, North American and Japanese companies should also be considering high growth markets, not just as a destination for their wares or for lower cost production, but as a potential source of investment. Through deals, HGM companies can unlock or accelerate their domestic opportunities by acquiring state-of-the-art technology and expertise or by buying into established global brands. And for many their home market is just one part of their growth story. Through deals, they are bringing their products and those of others to new territories by buying into established distribution channels, brand names and know-how. A growing number of HGM companies are already poised to go from being a national leader to a global one and are using strategic M&A to accelerate that move.

Getting to grips with new deal dynamics

Over the following pages we look at how the rise of HGM companies acquiring mature market firms brings not just a change of direction to the M&A market but a new dynamic. For HGM companies and mature market companies there can be very contrasting differences in culture, political and economic context and processes. There is no recipe for a great deal but when the ingredients change, it becomes even more important that both buyers and sellers know what it is the other wants from the deal. This issue came up repeatedly in conversations with our clients and deals partners[1] worldwide. Over the following pages, we first look at what is generating the rise of HGM – mature market deals. We then consider what HGM buyers are looking for in mature market targets, some of the most common differences in deal approaches and how buyers and sellers can manage them successfully.

A note on our terminology

Throughout this report the term "High growth markets", abbreviated to "HGM", refers to China, India, the Gulf Region (covering the Gulf Cooperation Council countries, i.e. Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and United Arab Emirates), Russia and Brazil. Under the term "mature market", we include the US, the UK, Germany, Australia, Japan, and Canada. The charts and figures used throughout cover only deals involving companies in and from those countries.

1 Deals is a global line of service in PwC comprising lead advisory strategic advice, valuation, due diligence, sale and purchase, agreement, part deal change and integration advice.

Getting to a good deal: critical aspects of M&A between HGM and mature market companies

Common challenges	*Suggested measures*
Addressing valuation mismatches	• Greater transparency by both buyers and sellers around deal drivers can increase trust and dispel unfounded expectations. • Sellers should not assume that an HGM company may have easier access to capital, including state funds. • Sellers need to understand the buyer's investment timeframe and shareholder environment before setting premia – Sellers may demand a higher premium from buyers they think are likely to be slow to complete. • Clarify valuation techniques to ensure both parties are working with the same parameters. • While multiples can be a guide, past deals are not always a reliable yardstick.
Agreeing a timeframe for completion	• Both parties need to understand what constitutes a 'normal' timespan for negotiations and completion for the other party to set expectations from the outset. • In cases where special approval processes need to be followed, e.g. the deal needs to be vetted and/or finance approved by a regulator, buyers should educate sellers early around their approval processes and timelines so that they do not become an obstacle. • Foster relationships with key decision-makers from an early stage so that dialogue is possible if the deal timetable begins to slip.
Connecting with decision-makers	• Take time early in the process to understand decision-making hierarchies – and who has the final say. This is particularly true for deals involving State Owned Enterprises. • Buyers bidding for targets with Private Equity involvement should have direct contact with the PE side as well the target company's management. • The time needed to develop relationships varies greatly from culture to culture; consider this when approaching decision-makers. Seek advice from people who understand these finer points and stay attuned to signals.
Reconciling deal process differences	• Plotting the deal process and due diligence approaches of both the buyer and seller will highlight where they diverge and provide a basis for discussion. • Communicating the reasoning behind due diligence practices can make the other party more comfortable/willing to cooperate with the process. • High growth markets can have very different reporting, tax and legal demands and systems that can slow the due diligence process and necessitate more requests for information: both the buyer and the seller need to be explicit about this.

Introduction

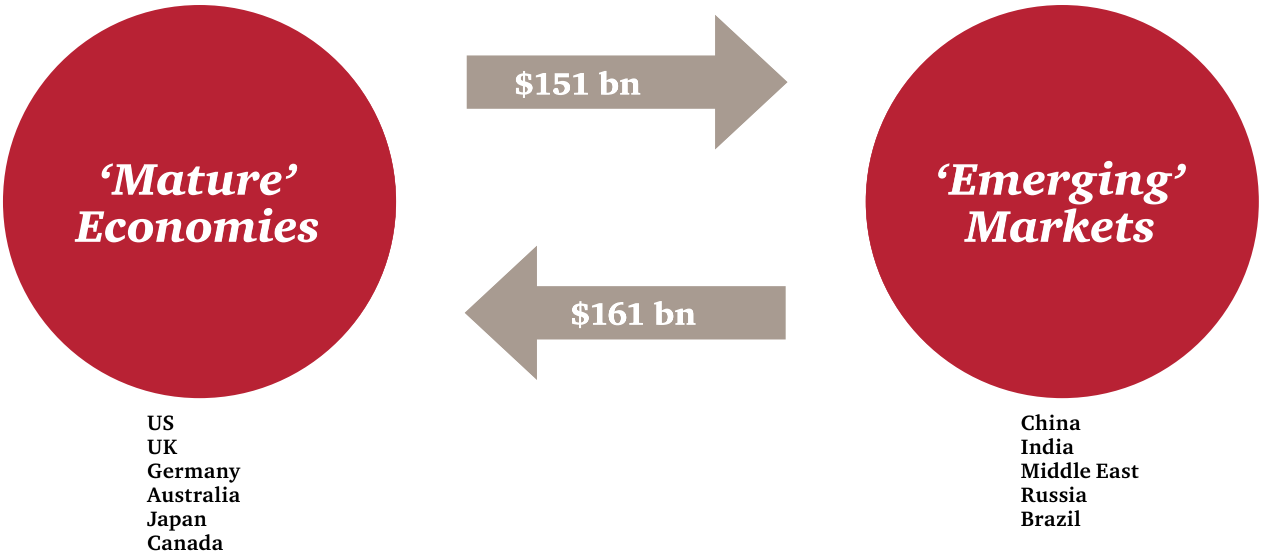
A new direction for global M&A

PwC's deals partners spend their time working with clients, buyers and sellers, across our many different territories. Even in the best of times, clients can find deal making a testing process. Identifying the right target or potential purchaser, aligning expectations and valuations and making the outcome work is a time-consuming process that requires experience and resources. Years of growth and consolidation in their key markets mean large global companies are usually geared for complex transactions. But the geography of deal-making is changing fast and so are the players. As the chart below shows, the last five years have seen more deal value flow from the largest high growth markets (HGM) to mature market economies than in the other direction. In 2012, HGM companies closed deals for mature market targets worth US$32.6 billion, almost three times the figure for 2005. HGM companies, both state-and privately-owned and more recently private equity houses are out looking for acquisitions and competing with their domestic and overseas rivals for deals.

Figure 1: Role reversal

HGM companies invest more in mature market ones than vice versa

The flow of investment from 'Emerging' to 'Mature' markets is at scale and greater that the flow the other way for the past five years



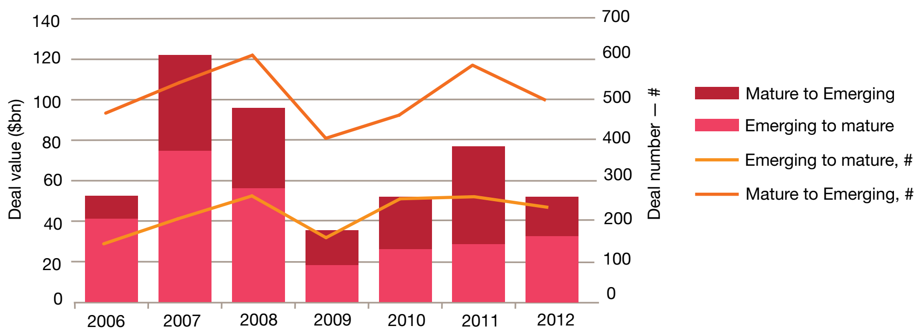
Note: Deals included are completed, disclosed deals where the final shares acquired was >20%
Source: PwC analysis of data from Dealogic

"As we emerge from the financial crisis in Europe, our deal-making will need to change to accommodate the new buyers from the East and South. If we don't change we risk missing an opportunity to engage with businesses that will play an important role in shaping our future".

Nick Page, PwC UK

Figure 2: Investment from high growth markets to mature markets on the rise

Investment flows, 2006 – 2012



Note: Deals included are completed, disclosed deals where the final share acquired was >20%
Source: PwC Analysis of data from Dealogic

You need more than acronyms to understand the markets

Despite the convenient acronyms, no two high growth markets or high growth market companies are alike. Understanding where a potential investor is coming from, in the true sense of the term, can make a huge difference to the success of a deal. There are many reasons why HGM and mature market companies are increasingly likely to find themselves sitting across the table from one another in the coming years. Many mature market companies need an investor or a partner who can bring access to high growth markets. On the other side, HGM buyers are looking for access to sales channels, know-how or brands. Despite a slow-down from the frenetic double-digit growth of a few years ago, high growth markets look set to continue as the motors of the global economy for some time yet. As long as each side needs the other, no one at the table can afford to get a deal wrong.

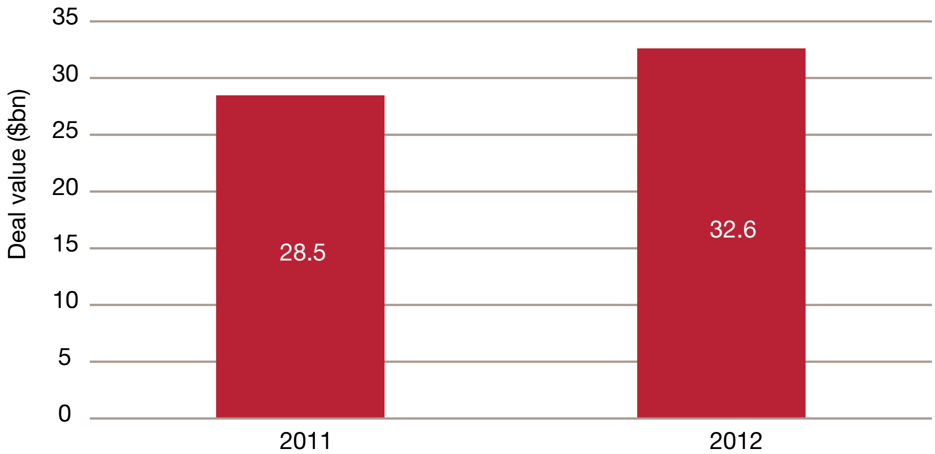
Pricing deals in roubles, rupees or renminbi can be challenging, but getting deals done when buyers and sellers do not speak the same language – figuratively and literally – is the really tough part. HGM buyers can have very different approaches to their mature market counterparts, reflecting their own strategic, commercial and cultural DNA. Few mature market companies will have experience of working with, let alone being acquired by, a HGM market company. Meanwhile, HGM buyers are also on a steep learning curve, which some have already climbed, about mature market approaches to deal-making. Both sides are going to have to learn fast to take advantage of a changing deal environment.

Make the most of PwC's experience for better deals

This report draws on the experience of PwC's global network of deals advisors and our insight from advising on hundreds of deals across very different markets. We look at the transaction continuum from deal sourcing to completion. In the following sections, we consider the aspects of deals that our experience shows us to be the most complex and we offer suggestions on how to head them off or resolve them.

Figure 3

Investment flow - Emerging to mature, 2011-2012



Note: Deals included are completed, disclosed deals where the final share acquired was >20%
Source: Dealogic

HGM buyers – the evolution of players and drivers

China's private sector emerging as an M&A actor

Many of the first Westward bounds deals from high growth markets were by states looking for the resources or know-how to stoke their economic growth. State-owned enterprises (SOEs) and Sovereign Wealth Funds (SWFs) from China produced several high profile deals over the last decade. Looking ahead, while its SOEs and SWFs will continue to invest overseas, we see the rise of Chinese privately owned enterprises (POEs) looking for mature market targets. Chinese Private Equity and financial services firms will also have an impact as they seek more investment opportunities than China's domestic market currently offers. As the spending power of China's domestic market grows, many Chinese POEs are looking at outbound M&A as a means to acquire technology and brands that they can leverage at home and to gain access to overseas distribution channels and markets.

"We expect to see more Chinese private equity buyers following their corporate counterparts in looking to markets in the US and Europe for businesses to partner with and invest in".

Calum Davidson, Asian Deals Leader, PwC Hong Kong

Russian dealmakers may look for more mature market targets

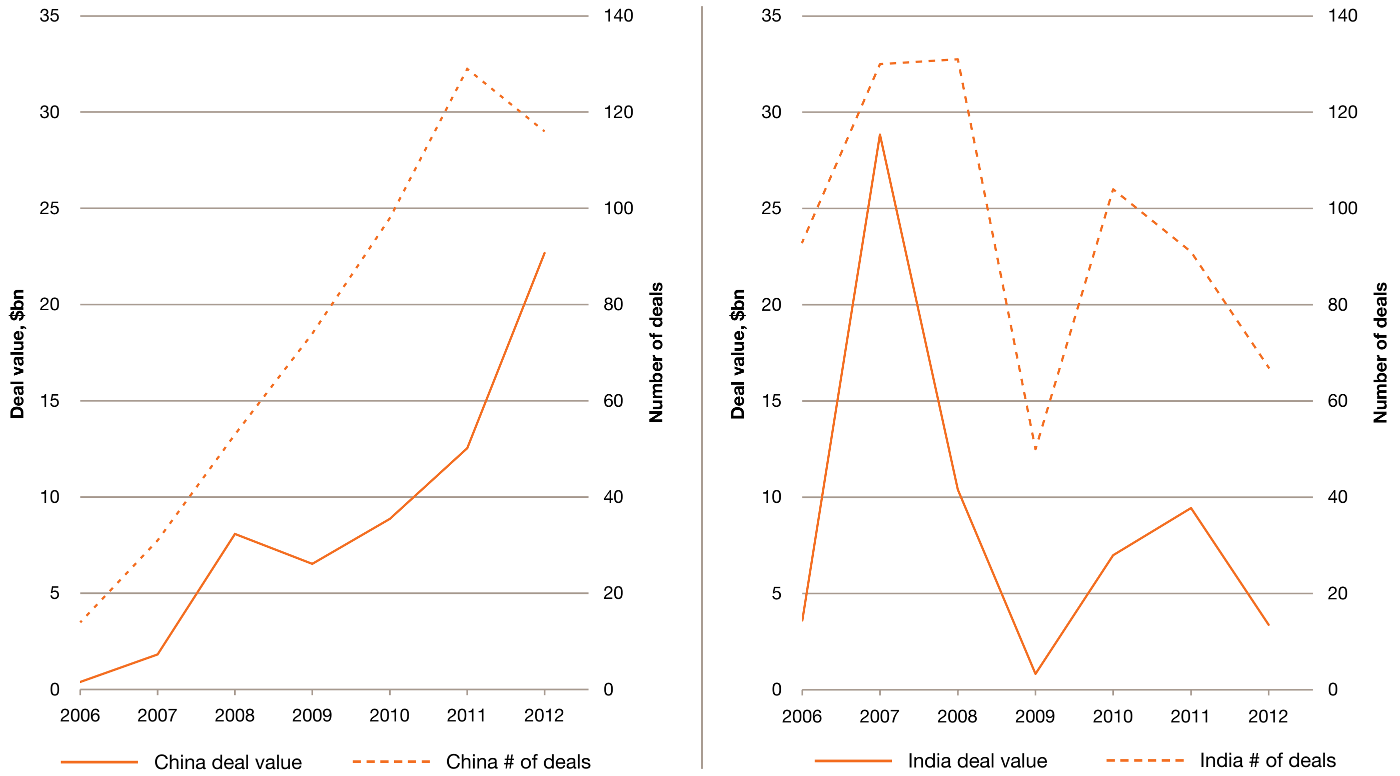
Though ranked seventh in the world in terms of outward FDI flows in 2011[1], much of Russia's outbound M&A has flowed east and south rather than into mature market companies. However, several large Russian privately-owned companies have invested westwards, with Severstal and Rusal acquiring steel assets and bauxite supply in the US and Europe respectively. Many Russian investors are cash rich and have already acquired mature market companies to complement their domestic business, and expansion plans, with new technology and expertise. Reports suggest that the latter were the drivers for Russian Railways US1$ billion acquisition of 75% of Gefco, Peugeot's logistics subsidiary. Meanwhile, some of Russia's domestic giants in banking or telecoms are seeking growth opportunities beyond their consolidated home market. Russia's recent accession to the WTO may mean that Russian companies may face fewer barriers to M&A involving access to technology and intellectual property, perhaps encouraging more Russian buyers to look to mature market companies.

India Inc remains a likely source of investment for mature market sellers

Like Russia, India's outbound M&A activity has been driven by its private sector. India's state-led investment has focused heavily on securing access to much needed energy resources. Many of India's larger privately-owned companies have also been active in the energy sector, with deals by companies such as Adani Enterprises Ltd.'s 100% acquisition of an Australian coal mine (worth US$2.7billion) or Reliance Industries, which took stakes of between 40% and 60% in three different American shale gas companies in 2010. Over the last three years, UK companies attracted more US$100 million plus investments (a total of five) from Indian buyers than any other county in the region. Though generating fewer deals and with lower M&A spend, India's outbound deal record has followed a similar pattern to that of China and India has historically been the second biggest source of HGM investment for mature market companies.

1 Global FDI Flows 2011, UNCTAD

Figure 4: Chinese investors lead on mature market M&A followed by India



Note: Deals included are completed, disclosed deals where the final share acquired was >20%
Source: PwC analysis of data from Dealogic

Brazil poised to build on historical ties

Brazil's business leaders traditionally have good ties with the US and Europe. A strong Real and slightly softer domestic growth meant that Brazil looked for overseas M&A opportunities, with a particular focus on North America and other high growth markets over the past years. National champions like Vale, JBD and Gerdau have led this drive in some of Brazil's traditional strongest industries – mining, agribusiness and steelmaking, respectively. However, Cielo's acquisition of Merchant e-Solutions (payments processing) and loche's acquisition of Hayes Lemmertz (an automobile parts manufacturer), both in the US, are good examples of outbound, mid-market deals in emerging, fast-growing Brazilian sectors. The Brazilian Development Bank has recently stepped up its policy to promote Brazilian outbound deals, with a particular aim of encouraging the emergence of Brazilian-based global companies in core industries, including agribusiness and mining. Following a period of tightening since 2010, the government is encouraging more lending to business, particularly through state owned banks, with a view to enabling them to expand abroad. Mid-sized Brazilian companies might look at more European targets, though our Latin American partners expect to see Brazil maintain its focus on the US and on high growth markets, particularly in Africa, building on historical ties with Angola and Mozambique.

The Gulf Region deals in diversity

The Gulf Region's M&A activities have been primarily SOE and SWF-led. Some, such as Abu Dhabi, have identified specific industries as part of a long-term economic diversification strategy to build domestic capacity in areas such as advanced technologies and to reduce their dependency on the US$. Abu Dhabi's International Petroleum Investment Company's (IPIC) mature market deals include energy targets but also engineering acquisitions such as Ferrostal. Another Abu Dhabi SWF, Mubadala, has mature market investments including stakes in Finmeccanica, EADS and GE. The Qatar Investment Authority and Kuwait Investment Authority have had a focus on financial targets. For the most part, the region's SWF investors seem to prefer small minority stakes in mature market targets but those small stakes can be very valuable.

Why high growth market to mature market M&A has room to grow

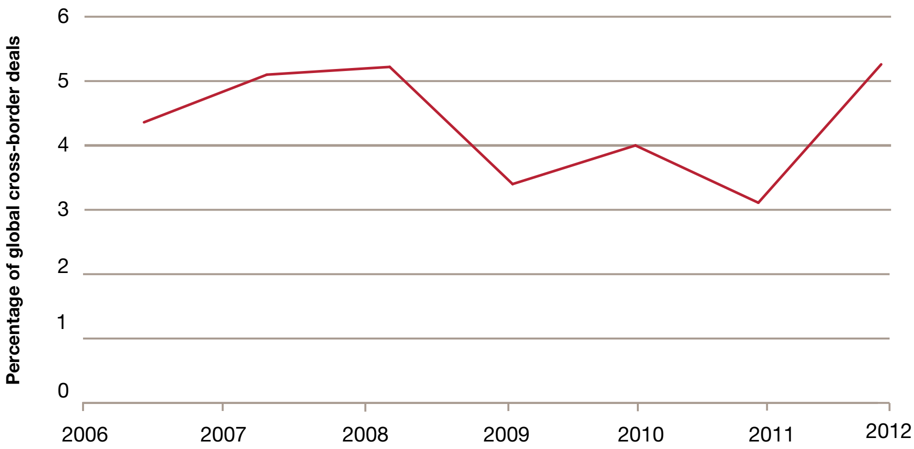
Although 2012 saw a lull in global M&A, totaling US$2,058 billion, a drop of 5.2% on 2011 and barely half of its peak in 2007, the global M&A market is still over twice the size it was just over a decade ago[2]. While they regularly make front-page news, mature market deals by HGM acquirers accounted for just 1.5% of total global deal value in 2012[3]. However, the number of mature market acquisitions by HGM companies has been rising and values are following a similar trend. A decade ago the US and Europe were the motors of M&A activity, looking ahead, we expect to see steady but significant growth in both the number and value of deals done by HGM buyers in both mature market and other high growth markets.

Figure 5: Room to grow

Emerging to mature share of global deals has increased since 2009

Investment from Emerging to 'mature' as a percentage of global deals value

Investment from Emerging to 'mature' as a percentage of global cross-border deals value



Note: Deals included are completed, disclosed deals where the final share acquired was >20%
Source: PwC analysis of data from Dealogic

2 'Reaching out in the search for growth', 'Deals & Dealmakers', Financial Times, September 19, 2012
3 Dealogic figures: covering disclosed completed deals for stakes of >20%

> *"Doing deals in the West is probably much easier than in Asia, as we get the flexibility to restructure the business to suit our needs"*
>
> **Chief Financial Officer, Chemical Industry, India**

The appeal of mature market targets to HGM buyers

Our experience shows that high growth market SOEs and POE buyers can have very diverse reasons for seeking overseas investment opportunities. However, Europe and the US are far from being their only M&A destinations. HGM buyers are very active in other high growth markets. Throughout South East Asia, Africa and Latin America, HGM companies have been doing deals for access to raw materials, to secure supply routes, to benefit from even lower labour costs or to compete for government contracts. So why invest in mature market companies?

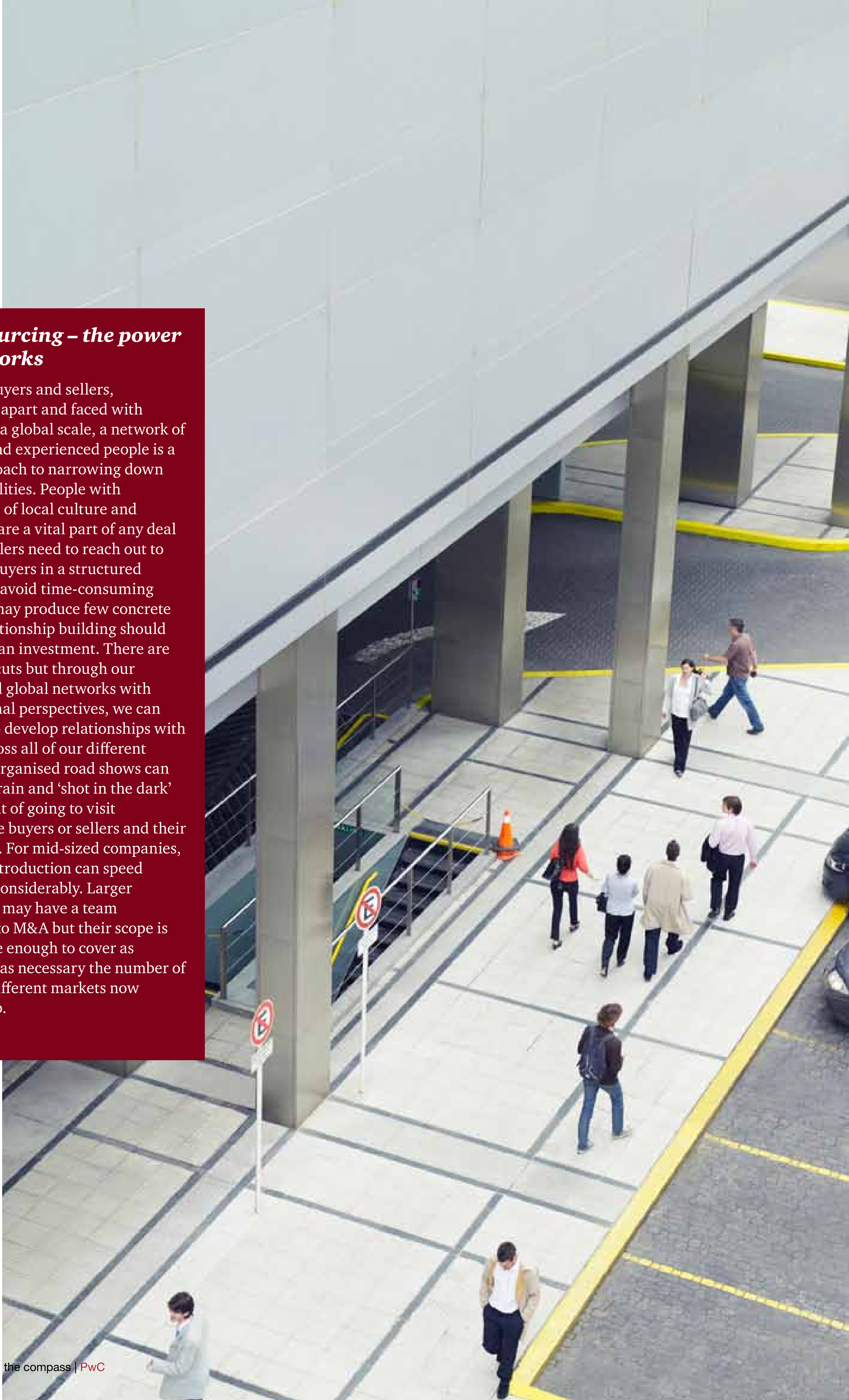
Looking at Westbound deals by HGM buyers over the past five years, we can begin to see what it is that pulls them towards mature market targets. Though each has their own centre of interest, we have identified some common motivators. In seeking out mature market companies, HGM buyers are doing deals to access established distribution channels and robust supply chains as well as the resources they have sought in the past. Many use their M&A to acquire technology and know-how. Some are looking for a brand, or management expertise, which they can use to gain an edge on their competition. Larger HGM companies may be using M&A to grow from being a local or regional player to being a global one.

Divestment spells opportunity for HGM buyers

Our transaction teams know HGM buyers who see the Eurozone as one distressed market – not a great starting point for negotiations. However, the outlook for the region is far less uncertain than it was even six months ago. Even with the travails of some countries, Europe still attracted 23% of total cross-border M&A value by non-Western buyers in 2012[4]. Many European businesses are doing well, with improved cost bases and exports aided by a weaker Euro. For many, weathering the crisis has made them focus on their core business and reducing debt. The Financial Services sector (FS), in particular, has seen many firms restructure, which has involved the divestment of non-core activities or retrenchment from certain geographic areas. The FS sector has generated considerable deal volume, with significant levels of intra-European M&A, and some good deals for HGM buyers[5]. Russia's OAO Sberbank acquired Volksbank Int AG and DenizBank Financial Services Group from their respective European parents. The deals brought Sberbank exposure to central and eastern European markets and Turkish markets[6].

We believe that continued deleveraging across Europe and the trend toward divestment of non-core activities will bring very interesting M&A opportunities to well-positioned HGM buyers. We expect this rise in availability of interesting targets combined with HGM buyers' access to finance, to produce even more HGM-market deals in 2013 and beyond.

4 Mergermarket, PwC analysis
5 See also 'PwC Sharing Deal Insights' – European Financial Services news and views, October 2012
6 'Sberbank to buy Volksbank International', Wall Street Journal, September 9, 2011



Deal sourcing – the power of networks

For both buyers and sellers, continents apart and faced with choices on a global scale, a network of contacts and experienced people is a good approach to narrowing down the possibilities. People with knowledge of local culture and industries are a vital part of any deal search. Sellers need to reach out to potential buyers in a structured manner to avoid time-consuming trips that may produce few concrete leads. Relationship building should be seen as an investment. There are few short-cuts but through our established global networks with international perspectives, we can help you to develop relationships with people across all of our different markets. Organised road shows can take the strain and 'shot in the dark' element out of going to visit prospective buyers or sellers and their operations. For mid-sized companies, a simple introduction can speed things up considerably. Larger companies may have a team dedicated to M&A but their scope is rarely wide enough to cover as effectively as necessary the number of new and different markets now opening up.

Understanding drivers: why it is even more critical in cross-border M&A

"The traditional strengths and values of German businesses have attracted considerable interest from both Chinese and Indian companies and these new partnerships are opening up sales and distributions channels that will prove mutually beneficial".

Volker Strack, European Deals Leader, PwC Germany

Deciphering deal rationale

The motivations of both buyers and sellers – and the degree to which they make them explicit – influence not only price expectations and valuations but how deals progress. Even buyers and sellers from the same region and industry need to comprehend their respective drivers. The experience of our transactions teams around the world shows that this is even more important for deals involving buyers and sellers from high growth and mature markets. HGM buyers may not realise that their drivers are unclear to their target. The mature market seller may have very little knowledge of the HGM company or its domestic market and may be unable to see their rationale. While it is impossible to generalise, in discussions with PwC transaction advisors in different markets, several common HGM company deal drivers came to the fore.

Access to market channels

For many HGM buyers, access to established sales channels for their goods and services is their primary rationale, as evident from a number of Chinese and Indian deals. Beyond its state-led headline deals into energy and utilities, much of China's outward investment has been into the engineering sector. German engineering companies have often been the target of choice. While these deals bring the Chinese buyer access to technology, they also bring access to German firms' valuable distribution chains. Ningbo Huaxiang Electric Co. recently took a 30% stake in the German automotive and electrical parts maker, Helbako Gmbh. It had previously formed a joint venture (JV) with another German auto parts supplier, Sellner Group in 2011. With its 14 established subsidiaries and JVs in Europe and the US, Ningbo Huaxiang aims to become an international player in the auto parts industry.

Indian investors have also followed this route, with deals such as that by Samvardhana Motherson Global Holdings Ltd. (a joint venture between Motherson Sumi Systems Ltd. and Samvardhana Motherson Finance Ltd.), in 2011 for an 80% stake in the German car parts maker, Peguform GmbH, for US$197 million from Cross Industries AG. Also in 2011, Wipro Technology Services acquired 100% of the global oil and gas information technology practice of the US company Science Applications International Corp. (SAIC) for US$150 million, thus gaining access to an established global customer base.

"The US and UK are attractive markets, allowing us to do both scale-based and skill-based acquisition"

Group M&A Head, Technology Industry, India

Access to technology and know-how

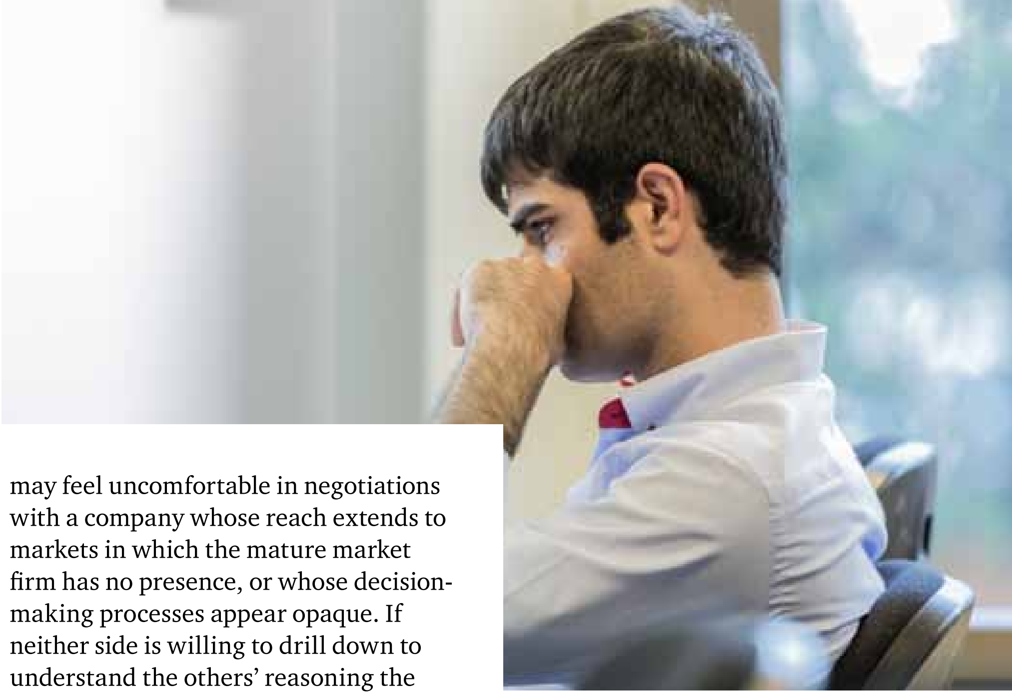
Several factors can drive a HGM company to buy into new technology and expertise. As their economies advance, competing on costs alone, particularly as wages rises, becomes more difficult. Developing a business that is more skills-based can bring greater value to their business – and has a valuable knock-on effect on their wider domestic economy. The latter being something high growth market governments are clearly keen to encourage. In the short to medium term, however, many HGM firms can still extract a lot of value from matching access to technology and innovation with their lower cost base. One example of this is the Indian wind power company, Suzlon's acquisition of Germany's REpower. Equally, the Chinese automotive company, Zhejiang Geely Holding, has made several acquisitions to tap into design and engineering expertise that it can leverage with its domestic production capacity. In 2010, it acquired Ford's Volvo operations and in February 2013, it completed a deal to acquire the assets of Manganese Bronze Holdings, which owns the London Taxi Company (LTC) – the maker of the UK capital's iconic black taxis. It had previously bought a stake of just under 20% of Manganese Bronze in 2006 and started an assembly line in Shanghai. With this new deal, Geely will to supply parts to LTC, which will assemble the cabs in the UK. Geely will also seek to develop a market for the taxis in other countries.

While access to technology remains a driver for many deals, it is becoming more of a two-way street. Certain leading HGM companies, such as China's Huawei, with reportedly half of their 150,000 employees devoted to research and development[7], are innovators in their own right. With its 2005 acquisition of IBM's PC division and, more recently, its purchase of the German PC company, Medion, Chinese computer giant Lenovo has leveraged its own R&D investment, through it access to new distribution channels, as well as expanding its product lines through these acquisitions.

Buying into brand names

Given how much time and expertise, not to mention luck, it takes to build a brand, it is hardly surprising that HGM buyers may prefer to buy rather than build them. Brand names can give HGM companies an advantage at home and abroad. The Chinese company Bright Foods bought into Weetabix to take a share of China's rapidly expanding market for western style food. Tata Motor's acquisition of Jaguar Land Rover (JLR) was in part an opportunity to create a synergy between the carmakers technology and Tata's lower cost labour base. The historic brand names and Tata's planned engine production and R&D facility near Shanghai (a joint venture with China's Chery Automobile) have given Tata a ticket to benefit from China's booming demand for luxury cars. A decade ago, JLR sold just 431 cars in China, in 2012 Tata sold 71,940 cars from its JLR stable, an increase of 70% on 2011 and making China Tata JLR's biggest car market, ahead of the UK, the US and Russia[8].

7 'Schumpeter: The best since sliced bread', The Economist, January 19–25, 2013
8 'Tata's JLR to add 800 new UK jobs on China demand', Reuters.com January 14, 2013



Going global

US$2.64 billion was the price Dalian Wanda Group, Asia's biggest cinema operator, paid in the second half of 2012 for 100% of AMC Entertainment Holdings, a US multiplex cinema group. Now the world's largest cinema operator, Wanda intends to invest another US$10 billion into the acquisition of US companies over the next decade. Global expansion is a key deal driver for Wanda in an industry that values volume and reach but it also hopes the deal will help overcome some of the restrictions on the Chinese movie industry. Indian companies have also long used M&A to expand globally. In 2012, India's Sun Pharmaceutical Industries Ltd. invested over US$592 to complete its acquisition of Taro Pharmaceutical Industries Ltd., and paid US$230 million for 100% of Dusa Pharmaceuticals Inc., both US drugs companies. Healthcare is a sector where established distribution channels are critical and costly to develop from scratch. These acquisitions brought Sun Pharmaceuticals a combination of expertise, access to markets in the US and elsewhere, as well as the scale needed to invest in future drug development programmes.

Investing in understanding for a better deal

From negotiating approaches to relationship building, the cultural, commercial and even generational norms of both buyers and sellers can heavily influence the deal-making process. In PwC's experience, it is important that both sides establish an understanding of the other's motivations to dispel misconceptions and to build trust. A company wishing to go global may not initially see the concerns of local management as a potential deal-breaker. An 'old world' incumbent may feel uncomfortable in negotiations with a company whose reach extends to markets in which the mature market firm has no presence, or whose decision-making processes appear opaque. If neither side is willing to drill down to understand the others' reasoning the deal process is unlikely to be successful. For buyers or sellers, an experienced advisor can shed light on the motivations, but also the constraints and concerns that could make or break the deal.

There is no 'one size fits all'

If acronyms such as BRICs blur the reality of just how different high growth markets are from one another, clinging to cultural clichés can also distort the perspective of both buyers and sellers. There are differences in the way companies do deals but they may come as much from generational, commercial or procedural differences as from cultural aspects. Our deals teams put a lot of effort to stop the sum of these differences getting in the way of a good deal. Purely cultural differences rarely scupper completion but they can complicate communications and good communications are essential to effective negotiations. Experienced, cross-cultural advisers can help the client factor in different norms and improve the deal process.

> *"To date we have only seen the tip of the iceberg in relation to HGM companies expanding inorganically, the stage is set for what should be substantial growth over the coming few years".*
>
> **John Dwyer, Global Deals Leader, PwC UK**

Getting to the dotted line in cross-cultural deals

An analysis of the past six years of HGM to mature market M&A, and discussions with our deals partners in different markets, highlight several issues affecting deal closure between HGM buyers and mature market sellers. Perhaps unsurprisingly, reaching a mutually acceptable valuation tops the list but other factors also emerge. In this section, we explore those most frequently occurring; how the cultural and commercial differences among markets can trigger them and how they can be resolved, if not avoided.

Addressing valuation mismatches

Given the macro economic conditions in Europe and the US over the past years, HGM buyers looking at targets in Europe or the US could feel that bargains should abound. On the other side, some mature market companies can too readily assume that HGM investors have easier access to funds, particularly from the state, and are willing to pay above the odds for their technology, brands or distribution channels. Mature market sellers can seek a higher premium if they lack confidence in the buyer or expect a protracted process to complete.

HGM buyers = generous multiples = an urban myth

There is evidence that some HGM buyers have been willing to pay a higher premium. Our own analysis of publically available information on deals from the past six years suggests that, on occasion, Chinese companies have paid above average multiples[9] but that on average Indian buyers seem to purchase at slightly lower multiples. These averages however do not tell the whole story and the deal price spectrum can be very wide for HGM-mature market acquisitions. In deals in the Mining and Metals sector, multiples can run high to reflect high capital investments. On the lower end, historically many Indian-mature market deals have relatively low multiples. For example, Mumbai-based Essar Group paid a multiple of just four times EV/EBITDA for 100% acquisition of the US business processing outsourcing (BPO) company Peoplesupport Inc. The deal, worth US$250 million, made Essar's BPO arm, Aegis BPO Services, an international BPO leader.

"Don't undermine the importance of customer diligence – focus on customer contracts, understand the strength of the relationship and the underlying currency to which the contracts are exposed"

Group M&A Head, Technology Industry, India

9 For a closer look at factors driving Chinese investors' valuations, we recommend the article '*From deal-breakers to deal-makers: Closing the valuations gap…*' from our report '**China deals – a fresh perspective**', October 2012
Download the pdf: from www.pwc.co.uk/emerging-markets/publications/china-deals-a-fresh-perspective.jhtml

The past is no guide to the future

In some regions, inflated valuation expectations are based on past deals. Some investors can be keen to dispel the notion that they are prepared to pay 'over the odds' and may be more recalcitrant about their price. This may have been a factor in Qatar National Bank's bidding for Franco-Belgian owned Denizbank, which operates in Turkey. Denizbank's parent, Dexia, also received a bid from Sberbank of Russia. Despite assumptions about Qatar's readiness to spend, they did not increase their offer and Russia's state-owned savings bank won the deal. Buyers from the Gulf Region typically do not like public transactions and, where this is unavoidable, will not want to be perceived as having paid more than fair market value. Some Gulf investors are able to deploy larger amounts of capital for longer periods of time but they expect the deal terms to reflect this, in their favour. Generally buyers from the area look for evidence of partnering and relationship building behaviour, in addition to getting the right price. Mature market sellers should be careful not to develop inflated expectations of a HGM buyer's ability to pay high premia. Ability and willingness to pay are very different and indeed, Chinese and Indian buyers are just as keen as their developed market counterparts to win deals on the most favourable terms they can achieve.

When the premium is not enough

As HGM buyers can also experience, offering a high premium is no guarantee of closing the deal. Mature market sellers may discount that premium or accept a lower rival bid for several reasons. While it may be frustrating from a bidder's perspective, seller uncertainty around the bidder's ability to secure finance or unfamiliarity with their approval processes can result in a deal going to a lower bid.

When competition for the target and tight timelines are inevitable it is important that the buyer does the groundwork to expedite the approval process as much as possible and that the buyer educates the seller before the process gets fully underway. Few sellers who are fully aware of the situation would intentionally structure their process to exclude viable buyers but an understandable lack of knowledge can mean some issues are put on the back burner by both sides only to scupper the deal later.

It is hard to generalise across different high growth markets but in some cases the premia HGM buyers are willing to pay may reflect synergies they know they can leverage in ways that are not always obvious to the seller or more significantly, not accessible to the seller. This underscores the importance of the seller's rationale being defined and comprehensible to the buyer.

"Size is not a measure of a good or bad deal"

Chief Financial Officer, Chemical Industry, India

Suggested measures

- Greater transparency by both buyers and sellers around deal drivers can increase trust and dispel unfounded expectations.
- Sellers should not assume that an HGM company may have easier access to capital or to state-funds.
- Sellers need to understand the buyer's investment timeframe and shareholder environment before setting premia.
- Clarify valuation techniques to ensure both parties are working with the same parameters.
- While multiples can be a guide, past deals are not always a reliable yardstick.

Agreeing a time frame for completion in a multispeed world

Deal processes can take longer to manage with a wider group on stakeholders as buyer teams from HGM companies may be less familiar with, comparatively under-resourced or lack the skills and experience of 'formal' developed market transaction processes. As already noted, timescales can also be affected by the need for state approvals, which though usually granted, can move slowly. Even without bureaucracy, investors in certain regions can move at a different pace, preferring not to work to accelerated timelines and, in some cases, demanding exclusivity.

Given that access to decision-makers is not always straightforward, and that processes may not follow their due course, there are many reasons why transactions can face delays with HGM acquirers. Delays and lengthier processes can also mean that mature market vendors have less confidence that the deal will complete. As already discussed, this lack of confidence may translate into the seller seeking a higher premium from the buyer.

Suggested measures

- Both parties need to understand what constitutes a 'normal' timespan for negotiations and completion for the other party to set expectations from the outset.
- In cases where special approval processes need to be followed, e.g. the deal needs to be vetted and/or finance approved by a regulator, buyers should educate sellers early around their approval processes and timelines so that they do not become an obstacle.
- Sellers may demand a higher premium from buyers they think are likely to be slow to complete.
- Foster relationships with key decision-makers from an early stage so that dialogue is possible if the deal timetable begins to slip.

"Don't get emotionally attached to a deal"

Chief Financial Officer, Chemical Industry, India

Private equity and openings for HGM buyers

A misperception among HGM buyers is that management in private equity backed companies will not have plans to cede control of their business and that private equity involvement is passive. The developed market reality is that with a private equity fund in a majority position, there is a very real chance of a transaction happening. HGM buyers should consider that, based on their tenure, a significant number of private equity investments could be for sale in the short to mid-term.

Connecting with decision-makers

Part of any successful deal is ensuring at least the backing, if not personal involvement, of the decision-maker or –makers. In some HGMs, a mix of cultural, hierarchical and linguistic factors can mean that the deal team is several degrees removed from those with decision-making power. In certain regions, the deal process may be delegated, with the key decision-maker only stepping in very late in the day. Elsewhere, many Indian POEs are family businesses where the decision lies with one person, often the founder, and these decision-makers tend to play an active role in deals. Buyers in the Gulf Region and Latin America can also be 'family heads' who have the ultimate say but direct access to those at the top can be difficult. In the Gulf countries, owners may be members of a ruling family, making negotiations more complicated. However, something we have noted across all regions is that when the buyers (or sellers) are entrepreneurs, who have built the business up, they do get personally involved in deal-making decisions.

Suggested measures

- Take time early in the process to understand decision-making hierarchies – and who has the final say. This is particularly true for deals involving SOEs.
- Buyers bidding for targets with private equity involvement should have direct contact with the private side as well the target company's management.
- The time needed to develop relationships varies greatly from culture to culture; consider this when approaching decision-makers. Seek advice from people who understand these finer points and stay attuned to signals.

Reconciling deal process differences

HGM companies new to M&A involving mature market companies may question the value of due diligence processes. Some can view it as expensive, irrelevant and even as ill-adapted to their needs and their business approach. Even if others, such as buyers from Brazil, India and Russia are more comfortable with the demands of due diligence, they may have different requirements. Brazilian buyers, for example, will be highly concerned by tax and labour issues, perhaps even more so than their US or UK counterparts, because these areas are particularly tightly regulated in Brazil.

Some HGM buyers' due diligence processes can appear opaque to outsiders. For example, even privately owned Chinese companies need approval for overseas investments from several state bodies[10] and banks will not green light funds until the deal has been approved, which can be a slow process. In Chinese SOEs, their chairperson's sponsorship is usually key to the process and outcome, and thus Chinese deal teams may devote considerable time to his or her information requests. Reconciling mature market due diligence practices with the processes particular to overseas investments by HGM companies is often complex and really requires experienced advisors.

Suggested measures

- Plotting the deal process and due diligence approaches of both the buyer and seller will highlight where they diverge and provide a basis for discussion.
- Where the buyer faces complex or potentially lengthy approval processes, the seller should be informed from the outset so that they understand what is 'normal'.
- Communicating the reasoning behind due diligence practices can make the other party more comfortable/willing to cooperate with the process.
- High growth markets can have very different reporting, tax and legal requirements and systems that can slow the due diligence process and necessitate more requests for information, both the buyer and the seller need to be explicit about this.

Building trust – the role of the advisor

Building trust in the value of the due diligence process is critical to reaching a successful deal. But despite the obvious need for experienced advice, if not familiar with US or European M&A approaches, executives in HGM companies can be uncomfortable with external advisers. Leaders may be unused to relying on a third party for advice and insight, especially when the deal may be the first overseas one they do. The adviser's role must sometimes be to convince HGM buyer's – or mature market sellers for that matter – to look at the bigger picture and, if necessary, to take 'bad news' on board: not always easy if it means disappointing a superior. Moreover, in more hierarchical cultures, deal teams and leaders may not wish to be perceived as 'needing' external advice. Some HGM buyers can see advisers almost as peripheral to the process, rather than leveraging their expertise fully.

10 All outbound deals require approval from the Ministry of Commerce and the National Development and Reform Commission (NDFC). SOEs also require sign off by the State-owned Assets Supervision and Administration Commission (SASAC). Overseas deals in foreign currency must also be approved by the State Administration of Foreign Exchanges (SAFE).

Conclusion

Re-setting the compass for a new direction in global M&A

As this report illustrates, there is no one size fits all approach to M&A transactions between high growth market buyers and mature market sellers. Deal-making is always a complex mix of strategy, economics and personalities. Cultural differences add another layer of complexity but they can be reconciled and may make the process even more rewarding. As HGM companies step up their role in their own economies and look abroad, their expansion will help drive value and volume in the global M&A arena. Competition for investment is also growing, as mature market companies are far from being the only targets HGM companies are considering. As we suggest in this report, HGM to mature market M&A has the potential to grow a very long way. We believe that we will see acceleration in this type of M&A over the coming years. A better understanding of the make or break areas – valuation mismatches; differing completion timeframes; the need to connect with decision makers; and process differences – can only improve the chances of a successful deal. The HGM buyers and mature market sellers best prepared for those differences will have a lot to gain.

Please get in touch

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Glossary

FS	Financial Services
HGM	High growth market
M&A	Mergers and acquisitions
POE	Privately-owned company
SOE	State-owned company
SWF	Sovereign Wealth Fund

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