T Magazine

Tax insight for business leaders

04

Deals back on the agenda?

Corporates revisit their M&A strategies

Emerging markets deals take center stage

How tax can make or break an acquisition

Signs of distress bring new assets to market

Imprint

Publisher:
Ernst & Young EMEIA Tax
Bleicherweg 21, 8002 Zurich, Switzerland

Marketing Director: Alfred Raucheisen
Program Manager: Alexander Lorimer
Special Advisor: Leor Franks
Content Advisor: Monica Kremer
Online Manager: Mikael Enoksson

Publishing House:
Infel AG
Militärstrasse 36, 8021 Zurich, Switzerland

Publishing Director: Elmar zur Bonsen
Editor-in-Chief: Rob Mitchell
Art Director: Guido Von Deschwanden
Editors: Fergal Byrne, James Watson
Project Manager: Michèle Meissner
Picture Editor: Diana Ulrich

Printer:
Rüesch Druck AG
9424 Rheineck, Switzerland

All rights reserved. Contents of this publication may not be reproduced whole or in part without written consent of the copyright owner.

A part of this issue will be distributed as an insert in the *Financial Times* across Europe, Middle East, India and Africa in May 2011.

The involvement of tax often makes the difference between winning or losing

Stephan Kuhn

Dear Reader

After three years of retrenchment, many companies have emerged from the financial crisis with strong balance sheets and increased organizational efficiency. And although the economic recovery remains patchy and uneven, an increase in M&A activity seems likely as companies take advantage of their stronger financial position, attractive valuations and improving credit conditions.

At the beginning of the upswing, companies are again thinking about growth. As part of their growth strategies, many are looking for acquisitions; either acquisitions in new markets (to reach new customers) or new products (to use more effectively existing distribution channels).

At the same time, the global map of M&A is changing. An important driver of the current increase in deal volumes is the growing ambition of emerging market multinationals. Having weathered the downturn well, these fast-growing, cash-rich companies are cementing their reputation as a new breed of global dealmakers. They are sizing up targets in other emerging markets, often to control infrastructure and to gain access to natural resources, and also looking further afield to acquire assets, brands and know-how in developed countries.

Despite a gradual recovery in M&A activity, a quick return to the pre-crisis days of mega-mergers and highly leveraged deals seems unlikely. Companies may be more optimistic about the future than at any time in the past three years, but most remain cautious. They are scrutinizing potential deals more carefully, conducting thorough due diligence and being more realistic about potential synergies. Part of this stronger discipline is driven by management, but investors and lenders are also becoming more questioning. Today, most stakeholders will require a clear and convincing rationale for potential deals and valuations before giving their blessing.

The need to extract the maximum possible value from a deal is encouraging companies to consider tax much more carefully in their transaction planning than in the pre-crisis years.
They now recognize that tax plays a vital role both in structuring a deal and the realization of any post-merger synergies. By getting the tax function involved at an early stage in the deal planning process, acquiring companies stand a much better chance of identifying tax savings and compiling more accurate valuations. Often, the involvement of tax may make the difference between winning or losing the deal.

In this issue of **T Magazine,** we assess the outlook for M&A across the EMEIA region against a backdrop of continuing economic uncertainty. We explore the deal structures and types that companies are likely to pursue and examine the important role that tax plays in maximizing the chances of a successful transaction.

We hope you find the publication valuable and stimulating.

Stephan Kuhn

Stephan Kuhn is Area Tax Leader for the Europe, Middle East, India and Africa (EMEIA) region at Ernst & Young.

Credits: Ed Thompson / LUZphoto; Getty / Justin Guariglia; Laurence Voumard; Cover: Keystone / EPA / Olivier Hoslet

8

20

42

Discover more content, news and features on the T Magazine website at www.ey.com/tmagazine

News

5 __ Global tax news
Round-up of recent tax developments.

6 __ M&A and competition policy
Large M&A deals present strong potential growth opportunities for corporates. But for regulators, these ambitious deals raise competition issues.

Features

8 __ A return to dealmaking
The financial crisis is giving way to a gradual return of confidence in M&A markets.

14 __ A changing global landscape for transactions
A visual representation charting the break-down of M&A by region and sector.

16 __ Risk and return of acquisitions in emerging markets
More and more companies are acquiring assets in rapidly growing emerging economies. But the challenges are considerable.

18 __ View from the hotseat
James Nolan of Royal Philips Electronics discusses trends in M&A.

Focus

20 __ Unloading ahead
Companies keen to focus on core competencies or raise cash are turning to carve-outs.

24 __ A healthy pipeline for M&A deals?
Giuseppe Monarchi of Credit Suisse offers his outlook for M&A activity.

26 __ A shift in the balance of power
Emerging markets are playing an increasingly important role in global M&A activity.

32 __ Driving value from transactions
Until recently, tax directors were rarely involved in every stage of a transaction but the quest for value from deals has seen them play a bigger role.

Management

36 __ Grappling with deal valuations
Valuation of assets is always challenging but is particularly tricky in a volatile environment.

38 __ Government sales ahead
Strained public finances and ongoing programs of liberalization are encouraging governments to embark on a new wave of privatizations.

42 __ Assets in need of care and attention
Distressed assets may look like bargains but they carry greater risks than normal transactions.

46 __ Getting to grips with a shifting policy landscape
Tax policy can play a vital role in determining the success or failure of a cross-border transaction.

Outlook

48 __ Today's transactions are creating value
The myth that transactions destroy value needs to be dispelled, says Scott Moeller, Director of the M&A Research Centre at Cass Business School.

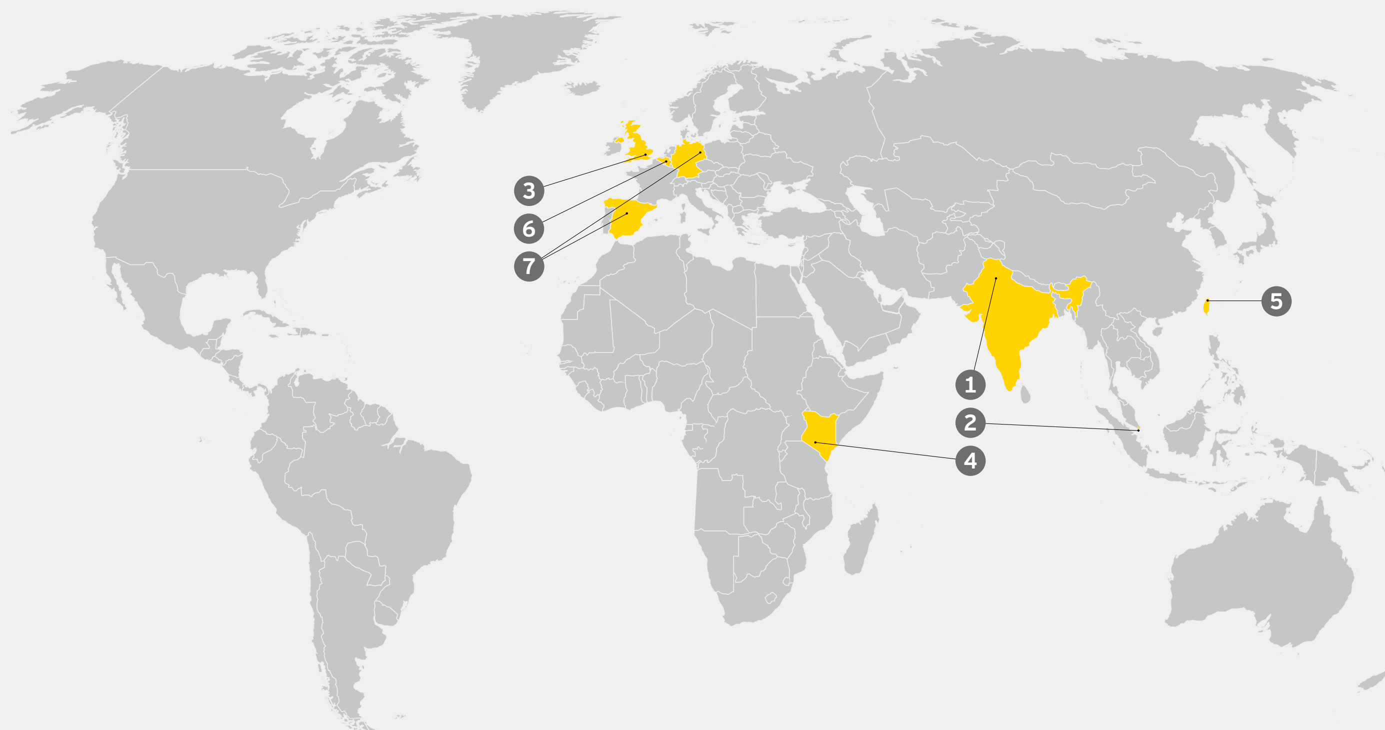
Cover

Joaquín Almunia, Vice-President of the European Commission and Commissioner responsible for competition

"The basic idea behind centralized merger control at an EU level is that all mergers with a significant cross-border impact must be cleared according to a uniform set of rules before they take effect. I believe this is good for companies and for fellow European citizens alike." Taken from a speech about merger control held in October 2010.

Global tax news

A roundup of recent developments from major governments and tax administrations



European Union

March 2011

The European Union has adopted formal proposals regarding a Common Consolidated Corporate Tax Base (CCCTB). The goal of the directive is to produce a uniform standard for calculating the tax base of multinational groups operating in the EU. The Directive is based on the assumption that companies will treat the EU as a single market for corporate tax purposes, instead of dealing with 27 different tax systems.

1 India

February 2011

Presenting his government's budget for 2011-2012, India's finance minister Pranab Mukherjee announced that the surcharge on income tax rates for domestic companies would be reduced from 7.5% to 5%, and from 2.5% to 2% for foreign companies. This would reduce the effective tax rates for both domestic and foreign companies.

2 Singapore

February 2011

In its 2011 budget, the Singapore Government announced the introduction of significant enhancements to the Productivity and Innovation Credit incentive, which was originally announced last year. Companies will now be able to deduct up to 400% of their expenditure on training, investment and other categories of activity covered by the scheme.

3 United Kingdom

February 2011

The British Chancellor George Osborne announced that the government was planning to impose a levy on bank balance sheets of 0.075% for 2011, rather than the 0.05% that was originally imposed. It is estimated that this will generate an additional £800m.

4 Kenya

March 2011

At a conference in Nairobi hosted by the International Monetary Fund and the government of Kenya, senior tax officials from more than 40 African countries convened to discuss ways of improving tax revenue mobilization across sub-Saharan Africa.

5 Taiwan

January 2011

The government of Taiwan introduced new thin capitalization rules, including a 3-to-1 debt-to-equity ratio, computation of non deductible interest expense, definitions of related-party debts, equity and interest expense, and tax return disclosure requirements.

6 Belgium

March 2011

The Belgian government has proposed changes to the participation exemption regime with respect to portfolio investments. The proposals, if enacted, would impact the Belgian tax regime on portfolio investments for both EU and non-EU dividends.

7 Spain and Germany

February 2011

The Spanish and German governments signed a new tax treaty to avoid double taxation that will replace the treaty currently in force that was signed in 1966. The structure and content of the new treaty, a draft version of which has been very recently released, is mostly based on the OECD's current model tax convention.

Credit: European Union 2011

M&A and competition policy

EU Commissioner **Joaquín Almunia**

M&A per country (2010)

Ranking by number of the top 10 countries

	Country	Deal Value (US$m)	Number of deals
1	United States	117,446	1,089
2	United Kingdom	90,292	647
3	Brazil	38,187	195
4	Australia	33,859	431
5	Canada	31,505	409
6	Germany	26,107	396
7	France	20,932	322
8	Spain	19,571	237
9	Netherlands	15,982	183
10	Hong Kong	14,861	163

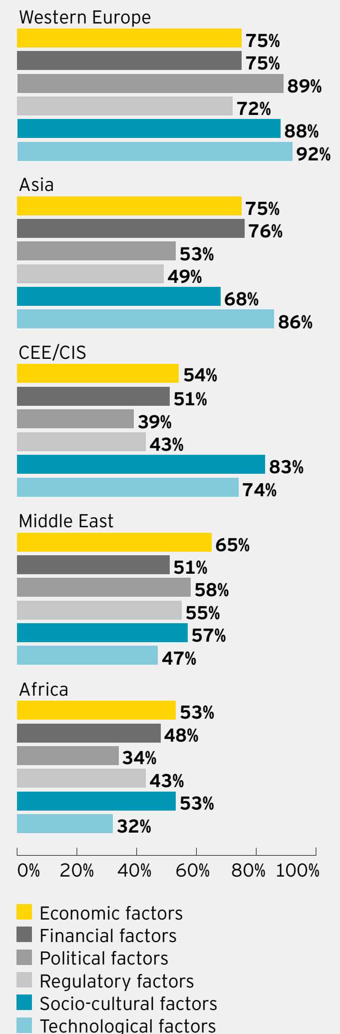
Source: Thomson Reuters

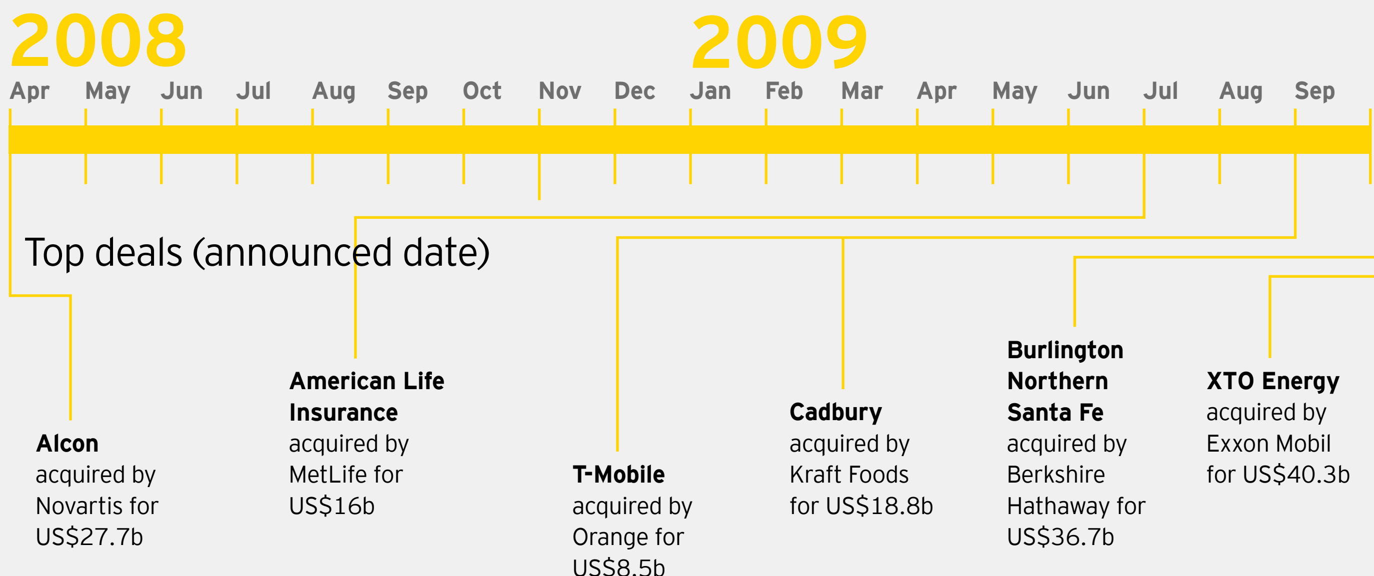
Although volumes dropped precipitously during the financial crisis, the past decade has seen a significant increase in the size of M&A deals. For companies, these ambitious deals can, if executed well, unlock strong growth potential. But for regulators, the increase in deal size raises competition issues.

In the European Union, merger regulation has had to move with the times. The sustained globalization of many industries has changed many of its core assumptions about what constitutes an appropriate market – from national ones, to multinational, to truly global. The key, for most regulators, is to strike a careful balance. On the one hand, mergers can and very often do have a positive impact on the economy, job creation, innovation and indeed competition itself. But on the other hand, there needs to be a framework to prevent abuse and the build-up of monopoly power.

Joaquín Almunia, the EU Competition Commissioner, recently argued: "Companies that say they must merge to compete globally, regardless of the competitive consequences for the home market, are not looking at the complete picture. Without merger control, we would see many more companies buying up their competitors, weakening the competitive structure of markets, and reducing incentives to innovate. The very existence of our system acts as a deterrent. Because we have merger control, we see very few attempts to merge to monopoly."

http://ec.europa.eu/commission_2010-2014/almunia/index_en.htm





Credit: Reuters / Toby Melville; Reuters / Stringer Italy

50%

A proposed production joint venture between leading international mining companies BHP Billiton and Rio Tinto, which would involve the two companies taking a 50% stake in their combined iron ore assets, was finally signed in 2009. The deal attracted intense scrutiny from competition watchdogs in the EU and Australia.

2.4b

In 2009, China's Ministry of Commerce rejected Coca-Cola's planned US$2.4b takeover of Huiyuan Juice, arguing that the US firm could abuse its dominant position in the country's beverage market. In recent years, both China and India have enacted tough anti-trust laws, and made it clear that they will take a firm line against deals that they perceive could create monopoly concerns.

"Competition stimulates and rejuvenates economies. A relapse into policies of nationalism and protectionism – whether in relation to goods or services or investment – would be a massive, and costly, mistake."

Vince Cable, Britain's Secretary of State for Business, Innovation and Skills, speaking at the European Parliament, in September 2010.

London __ United Kingdom

Following the acquisition of Cadbury by Kraft, the UK Takeover Panel issued a consultation paper that proposed changing the takeover rules to give acquisition targets greater protection against hostile takeovers, and to reduce the tactical advantages currently enjoyed by bidders under UK law.

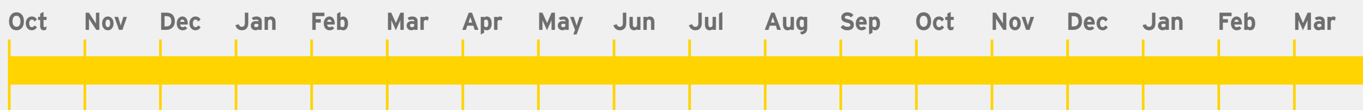
Rome __ Italy

The Italian cabinet headed by Premier Silvio Berlusconi (right, with Finance Minister Giulio Tremonti) discussed plans to adopt a series of measures that will prevent unwanted takeovers of Italian companies by overseas firms. The moves may include the establishment of committees to monitor strategically important industries, and the potential freezing of voting rights of shareholders in companies considered to be strategically important. The initiative follows a similar move implemented by France earlier this year.

Regulatory challenges

__ In March 2011, the UK Culture Secretary Jeremy Hunt announced that he would accept News Corporation's proposed bid for BSkyB, provided the media giant would spin off Sky News as a separate company. If these conditions were met, Rupert Murdoch's News Corp would avoid a referral to the UK Competition Commission.

__ The EU Commissioner Joaquin Almunia recently hinted that the proposed bid by Deutsche Börse to acquire NYSE Euronext is likely to face regulatory challenges. The Commissioner said he was concerned about the "vertical silo" business model and its impact on competition.



Carso Global Telecom acquired by América Móvil for US$17.8b

Smith International acquired by Schlumberger for US$11b

Zain Africa acquired by Bharti Airtel for US$10.7b

Lihir Gold acquired by Newcrest Mining for US$9b

Brasilcel acquired by Telefónica for US$9.7b

Genzyme acquired by Sanofi-Aventis for US$20.1b

US property assets of Centro acquired by Blackstone Group for US$9.4b

Credit: Ed Thompson / LUZphoto

US$209b

Total global value of corporate deal-making in January 2011, the highest in more than a decade, according to the Financial Times.

A return to dealmaking

After a subdued period of mergers and acquisitions, deal-making is making its way back onto corporate agendas, particularly in emerging markets. But a starkly different approach to such transactions is now being taken.

▸ **By Rob Mitchell**

Summary

As business confidence returns, so is a renewed appetite for M&A. But companies are taking a much more cautious approach to how they finance and structure such deals, value assets and quantify outcomes. The role of tax is also being more closely considered.

Over the past three years, large mergers and acquisitions (M&A) have been far from the minds of many executives. Although there has been a slow, steady flow of transactions throughout the downturn, deal-making activity has been for the most part subdued. Rather than putting in place ambitious plans to expand market or customer reach, most executives have focused on cost management, divestments and restoring balance sheets to health.

Even if companies did want to acquire, the external environment has often not been conducive to transactions. The banking sector's own focus on deleveraging has dramatically curtailed its lending capacity. Although data from the European Central Bank shows that net lending to companies has increased slightly over the past year, many banks are reluctant to loosen lending standards. And most corporates are choosing to keep hold of earnings rather than invest in acquisitions. The tentative economic recovery continues to encourage a cautious approach to dealmaking. Although emerging markets are growing at rapid rates, developed economies continue to face barriers to a strong recovery, including fragile business and consumer confidence, high unemployment, rising inflation and large government deficits.

Faced with these clouds on the horizon, many companies are adopting a "wait and see" approach before embarking on M&A strategies. According to Ernst & Young's April 2011 Capital Confidence Barometer, most corporates remain focused on organic growth, rather than M&A. Although the number of companies looking to acquire over the next six months has increased slightly compared the previous survey in October 2010, the survey predicts a fall in appetite for M&A over a longer timeframe. Other metrics, such as forward price/earning ratios, which can provide an indication of the market's willingness to do deals, have also dropped in recent months, suggesting the tide of investor confidence has yet to turn in earnest.

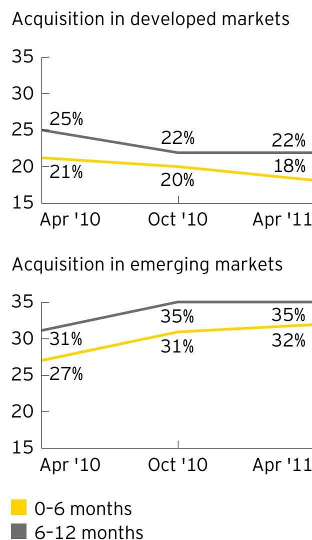
Signs of recovery

But despite these continuing challenges, there are signs of a nascent recovery in deal-making activity. According to Thomson Reuters,

Abby Ghobadian
Professor

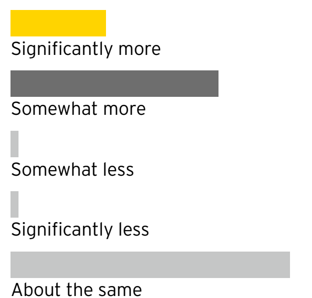
__ Abby Ghobadian is Professor of Organizational Performance at Henley Business School at the University of Reading. His specialist research subject relates to the various factors that influence organizational productivity and competitiveness and what can be done to improve it. He also edits the International Journal of Process Management and Benchmarking.

Which of the following are you likely to undertake or seriously consider in the next 6 and 12 months?



Source: Ernst & Young Capital Confidence Barometer

The rising importance of tax issues in deals



Source: Ernst & Young Global tax trends

Why is tax more important in an M&A context?

Source: Ernst & Young Global tax trends

announced M&A grew by almost 20% in 2010 compared with the previous year, to US$2.25t globally. The first few months of 2011 have also seen fairly strong activity, although some of this has been driven by divestments rather than true M&A. In February, there was a flurry of deals between stock exchange companies, with London Stock Exchange's announcement of a merger with its Canadian peer TMX swiftly followed by news that Deutsche Börse and NYSE Euronext were discussing a merger. In the same month, the Spanish bank Santander announced a bid for Poland's Bank Zachodni WBK, and the pharmaceuticals firm Sanofi-Aventis agreed terms for its US$20b acquisition of the biotechnology company Genzyme Corporation.

In the longer term, deal-making activity is expected to recover. A global survey of senior executives conducted for Planning for growth, a recent Ernst & Young report, found that three-quarters of respondents expected consolidation in their industry over the next three years. "Although we observe that in some markets companies are using cash reserves to fund organic growth, in the long run M&A will continue to be a strategic option as it is the most effective way of quickly expanding market reach," says Joachim Spill of Ernst & Young's Transaction Advisory Services in Germany.

With the financial crisis having increased the gap between the best and worst-performing companies, deals offer an opportunity for financially secure companies to strengthen their position further. "The financial crisis has widened the gap between the successful and not-so-successful companies in the economy, giving those that have done well the opportunity to consolidate their stronger position," says Abby Ghobadian, Professor of Organizational Performance at Henley School of Management in the United Kingdom.

M&A confidence on the rise

For most companies, particularly in developed markets, the past three years have been characterized by the need to focus on cost efficiencies and cash preservation. But with confidence tentatively returning and balance sheets now looking much healthier, a growing number of companies will inevitably be turning their attention to growth again. "Many companies have done all they can from a cost-efficiency perspective within their own organization," says Prof Ghobadian. "This leads them to consider M&A both as a means of achieving growth and as a source of further potential cost synergies from making the acquired company more efficient."

The twin-track nature of the global economic recovery means that the world's fastest-growing regions will become an important center for deal-making activity. The Planning for growth report from Ernst & Young found far higher levels of business confidence among respondents from Brazil, India and China than those in developed markets. With forward-looking earnings forecasts in these countries looking exceptionally strong, this optimism is likely to translate into a high number of deals over the coming months. Over the past year, deal volumes in emerging markets have increased much more rapidly than those in the developed world. According to data from Dealogic, a data provider, emerging market transactions grew by 65% in 2010 and accounted for more than one-third of global deal value and volume. This reflects a growing desire among multinationals to gain market share in some of the world's most dynamic regions.

Deal flows from East to West are also becoming more pronounced. Emerging market multinationals and sovereign wealth funds are in a cash-rich position, often have state backing and are hungry for natural resources, brands and know-how. This makes Western companies appealing targets, particularly at a time when valuations and exchange rates are still attractive. In March 2010, for example, the Chinese company Geely announced that it would acquire the Volvo brand and its assets from Ford Motors for US$1.8b. The bid by Korea National Oil for the UK oil explorer Dana Petroleum offers another example of this East to West trend.

Emerging market multinationals are also acquiring in other emerging markets. This activity is often driven by a desire to gain access to natural resources. In February, the Chinese oil and gas company Sinopec announced that it would take a 40% stake in Repsol Brazil, a subsidiary of the Spanish energy group Repsol YPF. Chinese companies have also invested heavily in Africa. In 2009, China became South Africa's largest trading partner.

The maturity of emerging markets from an M&A perspective varies widely. The MARC M&A Maturity Index provides a high-level summary of risks and opportunities for M&A transactions in 175 countries around the world. It has been developed by the M&A Research Centre at Cass Business School, City University London, of which Ernst & Young is a senior sponsor. The index shows that, among the BRIC economies, China tops Brazil, India and Russia in the M&A maturity rankings.Technological maturity has contributed strongly to the success of China, while regulatory and political issues have impinged on its progress. Brazil also shows strength in technology but is again held back by the same factors. Russia offers a similar profile, with a strong performance in the sociocultural arena, but an even weaker political score. And in India, good performance in financial and technological indicators is offset by regulatory, political and sociocultural concerns.

A new supply of assets

On the supply side, a growing trend for demergers and carve-outs will be another driver of M&A activity. "One clear trend we are seeing is companies re-evaluating the returns they achieve

Credit: AFP / Bjorn Larsson Rosvall / SCANPIX

Welcome to China: Geely chairman Li Shufu shakes hands with Ford CFO Lewis Booth to seal his firm's acquisition of Volvo from Ford.

from their capital – and one of the results of this is that they are selling assets that they no longer see as core," says Aidan Stokes, Global Director of the Transaction Tax Practice at Ernst & Young. "This means that we are likely to see a wide range of businesses coming up for sale over the next few years over and above those which would normally have been expected."

According to the Financial Times, large carve-outs are dominating deal-making activity. January 2011 saw the strongest start to the year for more than a decade, with US$209b of global corporate deal-making activity. Carve-outs formed a large proportion of this. The illustrations cited in the article include Cargill's US$24b spin-off of a majority stake in Mosaic, ArcelorMittal's demerger of its stainless steel division and Hutchison Whampoa's decision to raise US$6b by spinning off its ports business and listing it on the Singapore Stock Exchange.

Private equity funds will be another source of deal targets in the coming years. A looming debt maturity cliff means that many will need to refinance acquisition debt attributable to portfolio companies. Much of this was agreed at the height of the boom years, when finance was cheap and leverage multiples generous. Many lenders will be unwilling to renew such arrangements without substantial improvement in pricing and other issues, and few new lenders are likely to materialize. At the same time, exit by IPO remains unlikely for most assets. So, as global government stimulus recedes and refinancing pressures increase, it seems likely that the number of distressed assets coming to market will grow in number.

"Over the next few years, private equity funds will need to refinance a vast amount of debt at higher cost and on more stringent terms, which means that many will either have to tap investors for more equity or sell the investment," says Stokes. "Although some will be able to refinance this debt, the expectation is that there will be a lot of companies coming to market."

Volvo Geely

Chinese carmaker Geely continued the shift of deal-making gravity from West to East with its US$1.8b acquisition of European marque Volvo from its US parent Ford. The deal marked the largest purchase of a foreign car manufacturer by a Chinese company.

A new approach to dealmaking

While this combination of trends suggests that a return of deal-making activity is imminent, the way in which companies approach these deals will be fundamentally different in future. In stark contrast with the pre-crisis years, most companies will be much more cautious about the way they structure deal financing, value assets and quantify expected synergies.

Academic research has consistently shown that the majority of M&A transactions do not deliver all their expected benefits, with estimates for the proportion that do not live up

The role of tax in the post-crisis environment

__ The downturn in the transactions market has created an environment in which companies are being forced to squeeze greater value from their deals if they are to achieve their commercial and economic objectives. In practice, this has a number of important implications for how tax is managed in corporate transactions.

1. Anticipated tax efficiencies are now being evaluated more rigorously in validating the expected after-tax effects of deals. In turn, this is raising the profile of tax in the M&A context and changing the emphasis of tax due diligence to focus more on sources of future value.

2. The range of tax issues that companies are now considering in their transactions has expanded rapidly beyond matters such as tax relief for the costs of transaction debt. It now includes many areas that were not previously considered in transaction structuring.

3. Identifying tax savings and potential tax pitfalls early in the process of a transaction has become more critical – it can lead to more accurate valuations, which can make the difference between winning and losing a deal. This is particularly true in emerging markets, where tax regimes can be more uncertain and companies need to give themselves as much time as possible to evaluate tax risk. Early involvement of a company's tax function in the process of transaction planning can help to improve companies' ability to realize tax efficiency. Companies getting the most out of such deals will maintain a close dialog between their tax function and those initiating transactions.

4. The trend toward increasing scrutiny of transactions by tax authorities and the shift of M&A activity toward emerging markets are making companies more cautious about assuming tax risks. But the commercial imperative to seize the opportunities that are presented by a returning corporate M&A market ahead of their competitors is a powerful counterbalance for many companies. As a result, striking the right balance between managing tax risk and the most tax-effective transaction structures has never been more important. T

20.6%

The energy and power sector was the most active during full-year 2010, commanding 20.6% of announced M&A. According to Thomson Reuters, private equity-backed M&A activity totaled US$225.4b during 2010, the biggest year for global buyout activity since 2008.

to expectations generally ranging between 50% and 80%. Issues that can derail transactions range from overpaying for assets, poor timing or failures in due diligence or integration. "To be successful in M&A you have got to be extraordinarily careful with due diligence and you have got to walk away if the deal becomes too expensive," says Professor Ghobadian.

Investors are also likely to scrutinize deals more carefully and in an increasingly public manner. They expect assurances that the deal will meet executives' expectations. A recent survey by Schulte, Roth & Zabel and mergermarket found that two-thirds of activist investors are expecting more shareholder interventions in 2011. "In the current environment, the stakeholders in any deal are looking much more closely at the value that is attributable to synergies and whether that can be realistically achieved," says Stokes.

The role of tax in transactions

Careful attention must to be paid to the role of tax in structuring deals and managing synergies. A transaction has the potential to affect every area of a company's operations; but until now the impact of tax on the structure and overall economics of a deal has not always been considered. Instead, companies have tended to confine their consideration of tax in the context of a transaction to those areas requiring immediate attention to get a deal done. This is now changing. Rather than being seen as an enhancement that can be made after the decision to do a deal has already been taken, tax is increasingly seen as a fundamental component of the decision itself. "There is now much more focus on identifying potential tax synergies at the outset of a deal to give enough time to evaluate them thoroughly and make an informed decision about whether they should be reflected in valuations," says Matthew Peppitt of Ernst & Young's Transaction Tax Practice.

In Global tax trends, a recent report from Ernst & Young, more than half of the tax directors surveyed said that their organization places more emphasis on tax issues when conducting transactions than it did three years ago. In a growing number of companies, tax directors are playing a broader role across the whole life cycle of a transaction, from structuring the deal through to post-merger integration.

This growing importance of tax in M&A is driven above all by the pursuit of enhanced transaction value. In particular, companies globally are seeking to take account of future costs and savings, including taxes, when evaluating transactions. More than nine out of ten tax directors cited the increasing focus on tax efficiency to reduce the after-tax cost of deals as the principal driver of the growing importance of tax in the M&A context.

"Companies are now starting to look at the role of tax in a transaction much more broadly," says Peppitt. "They are considering the tax impact of the transaction on every area of a company's operations that may be affected by it, not just those matters that require immediate attention to get the deal done. Where appropriate, they are also recognizing the benefits in deal valuations." This broadening of the role of tax highlights the importance of bringing tax professionals into the deal-making process at an

Credit: Reuters / Chris Wattie

Deal challenger: Canadian industry minister Tony Clement saw off a hostile acquisition bid from Australian miner BHP Billiton.

Tony Clement

Canada's industry minister blocked BHP Billiton's proposed US$39b acquisition of Canada's PotashCorp in November 2010, arguing that the deal failed to deliver a "net benefit" to the country. The deal would have been by far the largest deal of 2010, had it been approved.

early stage. Although companies may want to keep planning teams small at the outset of a deal to ensure an efficient use of resources, earlier involvement from the tax department can be hugely beneficial. It offers companies the best opportunity to address the tax costs and realize the tax savings that the transaction presents and to reflect both in the deal valuation.

The need to involve tax specialists early in the process becomes even more important in the context of cross-border transactions, and particularly when the target is headquartered in an emerging market. "In some cross-border deals, you are dealing with countries that have less developed tax systems or where there is a lack of binding tax regimes," says Alistair Craig of Ernst & Young's Transaction Tax Practice. "You really need to understand the effect of those factors because they can have a fundamental impact on the transaction."

Equally, companies or sovereign wealth funds from emerging markets face challenges when they buy assets in developed countries. Acquirers from the Gulf states, for example, where tax rates are either very low or zero, may not be as familiar with the concept of tax as a value-adder or value-destroyer within cross-border deals. With tax administrations around the world stepping up enforcement in order to increase tax revenues, the risk of controversy associated with cross-border deals is becoming increasingly severe. The Indian tax authorities, for example, have challenged a number of major corporate transactions in recent years. Companies planning transactions in India are watching these cases carefully because their outcome could have significant implications on further cross-border deals in the region. India is by no means alone. Australian miner BHP Billiton's blocked US$39b bid for PotashCorp of Canada in November 2010 is another example of governments placing deals under the microscope.

Adopting a rigorous approach

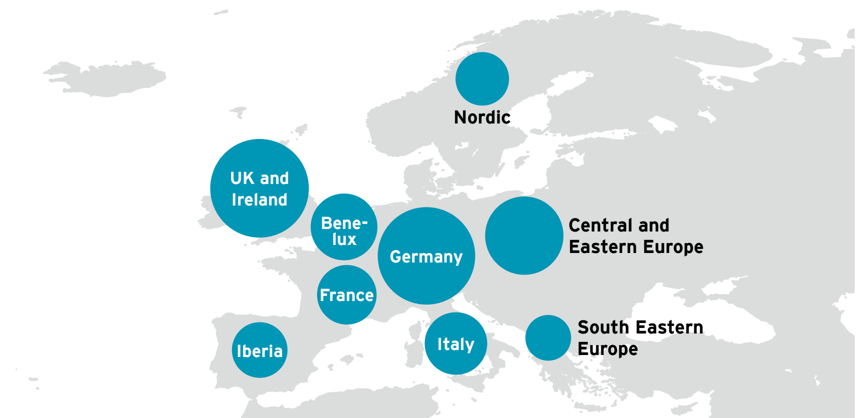
Given the risks that acquirers face when embarking on M&A deals, it is perhaps not surprising that realizing the full value expected from a transaction is so difficult. At a time of continuing economic uncertainty, it is undoubtedly challenging to make the right strategic decisions, value assets accurately and realize any expected synergies. But by adopting a rigorous approach to due diligence and ensuring that tax is factored into the valuation process from the outset, acquirers will give themselves a much better chance of being in the minority of companies for whom M&A deals are truly successful.

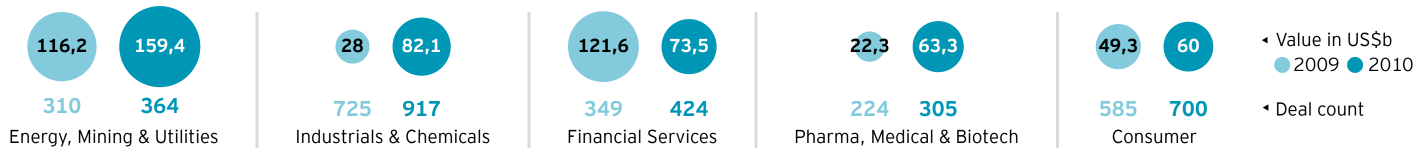
Credit: Golden Section Graphics GmbH

A changing global landscape for transactions

The world of M&A is changing. With the impact of the financial crisis still being felt, deal volumes and values are showing only tentative recovery.

__ Around the world, companies are once again turning their attention to growth. For some, this will mean a return of M&A activity as a way of securing market share or access to new markets. The precise mix of sectors and regions that will dominate M&A remains to be seen, but as the charts on this page show, history suggests that energy and natural resources, and financial services will be active, while the UK, US and China will be key players in their regions.

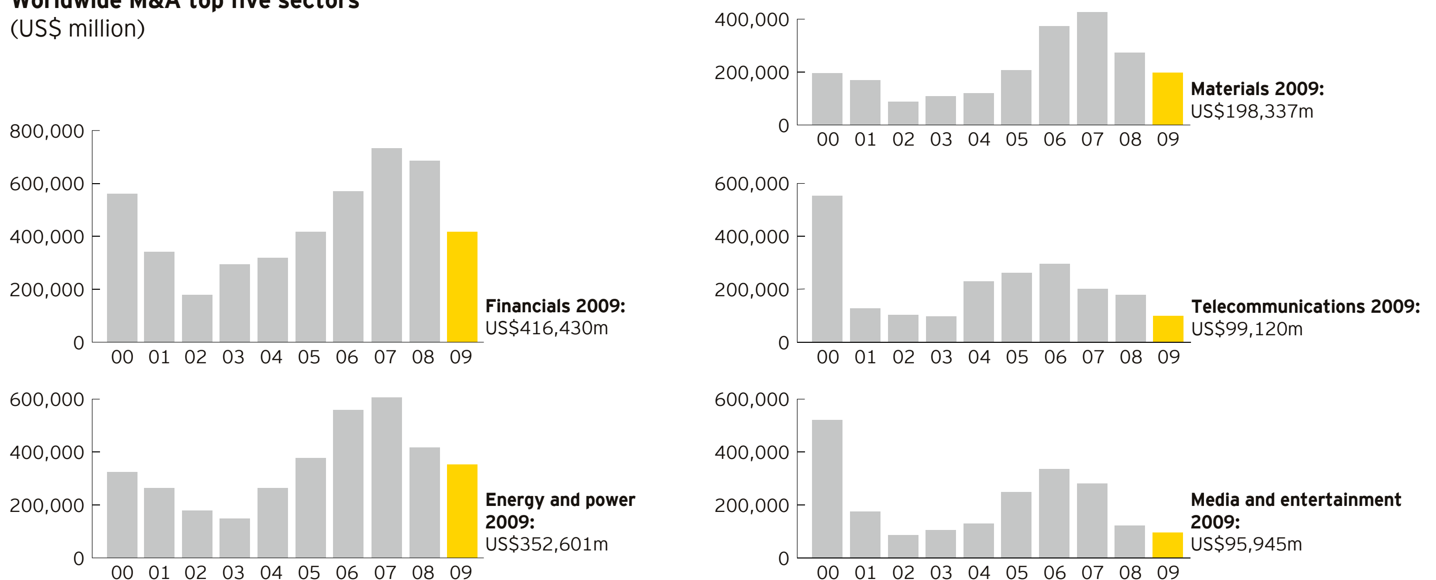




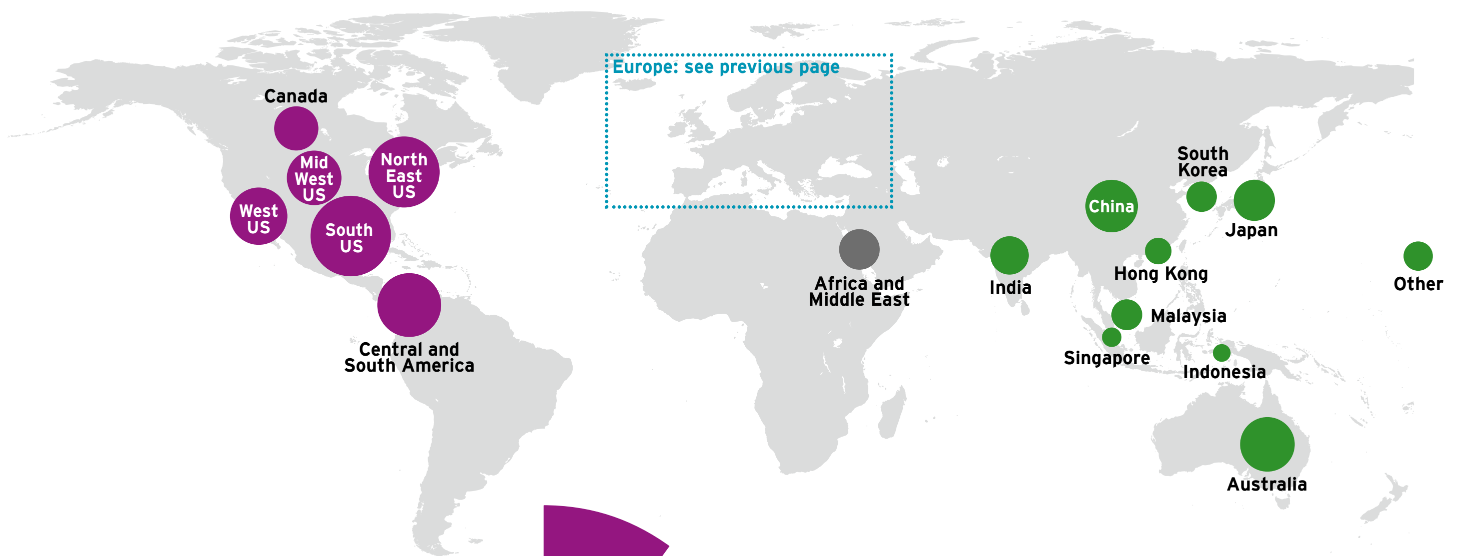
Top five sectors 2010, compared to 2009

Sector	Value 2009 (US$b)	Value 2010 (US$b)	Deal count 2009	Deal count 2010
Energy, Mining & Utilities	116,2	159,4	310	364
Industrials & Chemicals	28	82,1	725	917
Financial Services	121,6	73,5	349	424
Pharma, Medical & Biotech	22,3	63,3	224	305
Consumer	49,3	60	585	700

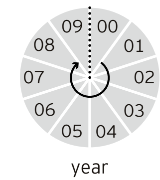
Value in US$b ● 2009 ● 2010
Deal count

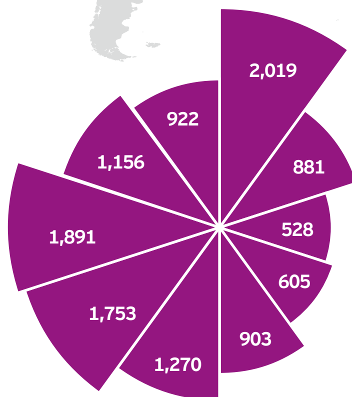


Sources: Thomson Reuters / mergermarket

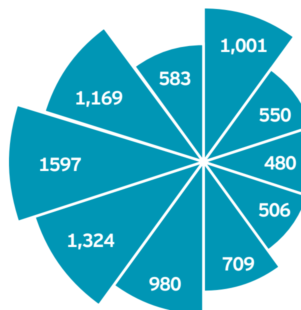


Value of announced deals, 2000–2009
in billion US$

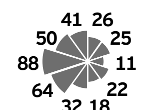




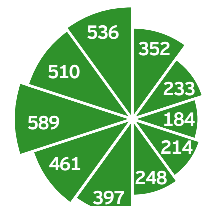
Americas



Europe

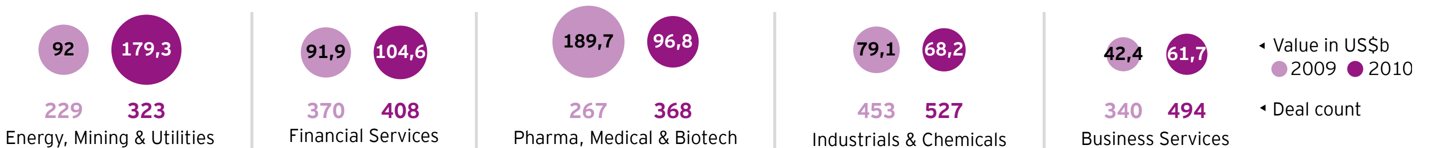


Africa, Middle East



Asia-Pacific

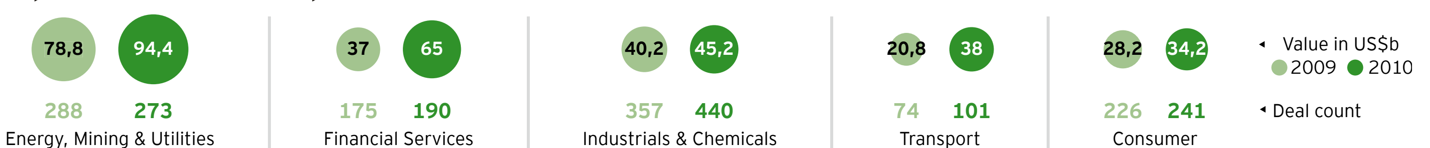
Americas: Mix of announced deals by geographic region 2010 – value and volume



Top five sectors 2010, compared to 2009

Sector	Value in US$b 2009	Value in US$b 2010	Deal count 2009	Deal count 2010
Energy, Mining & Utilities	92	179,3	229	323
Financial Services	91,9	104,6	370	408
Pharma, Medical & Biotech	189,7	96,8	267	368
Industrials & Chemicals	79,1	68,2	453	527
Business Services	42,4	61,7	340	494

Asia-Pacific: Mix of announced deals by geographic region 2010 – value and volume



Top five sectors 2010, compared to 2009

Sector	Value in US$b 2009	Value in US$b 2010	Deal count 2009	Deal count 2010
Energy, Mining & Utilities	78,8	94,4	288	273
Financial Services	37	65	175	190
Industrials & Chemicals	40,2	45,2	357	440
Transport	20,8	38	74	101
Consumer	28,2	34,2	226	241

Risk

and return with emerging market acquisitions

Rapid growth in emerging markets is encouraging more and more companies to acquire assets in these economies. But while the growth can be spectacular, the challenges are considerable.

89%

Mergers and acquisitions in India and China's mining and metals sectors grew by 89% in 2010, according to Ernst & Young's report Ungeared for growth.

By Ben Voyles

The emerging markets have been rising so relentlessly, it's easy to take the recurring miracle for granted. But as solid as the fundamentals may seem, there are no sure bets. Even if the emerging markets do prove unsinkable, business practices can be very different from what executives are used to in developed markets. Companies contemplating an acquisition should evaluate the target in a disciplined way, and probably even more carefully than they would with a mature market asset.

Any acquisition process essentially comprises three questions: What are you buying? What is it worth? And what are your options for buying it? As Aidan Stokes, Global Director of Ernst & Young's Transaction Tax Practice, who has spent over 10 years working in emerging markets during his career, explains: "The only things that are different in an emerging market are how one goes about answering those three questions – and the degree of certainty one can have about the answers."

What are you buying?

Companies need to be very clear about what they are buying – and whether there are potential liabilities as a result of historical practices. In many – though certainly not all – emerging markets, the frequency with which due diligence turns up "skeletons in the closet" from a tax perspective is far higher than in more mature markets.

Such issues turn up in many forms as a result of a number of techniques, but the effect is the same, in that the purchaser could be taking on significant undisclosed liabilities - and the penalties and interest may be worse than in most developed markets. In China, for example, the penalties alone could run to 500% of the tax. And the exposure need not be recent. The statute of limitations does not apply to "serious" tax violations in China, with "serious" defined

as errors in excess of 100,000 Renminbi – or around US$15,000.

The tax systems in many emerging markets are relatively new and the meaning of legislation is not always clear. Further, new statutes mean a limited body of case law and a significant proportion of individual tax officials are themselves on a learning curve.

What is it worth?

Valuation is the second important piece. Here too, the story may differ from an acquisition in a more mature market – with tax issues significantly changing the valuation model.

Stokes recalls one deal from his time in China, when a listed European multinational looked at acquiring a Chinese target group that had an effective tax rate of around 4%. As soon as the due diligence started, it became clear that the main operating business had been transferred to a newly incorporated company every two years, to take advantage of a two-year tax holiday that existed at the time for companies in that industry. As the European multinational had no intention of adopting such behavior, the earnings would be subject to Chinese tax of 20%-25%. This was more than was reflected in the valuation model and this alone was sufficient for the buyer to walk away.

In valuing an emerging market asset, one crucial tool is the pro forma profit and loss account. This seeks to model the profit and loss statement as if the new owner had run the business under a variety of (very important) assumptions.

In some cases, the profit and loss statement based on local accounting rules and the target's historical approach – particularly around taxes – can be significantly different from the pro forma profit and loss account. In addition to the ongoing implications for earnings, account must also be taken of any historic tax risks. Companies should also take into account withholding taxes applied to income flows coming out of the target – together with taxes arising in the hands of the purchaser. While all of this is equally true for an acquisition in a mature market, the frequency and scale of the issues buyers face are often much greater.

What are your options for buying it?

The options for financing in an emerging market tend to be far more limited than in a mature market – and not necessarily wholly as a result of the tax provisions themselves. Stokes says this is caused by a number of factors, including:

Lack of detail: in many emerging markets, tax legislation is extremely limited. Even when supplemented by guidance from the tax authorities, there are generally huge areas of uncertainty as to how issues will be handled.

Potential for change: even where one treatment applies, the potential for sudden change is high. Further, as tax authorities become more

175

The MARC M&A Maturity Index, which tracks the maturity of 175 countries in terms of their M&A maturity, found that Asia is emerging as the most favorable region for global M&A activity outside the traditional Western markets.

Conclusion

With their high-speed trains, high-rise office towers and fast-paced urban life, today's emerging markets are very different from the markets in which Western multinationals first began to invest 20 years ago. This is not just a veneer. Economic growth, the development of more robust institutions and advanced technology have transformed the lives of billions. However, this modernity is unevenly distributed. In many markets, tax and regulatory authorities are facing a challenge to catch up. Until they do, foreign buyers should proceed with caution.

sophisticated, the likelihood of significant (and regular) tax reform increases. Significant tax reforms took place in China in 2008, for example, and are expected in 2012 in India – with new provisions adopted from 2011 in Russia.

Lack of certainty as to application: in more mature markets, there is generally detailed guidance from the tax authorities as to how they will interpret contentious issues in the event of uncertainty, with a body of case law from the legal system providing further comfort. In emerging markets, this simply isn't the case – and this means cautious investors often take a conservative and proven approach.

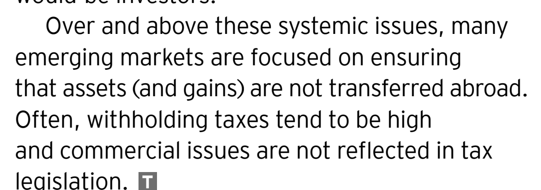
Slow or uncertain dispute resolution: if one has a dispute in a mature market, the issue may be appealed relatively quickly through the courts. The outcome of tax litigation in emerging markets tends to be more unpredictable – and can take far longer. For example, resolving a tax dispute in India by going through all levels of appeal currently may take anywhere between 15 to 20 years. In some emerging markets, too, a negative reaction of tax authorities to court proceedings is not always in the interests of the taxpayer.

Sophistication of the legal system: many things that would be assumed in a mature market in terms of achieving desired results may simply not be possible. For example, if the legal system does not provide for preference shares or a convertible instrument, the tax treatment that would apply is simply not relevant.

Exchange controls: finally, many emerging markets have stringent exchange controls, generally designed to prevent capital flight by residents. Whatever the intent, one practical corollary for foreign direct investors is that there are significant burdens on investors to determine the circumstances under which capital may be withdrawn.

If the relevant approvals are not obtained at the time of the investment, it may never be possible to extract the funds again. Further, additional income flows to a new foreign owner may not always be possible, given the need to convert local currency to make settlement, creating yet another planning challenge for would-be investors.

Over and above these systemic issues, many emerging markets are focused on ensuring that assets (and gains) are not transferred abroad. Often, withholding taxes tend to be high and commercial issues are not reflected in tax legislation.



Credit: Rob Huibers / LUZphoto

View from the hotseat

Royal Philips Electronics has been on the acquisition trail for years. James Nolan, its head of M&A, explains some of the megatrends that drive its deal-making decisions. *Interview by Gerri Chanel*

40

Philips, headquartered in the Netherlands and employing 119,000 people in more than 60 countries worldwide, has completed 40 acquisitions in the past four years.

T Magazine: How has M&A at Philips changed since you first arrived at the company?
James Nolan: I've been working in the M&A department here for 11 years and have been head of M&A for six years. During that time, we have refocused the company by divesting many businesses – for example, semiconductors – and reinvested those funds in growing our remaining businesses: lighting, hospital and home healthcare, and consumer lifestyle.

When I joined the M&A function, it was very centralized and quite Euro-centric. Now, we've really globalized. We are more globally decentralized and represented by multiple nationalities. And our acquisitions are more global as well, resulting in a significant number of acquisitions in emerging markets.

Why are emerging markets a focus for Philips?
Because emerging markets are the growth markets and tend to have favorable demographics. If you look at the demographics in Western Europe, they are quite challenging, with strict immigration policies and very low birth rates.

There can also be reasons to invest in emerging markets where the fertility rate is low. In China, for example, expenditure on children is increasing despite the one-child policy. Every child has two parents, both working, and then two sets of grandparents, so this is the only grandchild as well as the only child. In the affluent Chinese market segment, people will spend much more on these children, so this has been a good business for our AVENT brand of baby feeding bottles.

You mention demographics as one megatrend driving M&A. What are some of the others?
We see a second wave of globalization underway. Countries like Mexico, Turkey, Thailand and Indonesia are major centers of population that people aren't yet focusing on. Urbanization is another megatrend. For example, we just bought a company in India, called Preethi, which makes compact domestic appliances to serve an urban population. We look at M&A that serves an aging population, such as our 2007 acquisition of Lifeline, the world's largest provider of personal emergency response services. We've also done deals to expand our portfolio of solutions for health problems such as sleep apnea, which, along with obesity, is becoming a real issue.

What are some of the challenges of M&A in emerging markets?
Although it might sound banal, one of the biggest challenges is finding true value. We have seen an explosion of optimism in emerging markets but it is not always easy to invest there. In China, for example, owners of companies that are doing well do not want to sell – and they certainly don't want to sell to Western companies. They want to do IPOs where they will continue to run the companies they have built. And they command fantastic premiums over and above what we could possibly pay and still make money from. There is so much first-generation optimism in a market that only sees growth year on year. That's reflected in the valuations.

What else plays a role in M&A besides value?
One factor, among many, is that M&A is a long-term game. We don't just identify a company and then turn up at the door. Often, we will get to know companies over years and build a long-term relationship with them. People want to deal with a company that is known for its integrity and with senior officers who exemplify that.

Another key issue is investor relations. When paying a premium, it is important to explain to shareholders why we're paying that, how we're going to earn it back, and then how we're going to make money from the acquisition. You always have to maintain the trust of your shareholders.

How should acquirers justify paying a premium?
To some extent you always need to pay more than the stand-alone value of a company. This is what the premium is. If you just offer a company what it's worth without any premium, the owners will simply say, "Why should I sell it to you?" unless they need liquidity. The key challenge with M&A is how you recoup the premium. It's like entering a 400-meter race and you're standing 120 meters behind the rest of the field. You have to make up that 120 meters to catch up, then overtake the rest of the field. And if you don't do both, the deal is not successful.

As Executive Vice President and Head of M&A at Philips, Nolan leads a multinational M&A team consisting of 21 people, comprising nine nationalities across five countries. "We've really globalized," he explains. "We are more globally decentralized and represented by multiple nationalities."

"The key challenge with M&A is how you recoup the premium," says James Nolan.

Credit: Getty / Justin Guariglia

Unloading ahead

In the next few years corporate carve-outs and spin-offs will become more commonplace – but also more complex.

Hong Kong's port is one of the world's busiest, handling over 200,000 vessels each year.

Hutchison Whampoa
One of the world's biggest port operators, the Hong Kong conglomerate has carved out its ports business through an IPO on the Singapore Stock Exchange.

▸ **By Paul Kielstra**

Mergers and acquisitions may have been in short supply over the past few years, but carve-out activity has remained brisk. Although carve-outs fell out of favor in the run-up to the financial crisis, they have become increasingly popular in the past 18 months.

Examples of firms that have hived off assets via carve-outs include the 2010 sale by Royal Bank of Scotland of its payment processing division WorldPay, and the sale by Marsh & McLennan in the same year of its corporate investigations unit Kroll. This activity has continued into 2011. Already, corporate deal-making has been dominated by carve-outs, including Cargill's US$24b spin-off of a majority stake in Mosaic and ArcelorMittal's demerger of its stainless steel division, Aperam.

In the next few years, it is likely that carve-outs will become more commonplace. A challenging economic environment is encouraging many companies to focus on their

Cargill's US$24b spin-off of a majority stake in Mosaic is one of the headline deals of 2011

core competencies, which means that peripheral or non-performing assets will no longer be seen as part of the strategic vision. Regulation can also be a factor. In the financial services industry, some banks have come under pressure to sell off assets to pay down government debt. And at a time when access to credit remains constrained, carve-outs offer the opportunity to free up capital that can be more effectively applied elsewhere. "Ongoing mega-trends will further accelerate carve-out activity," says Max Habeck,

Summary
Companies are increasingly exploring carve-outs, or spin-offs, as a means of demonstrating the value of an entity in their business. But such deals, which are often complex, raise numerous challenges for those involved in planning them.

53%
The proportion of companies that involve their tax functions at an early stage of exit planning, according to Ernst & Young's Global tax trends report.

EMEIA Operational Transaction Services Leader at Ernst & Young. "Major industrial groups are currently "cleaning up" their asset base, demonstrating that they have understood investors' revised expectations. This will provide ample opportunity for buyers with a clear strategic roadmap."

Carve-outs, sometimes called spin-offs, involve a parent company selling some or all of an existing business. One route to achieving a carve-out has historically been via an initial public offering (IPO). By showing that the subsidiary can stand on its own two feet, while still retaining control of it, the parent company can demonstrate the value of the entity to potential buyers ahead of an eventual sale. The IPO can also raise capital that can be reapplied to fund other strategic objectives.

One of the most striking recent examples of a carve-out is the sale by Hong Kong conglomerate Hutchison Whampoa (HWL) of its ports business. In addition to being one of the world's largest port businesses, HWL holds substantial investments in property, retail, telecommunications, energy and infrastructure. Together, these assets yielded revenues of nearly US$40b in 2009.

The company has raised approximately US$6b by carving out its ports business and listing it on the Singapore Stock Exchange. The resultant holding company is a business trust named Hutchison Port Holdings Trust (HPHT). By selling about 75% of the units of HPHT, HWL will yield substantial funds that will help to pay down its debt. The IPO, which took place at the beginning of 2011, was one of the biggest in Singapore's history.

The exercise illustrates well how carve-outs are used to generate capital without severing assets completely from the parent company. Hutchison currently controls 308 berths at 51 ports in 25 countries. For the carve-out, it needed to begin by severing off its south China holdings, which are the oldest assets of the group and currently the most profitable ports. As part of the arrangement, there will be a

A challenging economic environment is encouraging firms to focus on their core competencies

non-compete clause with the rest of HWL's global port companies. In addition to holding about a quarter of HPHT units, the group will maintain influence by placing another subsidiary, Hutchison Port Holdings Management – in which it indirectly holds 80% of shares – as the new entity's trustee and manager of its assets.

Tax considerations shape carve-outs in many different ways. In the HWL carve-out, one major decision clearly influenced by tax considerations is listing as a business trust. Among the benefits of such a structure, dividends to unit holders do not attract tax. In fact, one consideration impacting the decision to list in Singapore, rather than HWL's home market in Hong Kong, could be that the latter does not have provision for listing business trusts – a situation which regulators are now examining. In most jurisdictions, if the parent company sells its shares of the carved-out entity directly, then it is liable to pay capital gains tax. The carve-out, however, can raise new money by issuing its own shares in an IPO, which has the effect of bringing cash into the carve-out but dilutes the ownership of the parent company.

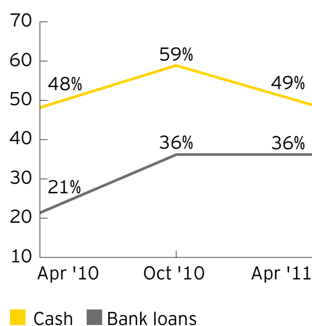
In some jurisdictions, a parent company can receive dividends from the subsidiary tax-free if it owns a significant proportion of shares in that subsidiary (often 80%). At a later date, the parent company can either spin off the shares to its own shareholders (usually tax free), sell them on the open market (which is liable to capital gains tax but still likely to be an after tax profit), or continue to have a majority stake in and tax-free dividends from the company.

The complexity of tax issues associated with a carve-out means that the tax function should be part of the discussion from the outset. Yet according to a survey conducted for Ernst & Young's Global tax trends report, only 53% of tax directors questioned say that their company involves the tax function at an early stage of exit planning. "It's critical to involve the tax director from the beginning to ensure that tax considerations are reflected in the transaction structure," says Roger Coates, Tax Director at Thomas Cook. "Bringing tax people in at the end of the process is a recipe for disaster – by that late stage you can already have unwittingly picked up sizeable and unnecessary liabilities." Earlier planning gives companies more options. "Those companies which are most successful consider tax well in advance of an exit – if left until a transaction is imminent or already under way, tax issues cannot always be addressed as effectively," says Matthew Peppitt of Ernst & Young's Transaction Tax Practice.

Early involvement by the tax function is important, but it can also be dangerous if its role tails off once the initial planning has taken place. "You do see tax brought in at the beginning to advise on structuring the transaction and then having no further involvement," says Coates. "That is risky because things can change and discussions can lead down other paths. It's critical that tax specialists are kept involved throughout the process. Sometimes there is no simple solution."

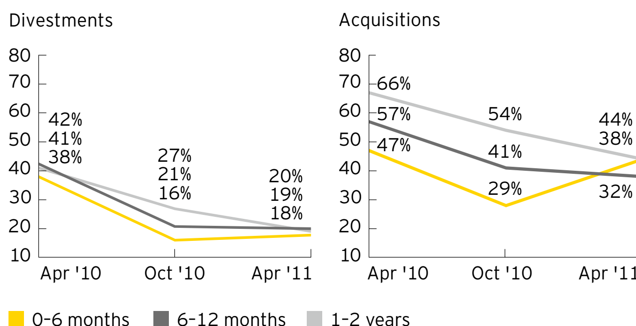
Adding to the complexity is the need to engage in tax planning that focuses not just on the requirements of the parent company in isolation, but also seeks to achieve value out of a carve-out transaction by accommodating the buyer. This may require simultaneous consideration of the tax situation of the seller, of the carved-out business when it is a separate entity, and of the – perhaps still unknown – buyer.

What will be your main source of deal financing in the next 12 months?



Source: Ernst & Young Capital Confidence Barometer

How likely is your company to execute divestments/acquisitions in the following time periods?



Source: Ernst & Young Capital Confidence Barometer

"These interests may compete," explains Peppitt. "A successful carve-out is all about finding what is going to be mutually agreeable."

This does not always have to be the most tax-efficient route for the seller. If, for example, a certain approach adds to the value of the asset for the buyer, and the parent company could accordingly charge a price premium in excess of its higher tax liability, it might be worth taking steps that would permit such an arrangement.

> **"Those companies that are most successful consider tax well in advance of an exit."**

Such complexity does not allow a one-size-fits-all approach, or even a comprehensive tax-planning checklist for carve-outs. Each case will have its own unique features. Nevertheless, certain themes common to these transactions make consideration of this multi-dimensional puzzle a bit easier. Typically, the seller will want to minimize tax liabilities, in addition to securing the best possible price. Besides looking to keep the price down, the buyer will wish to obtain tax reliefs for the purchase either immediately or over time. The buyer will also want to avoid tax risks related to earlier activity, such as deferred gains, from being triggered.

With these themes in mind, those preparing for a carve-out would do well to consider the following points as early as possible:

– ***Plan ownership from the start.*** A company carving out a new entity would normally have several options about how to structure its controlling interest. It could, for example, take on direct ownership of shares in the carve-out or maintain effective ownership through a holding company. Whatever the solution chosen, tax is an important factor in the decision.

– ***Financial statements for the carve-out*** need to do more than simply assign a percentage of the parent company's tax liabilities to the carve-out for any given year. Prospective buyers of a carve-out will want some type of financial statement to understand what is on offer. These statements, however, are equal parts art and science, because they must reflect performance that would have occurred had the carve-out been independent rather than what happened while it was part of the parent company. Preparation of these requires more than assigning a percentage of the parent company tax in a given year to the carve-out. Instead, the statement needs to show what taxes the new entity's activities would have attracted given its foreseen structure and tax jurisdictions, as well as any relevant reliefs.

– ***Consider the appropriate distribution*** of deferred assets and liabilities, as well as tax attributes. Among the most difficult problems in creating a carve-out is the distribution of deferred assets and liabilities between the parent company and the new entity. The split of assets and liabilities will be shaped by the business requirements of each entity, but the tax impact will also need to be considered. Similarly with tax attributes, losses carried forward might not be transferrable to a new entity in some jurisdictions or usable by the parent company in others. Moreover, a buyer may even have built up losses that will eliminate any tax liability from deferred income.

– ***Reduce the tax uncertainty for the buyer.*** Anything that decreases or eliminates risks associated with the carved-out enterprise will increase its value to a buyer, and therefore improve the price. Prior to any potential sale, sellers should make sure that they address any outstanding disputes with the tax authorities. This is especially important in international transactions, but it is also useful to get pre-transaction clearances from tax authorities for domestic ones where possible.

It seems clear that carve-outs are set to become a significant feature of the M&A landscape. Carve-outs almost invariably involve complex decisions, where tax is one of many issues. Early planning, however, is essential for companies to realize the full value of the asset they are selling. T

When does tax get involved in the deal?

45%
Soon after the deal is identified, as part of preliminary reviews by corporate development teams

37%
Once a decision has been made to perform initial due dilligence on a deal

18%
Only after initial due dilligence has been undertaken by other functions

Source: Ernst & Young Global tax trends

A healthy pipeline for M&A deals?

After several years of depressed M&A activity, deal confidence is returning, says **Giuseppe Monarchi** of Credit Suisse. *Interview by James Watson*

22.9%

Increase in value of total global M&A activity in 2010 over 2009, according to Thomson Reuters.

T Magazine: After several years of reduced deal volumes, how do you see the outlook for M&A in Europe over the next 12 months?
Giuseppe Monarchi: There are signs that the market is continuing to strengthen. I don't think we've seen massive shifts, but certainly during the last year confidence has started to build. It seems to me that we're off to a much stronger start this year, but I think it's too early to call a big revival in M&A yet. Certainly volumes are up on last year, but I don't think we'll end up anywhere close to the previous peaks.

Which factors are likely to increase the level of M&A activity?
There are a number of factors, but a lot of this has to do with the strengthening of the equity markets. Historically, there is a high degree of correlation between M&A and equity markets. There are also a number of economies pulling out of recession although, of course, situations may be quite different from country to country.

What are the downside risks that could hamper M&A activity?
In equity markets, the correlation I mentioned can work either way. To the extent that equity markets are weak, or volatile, that hampers M&A. And clearly geopolitical factors, such as what's happening in North Africa or Japan, can affect the mood. The extent to which these downside risks can prevent deals from taking place varies depending on the deal. In the case of strategic M&A, where there is a compelling strategic rationale, you can take a longer-term view. Significant market disruptions may hold such deals back, but generally they will continue. For opportunistic M&A, you need a shorter-term payback period, and if the short-term outlook is cloudy, then you become more cautious.

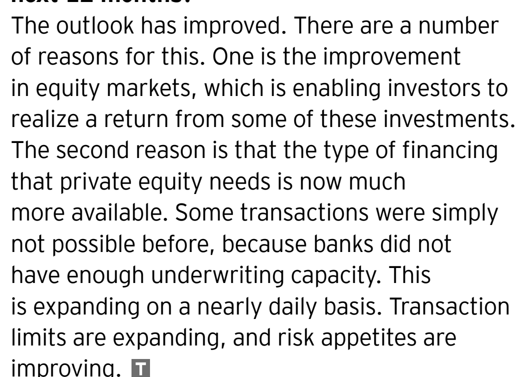
Which sectors and geographies do you think are likely to be most active in terms of future M&A activity and why?
In terms of sectors, natural resources have been very active, and will continue to be so. And often there is a geographic angle linked to those deals, which points towards emerging markets. Those are the two main themes we see. There are other themes of course, such as what will happen with financial institutions. We think there's a compelling rationale for consolidation in banks, with a number of transactions waiting to happen. Will that happen this year? Well, it's due to come back, but it may take a little longer.

In terms of cross-border M&A, which regions are likely to be the biggest recipients of M&A investment and why?
Emerging markets for sure. These economies have been growing steadily for a number of years. It's no longer just about developed market companies investing in emerging markets, which used to be the case. Increasingly, we see a lot of players from emerging markets investing in both developed and other emerging markets. The most attractive destinations are the biggest and most obvious, such as Brazil in Latin America, and India and China in Asia. I think that will probably continue to be the case. The development of African markets is clearly well behind, but this will be another place companies will look for growth in the longer term.

What trends are you seeing in deal financing?
High-grade corporates have had access to finance for quite a while. In the course of last year, financing market conditions went from strength to strength. What's shifted over the past six to nine months is the strength of the leveraged finance market. Leverage was available before, but it is now much more available in both absolute and relative terms. In contrast, I don't think you see as many stock deals, because these are more complicated and people often feel their stock is undervalued.

What change has there been in the extent to which shareholders are scrutinizing potential deals?
This is something we've seen for some time. In general, shareholders have become more vocal

Credit: Credit Suisse



Giuseppe Monarchi
Head of EMEA M&A Group

Giuseppe Monarchi is Managing Director at Credit Suisse's Investment Banking division, and Head of the company's Mergers & Acquisitions Group for Europe, Middle East and Africa. He has conducted a wide range of deals for the bank, including Lottomatica's acquisition of GTECH, the sale of Golden Telecom to Vimpelcom, the Greek Government's sale of OTE to Deutsche Telekom and Telefonica's acquisition of Vivo from Portugal Telecom.

– on both sides of a deal. Investors in the acquirer are keen to ensure that the deal will create value and that it is being conducted within very specific guidelines. And on the other side of the transaction, investors in the target company want to make sure that the deal achieves an appropriate value. They're not necessarily following what the board may recommend.

What issues should companies examine when they are considering the acquisition of emerging market assets?
One key issue concerns access to information and the quality of that information. Accounting standards may be different. Traditional approaches to valuation can be tricky. For example, just calculating the cost of capital can be very difficult in some markets. There is also the local regulatory environment to consider, which may include changes in tax law. In general, these markets are much more dynamic. This is not always a good thing, as it can bring unforeseen change, such as political unrest.

What is the outlook for private equity over the next 12 months?
The outlook has improved. There are a number of reasons for this. One is the improvement in equity markets, which is enabling investors to realize a return from some of these investments. The second reason is that the type of financing that private equity needs is now much more available. Some transactions were simply not possible before, because banks did not have enough underwriting capacity. This is expanding on a nearly daily basis. Transaction limits are expanding, and risk appetites are improving. T

Credit: Getty / ChinaFotoPress

Beating the gong: the chairman of PetroChina started an IPO ceremony at the Shanghai Stock Exchange in 2007.

Source: Thomson Reuters

China	2000	2003	2007	2010
Inbound value (US$m)	44,403.6	21,844.2	36,799.3	55,304.4
Outbound value (US$m)	5,509.0	18,286.4	42,098.1	68,322.4
Inbound number	288	875	1,375	1,033
Outbound number	142	642	1,022	880

A shift in the balance of power

Over the past decade, emerging market companies have become increasingly important players in the M&A landscape.

▸ **By James Watson**

__ The year 2010 marked a watershed of the development in global M&A activity. For the first time, deal volumes were more or less equally divided between North America, Western Europe and the emerging markets. Up until then, developed markets had always dominated M&A league tables, so the shift is hugely significant.

Over the past decade, emerging markets have grabbed an increasing share of M&A activity. As shown on the next few pages, the volumes of inbound and outbound M&A deals involving emerging markets have grown rapidly – often outpacing the growth in developed markets.

Cross-border M&A activity involving emerging markets is flowing in many directions. Multinationals from the developed world are looking east, keen to capture the benefits from rising consumption and economic prosperity against a backdrop of sluggish growth in their own markets. Meanwhile, emerging market multinationals are snapping up assets in the developed world, while also buying in other emerging markets.

A common driver of this deal activity – although by no means the only one – is a desire to gain access to natural resources. China and India, in particular, have been pushing to secure deals that will help to provide long-term energy and resource security. Ever-increasing commodity prices, a strong cash position and concerns about the scarcity of energy and natural resources are fueling deals even further.

A number of Chinese companies have acquired assets in resource-rich countries. In 2009, for example, Yanzhou Coal acquired Australia's Felix Resources for US$2.8b while,in the same year, Sinopec acquired the Swiss-registered oil and gas company Addax for US$7.2b.

But resource security is just one piece of the puzzle. Emerging market acquirers are increasingly keen to gain access to technology and to gain a foothold in rapidly expanding infrastructure networks. In 2010, for example, the Indian telecoms company Bharti Airtel acquired the African assets of Zain, a Kuwaiti group, in an all-cash deal worth US$10.7b. The deal gives Bharti access to a fast-growing market and increases its user base to 179m. The company's experience of running low-cost operations in countries where customers are on low incomes offers a foundation to support growth over the coming years.

Sometimes, outbound M&A from emerging markets has the goal of gaining access to valuable technology and intellectual property. When the Chinese car company Geely announced its US$1.8b acquisition of Volvo from US car giant Ford in 2010, it explained that one of the objectives of the deal was to integrate Volvo's design and technology expertise into three new manufacturing facilities in China. These would then be used to serve the fast-growing local market.

Emerging market acquirers are also keen to gain a foothold in developed markets. Even though their own markets are growing much more quickly, developed markets still hold many of the world's most prized assets. In December 2010 for example, the Indian company Sahara Pariwar acquired London's Grosvenor House Hotel for £470m.

Although relatively small, the Sahara acquisition highlights an important trend. Competition for the deal did not consist of Western hotel companies, but sovereign wealth funds from Qatar, Singapore and China. The balance in the M&A landscape is shifting, and it is emerging market acquirers who are becoming key players. T

3,000

According to Thomson Reuters, the most targeted emerging market nation in 2010 was China, with 3,000 deals worth a combined US$131.1b.

Credit: Getty / Bloomberg / F. Carter Smith

Largest global brewer: Anheuser-Busch InBev NV, grown from mergers of legacy brewing companies.

United States	2000	2003	2007	2010
Inbound value (US$m)	1,711,665.2	458,414.6	1,644,915.6	659,950.2
Outbound value (US$m)	1,548,797.8	483,373.6	1,612,842.6	688,746.3
Inbound number	9,997	6,999	10,437	6,753
Outbound number	10,558	7,295	10,916	7,103

Credit: Getty / Bloomberg

Connecting markets: Indian telecom company Bharti Airtel acquired African operations from Kuwait-based Zain Group.

India

	2000	2003	2007	2010
Inbound value (US$m)	4,866.6	3,291.3	33,038.1	20,541.4
Outbound value (US$m)	3,309.0	4,148.3	19,087.7	32,103.4
Inbound number	521	386	838	688
Outbound number	395	320	731	615

Credit: Keystone / Vladimir Smirnov

Treasures of the soil: The M&A market in the oil and gas sector sets the pace for other industries in Russia.

Russia

	2000	2003	2007	2010
Inbound value (US$m)	2,583.7	30,219.9	86,966.4	22,817.4
Outbound value (US$m)	1,763.3	30,675.7	82,349.3	29,892.9
Inbound number	310	341	594	3,105
Outbound number	248	330	500	2,775

Sweet taste: Kraft Foods acquired British confectioner Cadbury in 2010.

European Union

	2000	2003	2007	2010
Inbound value (US$m)	1,277,852.6	480,681.6	1,415,975.1	475,162.3
Outbound value (US$m)	1,526,893.4	466,071.9	1,468,107.7	425,793.2
Inbound number	14,021	8,817	14,272	12,774
Outbound number	14,163	8,433	14,104	12,455

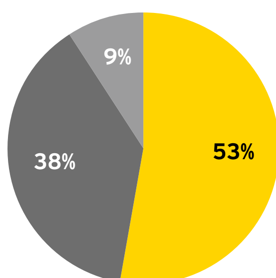
Credit: Ed Thompson / LUZphoto

Summary
M&A deals involve a great deal of complexity from a tax perspective, including pre-deal structuring to an assessment of liabilities. The involvement of the tax director is crucial for identifying efficiencies.

Driving value from transactions

Company tax directors can play a major role in driving value from M&A transactions, but only if they are included in the transaction early enough.

Tax function involvement in exit planning



- From an early stage
- When divestment plans are in progress and due diligence parameters are being set
- When divestment terms are close to agreement and when formal due diligence is requested by the buyer

Source: Ernst & Young Global tax trends

▸ **By Gerri Chanel**

While taxes, by their very nature, play a major role in the economics of an M&A transaction, the impact of tax considerations on the overall value of a deal has not always been fully recognized. Today, though, many companies are more focused than ever on driving the maximum value possible from potential deals. This means that they are taking a much broader view of the role of tax in transactions, and recognizing the significant role that the tax director can play in helping to drive value from deals.

Both tax directors and a company's corporate development team should be acutely aware of the impact of a transaction on their group's effective tax rate. But there is a plethora of tax issues, planning opportunities and risk considerations that can significantly enhance or limit transaction value – and tax directors bring these considerations to the table. One of the primary roles of the tax director is to identify opportunities to structure transactions that optimize the tax outcome – whether identifying tax synergies with the existing business (or issues that might undermine this), preserving tax assets such as losses in the acquired company, or minimizing transfer taxes.

Pre-deal planning also involves tax due diligence. In part, this involves identifying and mitigating risk arising from historic tax issues. But equally, says Janine Juggins, Global Head of Tax at Rio Tinto plc, it means focusing on sources of future value. "Tax due diligence needs to consider how the business will look in the future," she says. "Depending on the plans for the business post-acquisition, does it have a tax-efficient capital structure, are there any supply-chain planning opportunities, and what is the business going to look like in your corporate structure?"

Janine Juggins

Global Head of Tax, Rio Tinto

__ By assessing the tax details and implications of Rio Tinto's many M&A deals, Juggins is one of the key individuals behind the scenes of the mining giant's acquisition trail, making sure that such transactions are a success. "For a company like Rio Tinto that is generally making acquisitions with a long-term investment horizon, any tax planning that we do needs to be sustainable."

See interview on page 35.

Credit: Keystone / EPA / Wei Leung

Rio Tinto's diversified mining and resource operations have been built up through numerous M&A deals.

Rio Tinto

is a leading international business involved in each stage of metal and mineral production. The Group combines Rio Tinto plc, which is listed on the London Stock Exchange, and Rio Tinto Limited, which is listed on the Australian Securities Exchange. Rio Tinto produces aluminum, copper, diamonds, coal, iron ore, uranium, gold and industrial minerals. With production mainly in Australia and North America, Rio Tinto operates in more than 40 countries and employs about 75,000 people.

Assessing the implications

The tax director can add value to a deal by identifying and planning for:

- Availability of tax relief for financing costs in structuring a deal
- Tax-efficient or structured financing
- Pre- and post-transaction business combinations
- Indirect tax planning
- Tax-efficient supply-chain planning
- Intangible asset planning
- Employment tax and pension tax planning
- Ensuring post-deal execution and maintenance of pre-deal tax planning strategies
- Identifying tax risks in the target and strategies for mitigating those risks
- Addressing tax accounting issues to avoid post-deal profit impact for pre-deal tax liabilities
- Opportunities and risks in a wide range of other areas, depending on the company and the deal

The need for early involvement by tax in M&A transactions is fundamental but often not recognized. "Early involvement of a tax director in any transaction is critical to assess whether there are likely to be issues that could kill the transaction stone dead as well as preventing an unacceptable outcome further down the track," says Vinay Tanna, Joint Global Head of Tax at Diageo plc, which owns famous brands like Johnnie Walker and Guinness.

Alistair Craig, a Director in Ernst & Young's Transaction Tax Practice in London, points out that corporate development teams will sometimes bring tax on board at the last minute, when the deal is already structured. "This is too late," he says. "It is essential to involve the tax director early in the process so that the tax opportunities and costs are factored into the structure pricing and terms. Not getting this right can sometimes make the difference between the transaction happening or not."

Early involvement can also influence the transaction cost, timing and management's price expectations. For example, modeling is a process that can result in many iterations before getting to a refined view of the tax rate. If the tax input is not included in the first few passes, it can cause delays and unnecessary costs in the acquirer's post-deal income statements. In addition, if such costs are not factored in to early iterations of the model, management can have unrealistic price expectations, which are hard to adjust later in the process.

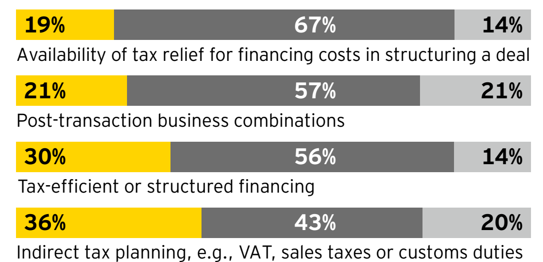
It's not just about price

In some situations, the tax director can play a role in the timing of a deal. In certain situations, it may be essential to set some conditions precedent with the seller that could impact the deal timetable. These may arise where tax rulings or clearances must be obtained as part of the transaction structuring – and before the deal can be closed. "You may be required to ask the providers of debt to make certain certifications in structuring a transaction to meet certain tax criteria," says Juggins. "This may require considerable explanation to the commercial team."

Cross-border complexities

Cross-border deals require particular attention. The tax director has a vital role to play in assessing whether tax risks exceed the board's risk tolerance – and in some cases, whether the deal happens at all. "It is vital to have a proper appreciation of each fiscal regime and how it could impact your business before planning transactions in that territory," says Tanna.

Areas considered for deal planning



- Is a primary component of transaction value
- Is an important part of the overall mix of fiscal factors
- Is not a significant factor

Source: Ernst & Young Global tax trends

The tax director often takes the lead in driving the tax accounting process. If items such as goodwill (or negative goodwill), pre-existing tax liabilities or other deferred tax issues are not accounted for properly at the time of the deal, there can be a post-deal hit to earnings and other unanticipated consequences.

Properly identifying pre-existing tax liabilities in the opening balance sheet of an acquisition is critical. If this does not happen, says Tanna, they will be treated as liabilities that have arisen afterwards and will impact earnings, particularly if indemnification or warranties from the seller are not adequate.

Synergy in post-merger integration

Companies must ensure that they structure deals that make sense from both a tax and overall business perspective. Tax directors can play a role here by unlocking synergies and by identifying where value generators and drivers lie together with the people who are key to their realization. Another area of synergy comes from unlocking trapped tax attributes of the acquired business, such as losses or benefits. "The value chain and future synergies are fundamentally at the heart of any acquisition because if you don't understand how the synergies are going to arise you're not going to understand the business case associated with the transaction," says Tanna.

Tax directors should also play a role in educating constituents that tax considerations alone should not make a deal pass the investment hurdle. "An anticipated tax holiday may disappear if there's a change in government or policy," says Juggins. The optimal tax outcome of a deal depends on an early and solid partnership between the tax director and the corporate development team. "This requires an established relationship and a dialog that fosters an understanding by the corporate development team of how tax can add value to deals," says Stephen Hales of the EMEIA Transaction Tax Practice at Ernst & Young. "These attributes need to be in place before a specific deal arises."

There must be a free flow of information between tax directors and the corporate development team to ensure success. "I don't think anything actually replaces the value of working at relationships and making sure the tax director has good lines of communication with the corporate development team," says Juggins. "While a company can put formal processes in place to require the involvement of tax, it's very important for the tax team to know the corporate development people. You need the kind of relationship where the development team will seek out the tax people at the outset."

When this is achieved, tax is an area that can add major value: "The opportunities for tax directors are as broad as their imagination allows them to be," says Tanna. T

Interview with Rio Tinto Global Head of Tax, Janine Juggins:

"Any tax planning we do needs to be sustainable."

Rio Tinto, a leading global mining group that works in some of the world's most difficult terrains and climates, began life in 1873 as a venture to extract copper at an ancient mine in southern Spain. Here, Rio Tinto Global Head of Tax Janine Juggins talks to T Magazine about the role of the tax director in mergers and acquisitions.

T Magazine: How would you describe the ways a tax director adds value in the M&A arena?

Janine Juggins: The tax director identifies tax efficiencies in the transaction structure and manages tax risk. He or she also contributes to the successful integration of the asset and manages some of the legacy issues that result from the transaction. Tax directors play a unique role. They need to both interpret tax law and understand financial impact, but the most valuable thing they bring is the need to apply their problem-solving skills in a very commercial way.
The best tax planning strategies are always in tune with the underlying commercial drivers of the transaction. And, above all, tax professionals need to exercise significant professional judgement in a way that's consistent with the tax risk parameters set by the board.

How important is it for tax directors to get involved early on in the planning of a transaction?

To add significant value, every tax director will tell you the earlier the better. The earlier you identify either opportunities or pitfalls, the better prepared you are during the negotiation process. This can also help the company be more efficient. For example, if you find something that's so material that it can't be resolved, cutting off the transaction as early as possible in the process saves a lot of money and time.

The degree of involvement obviously changes as the transaction progresses. What works really well is to make sure that, at the very start of a transaction, the tax director is told what's going on in outline and what the key underlying drivers are. If you're not involved right at the start, there's a risk that things can get agreed before anyone on the deal team appreciates that there are tax consequences.

Does Rio Tinto do anything to enhance how the tax and business development teams work together?

The business development teams at Rio Tinto now go through an induction process and tax is one of the functions that plays a part in that program. So we will have the opportunity to meet new business development people and explain to them what we do. Another practice is that the business development team organizes regular update meetings to which the tax partners are invited.

What are some other elements of your approach to tax in M&A deals?

For a company like Rio Tinto that is generally making acquisitions with a long-term investment horizon, any tax planning that we do needs to be sustainable. This means ensuring that it is in step with the way that we manage our business as a long-term investment.

At the start of our investment process, we review how we expect the incremental cash that's generated by our project to be distributed among a broad range of stakeholders. Understanding how those potential cash flows are shared is a really helpful tool to help you analyze whether you've got something that's got a good chance of delivering a sustainable outcome. This is perhaps most appropriate for industries with very long-term investment horizons, such as extractive industries, the energy sector and infrastructure.

Transaction memos, where you set out the transaction steps and the treatment of each step in the transaction, are invaluable to ensure that you really have thought through every angle. T

Credit: Keystone / Photoshot / Richard B. Levine

Grappling with deal valuation

Calculating the likely future value of an asset is often challenging, especially in an uncertain and volatile marketplace. But getting this right is crucial to the success of a proposed merger or acquisition.

Wireless lead: AT&T has moved to reshape the US telecoms industry with an agreement to buy T-Mobile USA from Deutsche Telekom.

▸ **By Rob Mitchell**

A successful M&A deal depends on a variety of factors, but an accurate, realistic valuation model is undoubtedly one of the most important. As a forward-looking measure of financial performance over a period of several years, valuation is an inherently uncertain process. There is a huge range of unexpected factors that can affect future cash flows, from changes in the macroeconomic environment to new competitors. But while there can never be certainty about what the future holds, a rigorous approach to valuation can improve the chances of long-term success in a variety of scenarios.

The most common way of determining the value of an asset is the discounted cash flow (DCF) method (see sidebar on next page). Using this approach, an acquirer will seek to value the asset by calculating the value of cash flows over the life of the company, taking into account depreciation, capital expenditure and amortization. A discount rate is then applied to reflect the costs of capital.

Estimating future cash flows is rarely simple, but economic volatility compounds the challenge. "When there is uncertainty and volatility in the market, it can be very difficult to project future cash flows of a potential target," says Kenneth Lehn, Samuel A. McCullough Professor of Finance at the University of Pittsburgh in the United States. "Although acquirers want the range of values on a target to be as narrow as possible, the sensitivities that you would run in a volatile environment are likely to encompass a wider range of outcomes."

Financial modeling techniques, such as sensitivity analysis, can help companies to test

their assumptions against both benign and adverse scenarios. By assessing the impact of changes in different input variables, such as costs, economic growth or revenues, acquirers can have a much better picture of the viability of their valuation under various scenarios.

As more and more companies consider acquisitions in emerging markets, they will face new valuation challenges. Compared with deals conducted in developed economies, emerging markets often suffer from a lack of price history and empirical market evidence on which to base valuations. In addition, accounting practices may vary, making it difficult to benchmark a deal against comparable transactions in other jurisdictions. "There is an increased need for due diligence when acquiring in emerging markets to take account of differences in tax systems and treatments," says Alexis Karklins, the Valuation and Business Modeling Services Leader for Ernst & Young's Europe, Middle East, India and Africa region.

Any valuation model needs to take into account expected synergies from the deal. Typically, the corporate development team will seek input from managers across a range of business functions, including sales, human resources, finance and marketing, to determine where synergies can be expected. Common synergies may include a reduction in headcount, process improvements, a reduction in sourcing costs and the rationalization of IT systems or manufacturing.

But while the potential for operational synergies is generally well understood in valuation models, the impact of tax is less widely considered. "All too often, acquirers only think about synergies from an operational perspective," says Karklins. "They don't think about structuring the deal in a tax-efficient way or building post-merger tax synergies into the valuation model. These should both be crucial aspects of any potential synergy calculation."

In some cases, the consideration of potential tax synergies can make the difference between winning or losing a deal. Acquirers that have built tax savings into their model can offer a higher valuation than a competitor that has not taken these efficiencies into account, and may therefore be a more attractive bidder.

There is an increased need for due diligence when acquiring in emerging markets

"Integration often involves restructuring the business, regrouping or moving functions from one jurisdiction to another and rationalizing business units and the supply chain," says Karklins. "By building tax synergies into the valuation model, acquirers can identify and recognize a wide variety of tax savings across a number of areas." Speaking at Ernst & Young's 2011 Pan-European Tax Executive Workshop in Rome, Aidan Stokes, Global Director of the Transaction Tax Practice at Ernst & Young, described this trend further. "Companies now place much more emphasis on tax issues than they did three years ago, and many attribute this to the competitive pressure to improve the returns from their deals in an uncertain economic environment," he explained.

Despite the benefits to be gained from taking tax synergies into account when planning transactions, collaboration between valuation teams and tax departments remains the exception, rather than the rule. "In an ideal world, appraisers and tax directors would work hand in hand but all too often they operate in very different worlds," says Karklins. "Valuation and tax are seen as different disciplines and this ultimately means that acquirers are not capturing the value from deals that they should be."

The valuation of intangible assets may be another spur for tax departments and corporate development officers to collaborate more closely. Traditionally, the valuation of intangible assets has been a key challenge. "Intangible assets, such as trademarks or copyrights, that generate independent cash flows, are generally reasonably straightforward to value," says Professor Lehn. "Where it becomes much more difficult is in the area of assets that don't stand alone as independent assets, such as brand or corporate culture, but affect the overall cash flow of the firm. You can't segregate those cash flows from the rest of the firm so you have to figure out a way to pass the contribution of these intangible assets on to the company's overall cash flow."

One approach that companies can take is the "relief from royalty" method. This involves M&A appraisers valuing intangible assets according to the amount that an independent purchaser would be willing to pay for them. This bears many similarities to the "arm's length principle" that underpins transfer pricing methodology. "The question that is now emerging is whether there is any consistency between the parameters that we're using for the valuation methodology and those underpinning the transfer pricing policy," notes Karklins.

Tax synergies and tax-efficient deal structuring can play a major role in enhancing the value of any deal, but companies must also avoid controversy. With many governments around the world seeking to maximize their tax revenues, there is an increased risk of abrupt legislative change or step changes in enforcement. "Around the world, tax administrations are becoming more reluctant to see aggressive positions and deal structuring," says Karklins. "It is therefore essential that acquirers take good advice not only to ensure that they realize tax synergies but also that they do so in a way that will not pose risks from a tax controversy perspective." T

Valuation methods

There are essentially three valuation methods for M&A transactions:

Discounted cash flow: the DCF approach is probably the most widely used valuation method. It involves valuing an asset based on the present value of its projected free cash flows over a period of time and applying a discount to take account of the cost of capital. The DCF valuation also includes a terminal value, which refers to the value of the investment after the projected period is complete.

Comparable companies analysis: the comparable companies approach involves identifying companies that have similar characteristics to the target and basing the valuation on a comparison of certain financial ratios, such as a price/earnings multiple, across this peer group.

Precedent transactions analysis: the precedent transactions approach involves basing the valuation on the prices paid by purchasers of similar companies under similar circumstances.

Government sales ahead

An urgent need for additional funds is forcing governments around the world to re-examine their assets to see what could be put up for sale. But past experience has shown the need to tread carefully.

Summary
Major privatizations are looming as governments scramble to raise funds. But those seeking to maximize these deals need to consider both the timing and approach used to ensure deal success.

▸ **By Rodrigo Amaral**

Cash-strapped governments in some countries will need to use every tool at their disposal to restore public finances to health. And while tax increases and spending cuts will be the main methods used to reduce deficits, a significant number will turn to privatizations as an additional way of raising much-needed funds.

The disposal of state-owned assets could certainly play an important role in raising government revenues. Over the next five years, it has been estimated that in total, European governments could raise more than €650b through privatizations. In the United Kingdom alone, the sale of remaining commercial enterprises held within the public sector could yield up to £90bn over the next few years, according to the Adam Smith Institute, a think-tank. This figure includes the potential sale of the Government's stakes in the Royal Bank of Scotland, Lloyds Banking Group and Northern Rock, as well as Network Rail, Scottish Water and Channel 4, the broadcaster.

In addition to providing a much-needed injection of capital, privatizations can also help governments to cut costs over the longer term. By handing over responsibility for a service to the private sector, governments can reduce the costs of delivering essential services to the public, giving an extra boost to deficit-cutting efforts. In some jurisdictions, privatized companies can also generate additional tax revenues – an important goal at a time when many governments are struggling with record fiscal deficits.

For corporates turning their attention to growth strategies, this new wave of privatizations could well be a source of potential acquisition targets. "It is likely that many cash-rich companies and pension funds would jump at the opportunity to buy some of the assets that are coming to the market," notes James Close, of the Government Services Practice at Ernst & Young in the United Kingdom.

Governments seeking to maximize the sale price of their assets will need to consider the timing of their sales carefully. Conditions in financial markets will be an important factor. More buoyant equity markets will lead to higher valuations, although ongoing volatility means that it will be difficult to plan ahead.

In recent months, a number of European governments have announced that they will engage in privatization efforts, which means that many assets could be coming to market at around the same time. This creates the potential for market saturation and a depression in prices. For example, Greece aims to raise up to €7b by selling stakes in airports, energy firms, the postal service and a manufacturer of defense equipment. Portugal has outlined plans to sell its remaining stakes in the energy companies Galp and EDP and an electricity distributor REN, along

Credit: Keystone / Camera Press / Guillermo Navarro / ALFAQUI; BilderBox

€7b

The Greek government has outlined plans to raise €7b from the privatization of assets ranging from its postal service to its airports and utility firms.

Madrid Airport

Spain plans to raise €8b by selling 49% of its airports authority, while allowing Madrid Airport to be run by private concessions.

Hellenic Post

The Greek postal service is one of a number of state assets that is being considered for privatization, as part of the government's plan to raise up to €7b.

Credit: Keystone / EPA / Yuri Kochetkov; Reuters / Eddie Keogh

Rosneft

The Russian government has outlined plans to sell a 15% stake in Rosneft, the state oil company, as part of wider plans to raise US$32b from the sale of state assets.

Royal Bank of Scotland

RBS is one of the assets that the UK government is looking to re-privatize, in order to realize a return on its 84% stake in the bank that it took on during the financial crisis.

with TAP, the airline. It is also looking at a sale of its share of Inapa, one of Europe's largest paper distributors, although the execution of the privatization program will be delayed until after the elections convened for early June.

Spain is launching the partial privatization of its national lottery operator and its airport authority, AENA, while also offering both its Madrid and Barcelona airports as private concessions under a 40-year license system. It is also planning to sell stakes in the country's cajas, or savings banks. And all are considering going to market in the near term.

It is not only cash-strapped, Western governments that are following the privatization route. Some emerging European countries are using it as a means to enhance their economic prospects. Poland has an ambitious divestment program in place, while Turkey, Serbia and Croatia are also considering disposals. Russia has embarked on an ambitious privatization process, which includes the sale of a 15% stake in Rosneft, the oil giant, a 7% stake in Sberbank, and the recently completed secondary public offering of VTB, a formerly state-controlled bank. The Russian government hopes to raise a total of US$32b from these sales over the next three years.

While budget pressures may encourage governments to act quickly, research shows that officials would do well to proceed cautiously with privatizations. In a survey by Ernst & Young of officials in several countries that had been involved in privatizations, 70% said that they did not maximize value during the process. And an overwhelming majority of 90% said that they would like to have had more time to prepare if they were to go through the process again.

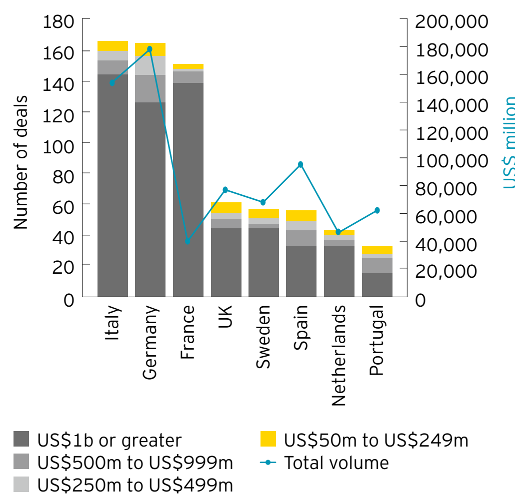
Careful planning of a privatization, including the consideration of more innovative structures for the transaction, can help to maximize the value of the sale. At the most basic level, it may well prove more profitable to sell off an asset in component parts over a period of years rather than all at once.

European governments could raise more than €650b through privatizations

Governments may also want to look at less conventional deal structures – for example, at present there is extensive press speculation as to how the UK government will go about selling off its 84% stake in RBS and 41% stake in Lloyds Banking Group, which were taken on following emergency bail-outs in the financial crisis. One idea mooted is the prospect of each UK citizen taking a stake in the banks.

But governments also need to look at a broader range of factors than just maximizing the price. They also have a responsibility to ensure that the privatization process brings benefits to society that are not always financial. "The goal of privatization may be to raise money for the government, but this is not the only factor to be considered," says David Murray of Ernst & Young's Transaction Advisory Services in the UK. "Governments also need to think about the post-privatization landscape and the impact of the sale on both the economy and society."

Privatization deals by country, 1995–2010



Source: Thomson Reuters SDC Platinum

Privatization can sometimes be a controversial issue, particularly if voters consider the asset to be part of their national heritage or culture. When the UK Government announced that it was planning the sale of woodland held by the state-owned Forestry Commission, public opposition to the plan was extremely vocal. In February 2011, the Government announced that it would put part of the sale on hold and re-examine the criteria for the disposal.

This highlights the importance of choosing assets to be privatized carefully. In general, governments prioritize assets that are likely to generate the most investor interest and that are straightforward from a political and economic perspective. "The focus right now is on selling stakes in companies that are very easy to divest," says James Close.

Equally, financial markets may complain that privatization efforts are not going far enough. The Irish Government has been criticized for not including the sale of its attractive utilities companies among the budgetary measures introduced to cut the country's deficit. In Austria, the Vienna Exchange has publicly challenged politicians to invite private investment in the many energy and transport firms that are owned by state entities.

"Privatization remains an emotional political term, and there are divergent views about it in Europe," says James Close. "But the scale of deficits makes the economic reality more significant than political ideology. The bottom line is that governments need the money." T

70%

In the Ernst & Young survey Maximizing value from privatizations, 70% of respondents admitted that they did not maximize value during the privatization process.

Credit: Laurence Voumard

Assets in need of care and attention

Adverse conditions have led to a rise in distressed assets, such as companies on the brink of failure. But those stepping in to snap up a deal will need to move fast and deal with numerous challenges.

53%

According to Ernst & Young's Global tax trends survey, 53% of companies say that they would consider a distressed asset deal should the right opportunity present itself.

▸ **By Bill Millar**

Buy low; sell high. The idea that an acquirer can generate handsome returns by buying assets cheaply is alluring. So much so that an array of "financial" investors (private equity firms, hedge funds and banks) and "strategic" acquirers (traditional corporations) are in hot pursuit of distressed assets. Throughout 2010, a number of hedge funds and other financial buyers, including CQS and Oaktree Capital, launched funds specializing in this market. Many are focusing on acquiring distressed debt from troubled companies. According to a recent survey from Prequin, a data provider, nearly one-third of institutional investors saw distressed debt as among the most attractive opportunities.

Summary

Acquiring distressed assets can lead to a bargain. But a successful outcome depends on a wide array of considerations, from potential product liabilities to regulatory issues. Such deals also bring tax complexities and risks.

An array of challenges

But there are limits to the opportunities. First and foremost are the intricacies and risks associated with such deals. As Bridget Walsh from Ernst & Young's Transaction Tax Practice explains, such assets are usually distressed for a reason. "They can have any number of fundamental flaws, so taking them on requires considerable know-how along with sophisticated due diligence," she says.

Companies that have been under financial stress for some time may well have a range of issues. A common problem is the failure to keep up with funding of pension liabilities. Acquirers may find themselves liable to fill funding gaps or deal with other liabilities, such as employment contracts. In some cases, however, these liabilities can be negated by insolvency.

Product liability and regulatory issues can also be problematic with distressed acquisition targets. In the run-up to distress, companies often begin to compromise on quality, which can lead to the risk of extensive warranty claims at a later date. Or perhaps poor quality led to distress in the first place. A purchaser should explore possible buyer or client warranty issues faced by the target. Similarly, depending on the target's industry, due diligence should include a close look at facilities, supply chains and

Vice President and Head of Mergers & Acquisitions

__ Arnd Schwierholz has been Vice President and Head of Mergers & Acquisitions at Deutsche Lufthansa AG since 2004. He has been with Lufthansa since March 2002, when he joined the company as Vice President of Lufthansa Commercial Holding, the Group's investment vehicle, helping to streamline the Group's non-core portfolio.

See interview on page 45

The recent Ernst & Young publication Distressed Asset Investing: Finding Opportunities and Addressing the Risk includes a checklist of questions that companies should ask themselves before moving to acquire a distressed asset.

The checklist is available for download on www.ey.com/tmagazine/04/assets

products, with special attention to regulated substances, hazardous materials, recalls of related products or even violations of trade or operational regulations. In the run-up to a sale, it is possible that the seller may not be paying sufficient attention to these issues, which could cause significant problems for the buyer.

A distressed target may also expose the buyer to breach of contract claims. Often, such companies may be guilty of having violated the terms of contracts with suppliers or customers. Due diligence here should include analyzing how faithfully the firm has been at meeting its contractual obligations — and finding out whether there are any potential penalties or damages involved.

Not to be overlooked are challenges in the integration of distressed assets. Physical assets may be in disrepair or well behind in routine maintenance schedules. It is also possible that top talent at a failing firm will have already left, leaving behind a less experienced and possibly demotivated workforce.

How to acquire

For those undaunted by these challenges, the first step is to identify and pursue appropriate assets. Be warned: distressed asset transactions are highly competitive. Moreover, they tend to proceed at a rapid pace, with deals often moving from opportunity awareness to deal closing in less than 30 days. To participate, a buyer must enter the arena well prepared and ready to move fast. It will be important, for example, to have a clear idea of the types of assets desired as well as the capital available for their acquisition. Decision-making processes will need to be streamlined, while valuation and due diligence resources must be ready at a moment's notice.

Moving fast will also mean early identification of opportunities. The first line of information gathering is a company's own staff. Those who know where and how to look will see the early warning signs of distress well before any actual event. Ask sales and supply chain managers to discreetly query their contacts, customers and clients regarding any problems with deliveries or order fulfillment. Meanwhile, ask finance staff to stay on top of credit alerts, downgrades or similar events, which can be precursors to severe distress. Expanding awareness throughout the organization can lead to better intelligence and create a competitive head start. Lufthansa's 2009 acquisition of Austrian Airlines, for example, was aided by the two companies' existing alliance, which helped ensure close awareness of the target's operating situation.

Would-be acquirers that suspect an asset may be in distress could even approach the target in advance of any legal proceedings to see if it is possible to negotiate "pre-event" terms. An early approach may reduce the likelihood of a rock-bottom price, but it does mean that there will be less competition from other bidders.

Alternatively, prior to any formal insolvency, an acquirer might elect to begin buying the shares of a target on the open market, a strategy often referred to as "buying the option." Or a buyer might also purchase a target's debt, the so-called "loan to own" approach.

The most taxing issues

In addition to the challenges already described, distressed assets carry heightened tax complexity and risk. "These companies often exhibit a considerable number of tax problems," says Walsh. "They may be behind in tax filings or transfer pricing documentation and that means they may have judgments against them, pending or otherwise. Similarly, the sale or any pre-sale reorganization could trigger tax liabilities, which transfer to the purchaser."

The prevalence of these problems means that tax considerations figure prominently in the structuring of most distressed asset deals. For example, in an insolvency situation, acquirers may seek to gain control of the assets themselves, rather than ownership of a company or its shares. "This enables the buyer to take over the assets without assuming any lingering tax issues or, for that matter, many of the potential product liability, regulatory or related risks," says Walsh.

Tax rules can also come into play in cases where a would-be seller of distressed assets cannot find a suitable buyer. Often, a management team will perceive that the mediocre or even negative performance of distressed assets is proving to be a drag on the business as a whole. In such cases, companies may choose to divest such assets from the corporate parent via a carve-out. This means that the unwanted assets are separated from the parent company's balance sheet to create an entirely new company. In most cases, however, such a transaction is in principle a taxable event, generating immediate cash-flow consequences.

One last challenge

For those with the courage, often born of experience, distressed asset investing can be rewarding. But despite ongoing turmoil in the macroeconomic environment, there may be fewer opportunities than imagined. Those on the hunt for distressed assets in sectors, such as real estate, are finding their efforts disadvantaged by a rebound in risk appetite that has raised prices on many would-be bargains. Meanwhile, banks and other lenders are increasingly getting involved and doing more of the needed work-outs themselves. "They're finding that this is better than taking the hit to capital," explains Walsh.

No doubt distressed assets are out there. But in addition to the many challenges associated with profiting from their purchase, the biggest difficulty of all may be finding appropriate targets in the first place. T

Credit: Keystone / Martin Ruetschi

Take-off for dealmaking

Consolidation in the airline industry used to be rare, but a tough decade has served as a deal catalyst. Arnd Schwierholz, Vice President and Head of M&A at Lufthansa explains why.

Lufthansa has been an active acquirer of ailing airlines across Europe.

▸ **Interview by James Watson**

What are the recent M&A trends that you have seen in the airline industry and how have you responded?

Arnd Schwierholz: Ten years ago, the airline sector was highly fragmented, with little M&A activity. That has changed dramatically, especially in the past five years. Today, we see a considerable amount of consolidation, typically within the same geographic region. There have been a number of mergers in the United States, as well as some activity in Latin America and Asia. You also see a lot of consolidation in Europe, with Lufthansa playing an active role.

There have been two objectives for our transactions. The first is to consolidate our position in key markets and grow our revenues. Companies such as SWISS International Air Lines, acquired in 2005, Brussels Airlines and Austrian Airlines, acquired in 2009, are all market leaders in their home markets and have additional exposure in emerging markets.

Secondly, those companies have been struggling to survive on their own. SWISS had been just coming out of bankruptcy when it was acquired by Lufthansa and Austrian Airlines only survived because of a €200m rescue loan from the Austrian Government. By putting our revenue and cost synergies on top of the solid market positions, those companies have a good chance to find their way back into profitability. Indeed, SWISS has already done so.

What is the outlook for M&A in the airline industry?

With the recent merger of British Airways and Iberia, I think the level of consolidation activity within Europe has peaked. Will there be other acquisitions? There are obviously some more candidates, but not at the same level as before. Most players will be looking at high-growth emerging markets to see what kind of M&A can be done there. Of course, the regulatory framework is not easy in those countries. And taking a majority position outside Europe is difficult. There needs to be more political will to form the basis for further consolidation.

€1.1b

The Lufthansa Group ended the 2010 business year with a strong balance sheet. The Group earned a full-year operating profit of €876m, and net profit rose to €1.1b.

Do you consider alliances in the industry, such as your own Star Alliance, as an alternative model when M&A deals are not feasible?

At Star Alliance, it's all about customers. An airline will always try to provide them with a global and seamless offer but one single airline will not be able to do that on its own. That's why we need partners. A lot of things we do within an alliance, such as aligning our frequent flyer programs and harmonizing our products, we do in an acquisition as well.

In an acquisition, you get far more aligned in terms of synergies compared with an alliance, but you take on much higher operational and balance sheet risks when consolidating those companies. If you look at airline M&As, these are probably 50-50 in terms of revenue and cost synergies. Our hypothesis is that you can capture a lot of the revenue synergies in an alliance, but not as much on the cost side.

What options do you consider to drive growth for Lufthansa?

Growth is driven across three pillars in the sector. One is organic growth. European and Middle Eastern carriers are all adding capacity. Consider the huge order books for planes such as the A380 which, due to their low unit costs, are fundamentally changing the industry. The second pillar is about alliances. The third is M&A, which is used on a more opportunistic basis. We look at specific markets to see how we can serve that market best and whether there is room for organic growth, or if we can find the right alliance partner, or if there is room for M&A. Obviously, this requires a selling partner, as well as the necessary cost and revenue synergies.

Many airline deals involve distressed assets. How do you deal with the issues that such transactions raise for you?

Unfortunately in our industry, a lot of deal opportunities are in a distressed situation. Airlines tend to have highly leveraged balance sheets and high operational leverage. Softness in demand or a rise in oil prices puts them in a difficult situation.

Government owners, in particular, have been trying to wait as long as possible to follow a stand-alone strategy, and only if things get really tough do they turn to M&A. If you take the example of Austrian Airlines, we tried to minimize taking on risks by applying an acquisition framework that included a mechanism for an earn-out for the Government as selling shareholders instead of the public share price that has been paid to the free float. There was also a balance sheet restructuring with the help of the Austrian Government to put Austrian Airlines' balance sheet on more competitive terms. Of course, we did our due diligence to cover all aspects of their financial and legal situation. We also came up with a plan to revise their operational performance and look at what we could do together in terms of revenues and costs. T

Credit: AAP Image / Alan Porritt

Michael D'Ascenzo, Commissioner of Taxation at the Australian Taxation Office, has taken a firm line on the taxation of foreign investments.

Getting to grips with a shifting policy landscape

With tax policy changing rapidly around the world, potential acquirers would do well to understand how forthcoming legislation might affect their investment

▸ **By Fergal Byrne**

Changes in tax policy can have a significant impact on the profitability and even the viability of cross-border mergers and acquisitions. More than ever, companies interested in pursuing cross-border mergers and acquisitions need to develop a perspective on where tax policy is heading across different jurisdictions. In order to be armed with the right information, companies need a thorough awareness of a country's political, economic, regulatory and fiscal outlook, which are all key determinants of its tax policy.

"Having what we call good tax authority intelligence – understanding the issues that the tax authority has at the forefront of its mind when developing tax policy – can help companies to make a much better appraisal of the risks around any particular investment," says Chris Sanger, Global Head of Tax Policy at Ernst & Young.

Although tax policy varies widely from one jurisdiction to another, there are some common themes that can be identified - and often, there is a clear line between developed and emerging markets. For many developed markets, the priority is to restore public finances to health in a way that maintains their overall competitiveness. "Many countries faced with a shortfall in their funding are looking to raise tax revenues," says Sanger. "But they are fully aware that their

5.8%

Australia is seen as an attractive destination for foreign direct investment (FDI). Over the last five years, inward FDI stock has increased by an average of 5.8% per annum, according to the Australian Trade Commission. As of 30 July 2010, the stock of inward FDI in Australia was about US$447b.

policies will directly impact inbound investment. Accordingly, they are attempting to develop policies that do not hinder investment in their country."

Even in developed countries with record deficits and debt-to-GDP ratios, the focus continues to be on making the tax environment conducive to foreign investment. Countries such as Ireland, for example, rely on foreign investment for the growth that will be required to reduce their deficit to a level that is seen as acceptable by the European Union and International Monetary Fund. Despite putting in place a package of fiscal austerity measures, Ireland has been very careful to ensure that its low corporate tax rate remains unchanged.

Large emerging markets, on the other hand, do not face the same pressures. "Countries like India and China tend to be more focused on internal considerations, rather than international competitiveness," says Sanger. "This means that they are likely to take a more aggressive approach to raising tax revenue."

Although tax policy varies widely, there is an increasing trend for policy to be exported from one country to another. This means that the risks that crystallize in one country can rapidly be transmitted, as policy options, to governments in other countries. The treatment of indirect capital gains, for example, has been in the limelight in India and Australia, while China has brought forward Circulars 601 and 698, which also relate to this area.

In part, this policy transmission is due to the fact that many governments are now talking to each other about tax policy. Tax information is being shared across borders to an unprecedented extent, and this naturally encourages greater convergence of tax policy. Supra-national institutions, such as the G20 or OECD, also play a role. They are increasingly developing frameworks on particular areas of tax policy, providing the basis for governments to develop their own implementations.

But despite this trend for greater convergence of tax policy, companies must be extremely careful to examine carefully the idiosyncrasies of individual markets. Tax policy remains uncertain and, by failing to take the situation in a particular market into account, companies may find that their investments are not as viable as they first thought. Below, we outline some of the key policy trends that are being seen in specific jurisdictions.

Australia limiting tax concessions

New developments in Australia could have a profound impact on the taxation of cross-border investments that are made into the country. In 2009, the Australian Taxation Office (ATO) issued two draft rulings, both finalized in 2010, which clearly state the ATO's belief that gains on Australian investments made by foreign investors (including private equity firms) can be revenue profits rather than capital gains. This means that they are subject to ordinary rates of income tax if they have an Australian source, instead of being tax-free capital gains. Any attempt to interpose a holding company in a tax treaty country to access a tax exemption without a sound commercial purpose will be regarded as treaty shopping by the ATO and may be attacked under Australia's anti-avoidance rules.

China taxing indirect sales of investments

In December 2009, the Chinese tax authorities issued Circular 698 which, among other things, had the effect of taxing indirect sales of Chinese investments made by foreigners. It applies where there is an intermediary country company between the foreign investor and the Chinese investment and where the intermediary is sold rather than the investment itself.

Where the use of the intermediary cannot be justified for business or commercial reasons, the existence of the intermediary can be ignored, thus potentially exposing the sale to Chinese taxation. In addition to asserting China's right to tax such gains, the circular imposes a self-reporting obligation on a foreign seller to report such sales and to provide relevant information.

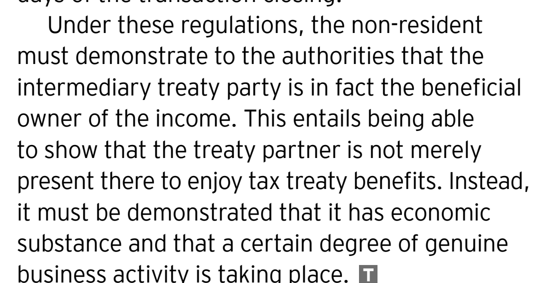
India implementing a new tax code

In the past, foreign investors in India have often invested through companies in Mauritius, relying on the treaty provisions to protect against taxation in India of capital gains. India is now focusing far more on the substantive nature of the Mauritian intermediary before it is willing to provide treaty benefits. Under a broader move, there is a suggestion that India's new tax code (known as the Direct Tax Code) will have the effect of treating all capital gains as ordinary income.

Indonesia combating treaty abuse

In November 2009, the Indonesian Government released two regulations designed to combat treaty abuse. DGT Regulations 61 and 62 set out a series of new procedures that must be followed in order for reduced rates of withholding tax to apply to payments made to foreign residents under various treaties.

In July 2010, the Indonesian Government released a new regulation where any merger or acquisition – exceeding a certain size – must be reported to the Commission for the Supervision of Business Competition within 30 business days of the transaction closing.



Under these regulations, the non-resident must demonstrate to the authorities that the intermediary treaty party is in fact the beneficial owner of the income. This entails being able to show that the treaty partner is not merely present there to enjoy tax treaty benefits. Instead, it must be demonstrated that it has economic substance and that a certain degree of genuine business activity is taking place.

Today's transactions are creating value

Biography
Scott Moeller is a professor in the Practice of Finance and Director of the M&A Research Centre at the Cass Business School, City University London. He has extensive experience in global M&A and is a much sought-after speaker and commentator.

There is a common perception, often repeated in articles and research reports, that the majority of mergers and acquisitions end up destroying, rather than creating, value. But while this once may have been true, recent research shows that this is no longer the case. It is time for companies and investors to update their thinking and realize that transactions lead to value creation.

It is easy to see why this misconception has lingered. In previous merger and acquisition waves, such as those in the 1980s, 1990s and the one ending in 2002, it is true that most deals failed to create significant value — and often destroyed it. But empirical data, some produced by the M&A Research Center at the Cass School of Business, shows that the tide has turned. Looking at deal activity since 2004, those companies that execute transactions regularly tend significantly to outperform those that do not.

So what has changed? Perhaps most notably, companies are becoming much more capable at conceiving and executing transactions. They are spending more time understanding the strategy behind their deals and are much more focused on what they are trying to achieve. Instead of just doing a deal to do a deal, they are seeking to do the right deals.

Another change is a greater focus on post-merger integration. In the past, too many companies failed to plan for this. Only when they had won the deal did they think about how to integrate the acquired company. Today, companies are making plans for their new assets even before the deal closes. There is a conscious alignment between a deal's strategy and the operations that are necessary to achieve it. Companies are assigning responsibility to specific actors in the integration process to make sure all the levers that will create value are being pulled. This, to me, is a very large departure from prior deal-making cycles.

It is also clear that companies are realizing the importance of an expanded definition of due diligence. In the past, this was very much a legal and compliance-driven exercise. But today, companies are employing due diligence resources to evaluate and validate a much wider range of deal components and are much more focused on the issues that can add or detract from the value of the deal. Consider the fact that, out of four of the largest deals announced in the past year, only one actually made it to closing. This says a great deal about the degree to which companies are using due diligence to validate their decisions.

Thanks to these and related changes, companies are becoming more skilled at identifying and executing transactions. But this is not to say that transactions are becoming a core competence for corporations. On the contrary, those companies that are most successful are the ones turning to outside experts, for whom dealmaking really is a core competence. Even those who do the most deals rely on the expertise of outside accounting firms, consultants, investment banks and law firms. I believe this is making a tremendous difference in helping to maximize the chances of a positive outcome for a potential deal.

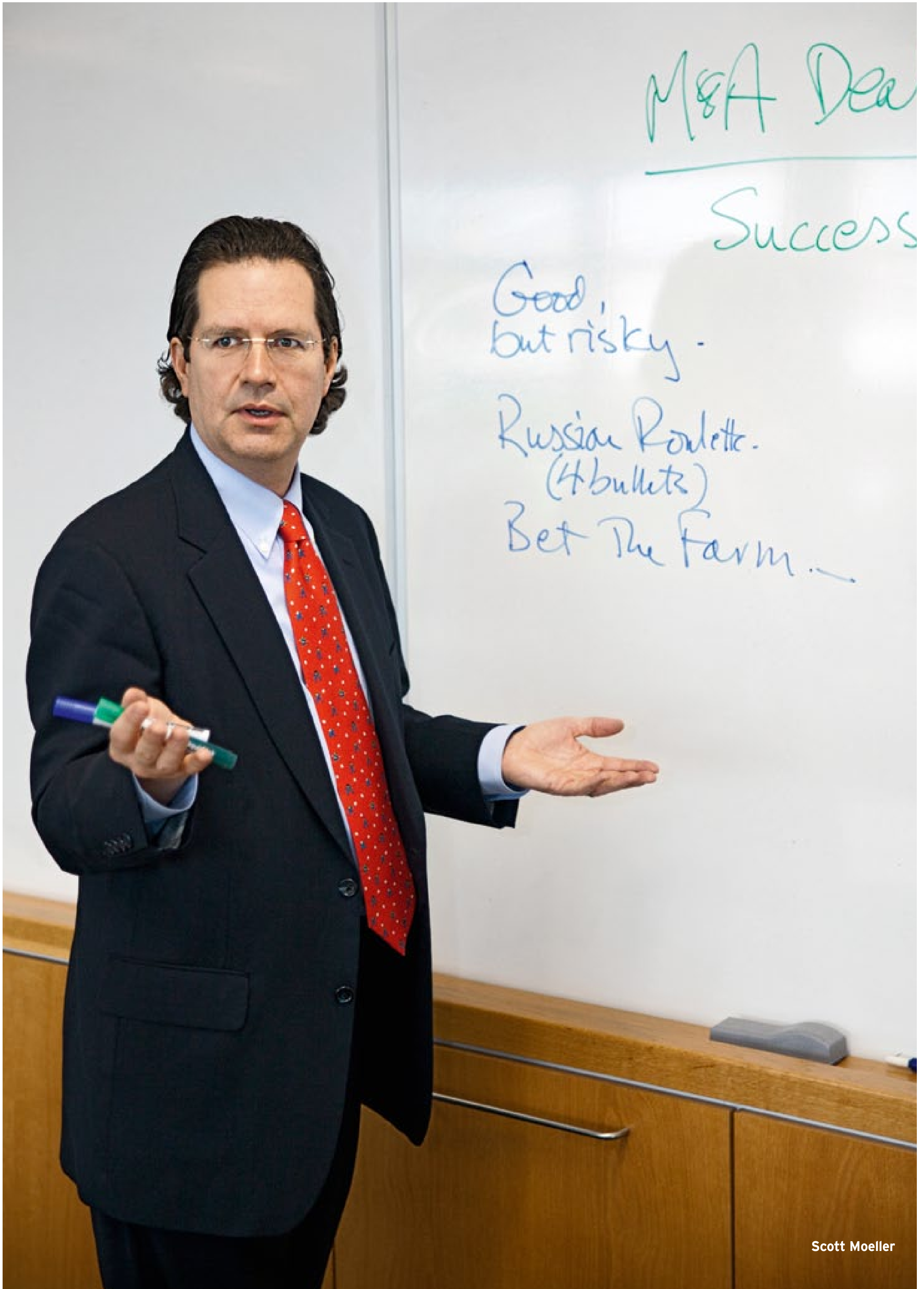
Companies today are also finding that they have to pay far more attention to tax issues. Relative to earlier merger and acquisition waves, today's deal landscape features many more cross-border transactions. That means more jurisdictions, more tax positions that need to be evaluated and more sets of rules to be followed. This is another reason why firms are relying more on outside expertise.

Our research is also showing that, whenever companies have a change in leadership, that significantly increases the likelihood of a major transaction. On average, companies will announce a major deal, either an acquisition or divestiture or both, within the first seven to nine months of a new CEO's arrival. The likelihood is greater if the executive has been brought in from the outside — and greater still if the outgoing CEO did not play a major role in the selection of the new CEO. This makes sense when you consider that, by bringing someone in from the outside, a company is signaling that it aims to move in a new direction.

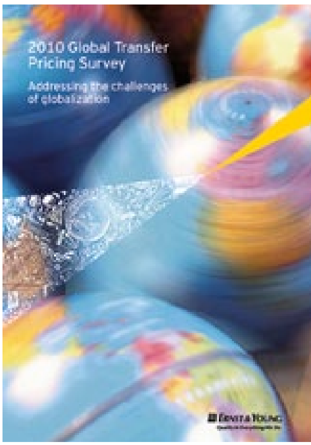
So the overall message is that it is time to update the thinking. Yes, there was a time when dealmaking led to value erosion. In many cases, transactions were at best neutral and, in too many cases, counterproductive. But the empirical evidence today links dealmaking with significantly stronger overall performance. For companies seeking to pursue acquisition strategies, and for those that provide services to the dealmakers, this is good news.

By Scott Moeller,
Director of the M&A Research Centre,
Cass Business School

Credit: Ed Thompson / LUZphoto

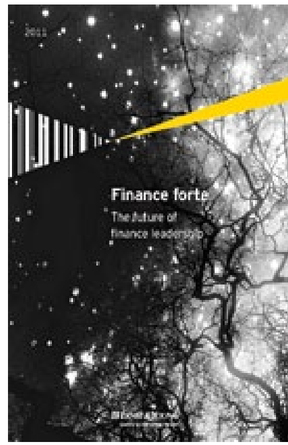


Scott Moeller



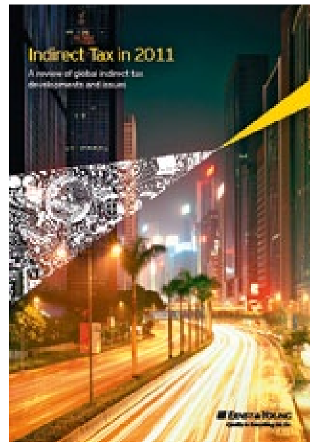
2010 Global Transfer Pricing Survey

Since 1995, Ernst & Young has surveyed multinational enterprises (MNEs) on international tax matters with special emphasis on what continues to be a leading international tax issue – the increased regulatory activity around transfer pricing.



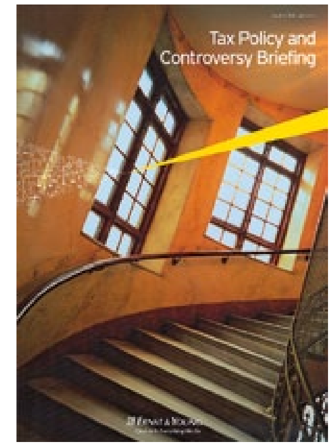
Finance Forte

No one expects the top finance job to be easy. As organizations look ahead to an uncertain future, the responsibilities of the CFO role will only increase. Finance forte provides insight on the future of the CFO role and what current CFOs, aspiring CFOs and boards need to do to keep up.



Indirect Tax 2011

With the ongoing shift to indirect taxes of all types, it is more challenging than ever to understand the changing indirect tax landscape. This publication provides a high-level overview of significant developments in indirect taxation that may have an impact on global businesses.



Tax Policy and Controversy Briefing

As governments try to balance increasing competitiveness with boosting revenues, and tax authorities adapt their enforcement strategies and policies, staying up-to-date with the tax landscape is a challenge. This quarterly publication covers the key issues.

Preview

In issue 5 of T Magazine, which will also be published as an insert in the Financial Times, we will focus on sustainability. Topics covered will include:

- **The emerging tax policy agenda**
- **Increased calls for corporate transparency**
- **Sustainable sourcing of raw materials**
- **Developing a carbon strategy**
- **The challenges of putting a price on carbon**

Connect with T Magazine

Website

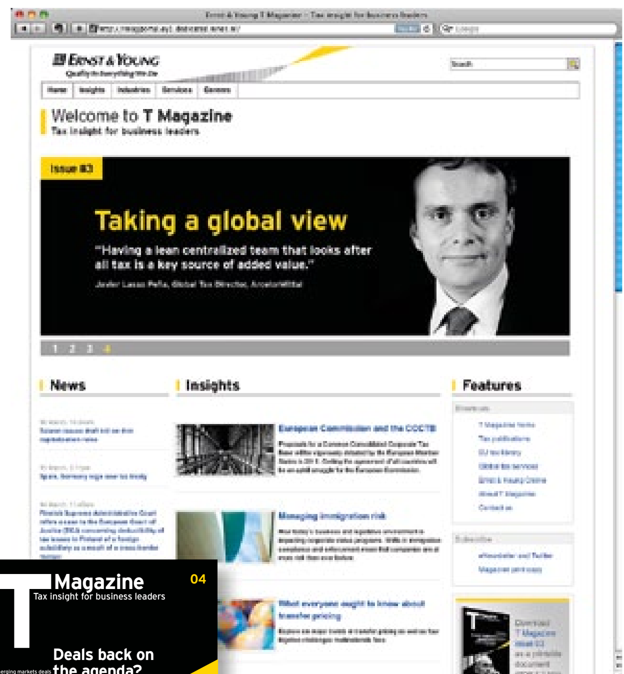
Stay ahead with international tax news, the latest tax insights and web features on www.ey.com/tmagazine

eNewsletter

The latest news and insights from the T Magazine website delivered to your inbox. Submit your subscription on www.ey.com/tmagazine/enewsletter

Twitter

Follow T Magazine on twitter.com/eytmagazine



Contact for subscription:
tmagazine@ey.com

Comments

If you would like to contact the editorial team of T Magazine, please send an email to tmagazine@ey.com

Ernst & Young

Assurance | Tax | Transactions | Advisory

About Ernst & Young
Ernst & Young is a global leader in assurance, tax, transaction and advisory services. Worldwide, our 141,000 people are united by our shared values and an unwavering commitment to quality. We make a difference by helping our people, our clients and our wider communities achieve their potential.

Ernst & Young refers to the global organization of member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit www.ey.com

About Ernst & Young's Tax services
Your business will only achieve its true potential if you build it on strong foundations and grow it in a sustainable way. At Ernst & Young, we believe that managing your tax obligations responsibly and proactively can make a critical difference. Our global teams of talented people bring you technical knowledge, business experience and consistent methodologies, all built on our unwavering commitment to quality service – wherever you are and whatever tax services you need.

Effective compliance and open, transparent reporting are the foundations of a successful tax function. Tax strategies that align with the needs of your business and recognize the potential of change are crucial to sustainable growth. So we create highly networked teams who can advise on planning, compliance and reporting and maintain effective tax authority relationships – wherever you operate. You can access our technical networks across the globe to work with you to reduce inefficiencies, mitigate risk and improve opportunity. Our 25,000 tax people, in over 135 countries, are committed to giving you the quality, consistency and customization you need to support your tax function. It's how Ernst & Young makes a difference.

© 2011 EYGM Limited.
All Rights Reserved.
EYG No. DL0390

This publication contains information in summary form and is therefore intended for general guidance only. It is not intended to be a substitute for detailed research or the exercise of professional judgment. Neither EYGM Limited nor any other member of the global Ernst & Young organization can accept any responsibility for loss occasioned to any person acting or refraining from action as a result of any material in this publication. On any specific matter, reference should be made to the appropriate advisor.

www.ey.com

The best answers lie within.

Do the world's leading businesses purchase innovation from outside or develop it from within? Through extensive research with 1,400 senior executives around the world Ernst & Young has developed key insights into how the world's leading businesses are returning to profitable growth. To learn more about Competing for Growth, contact your local Ernst & Young office or visit ey.com/competing-for-growth

See More | Growth