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Welcome to DC Edge

DC Advisory's twice-yearly round-up of the emerging trends in mid-market M&A.

The inescapable topic of the moment is the influx of Asian bidders for European assets. Total deal volumes might be shrinking but transactions from Asia continue to increase unabated; both Japanese and Chinese buyers account for a rapidly growing proportion of European M&A activity.

In this issue, we take a closer look at why Asian buyers have begun to embrace international acquisitions. Through our parent company, Daiwa Capital Markets, and a number of recently closed cross-border transactions, we feel this is a trend on which we are well placed to give comment.

We hope you enjoy this first edition

DC Advisory



issue 1

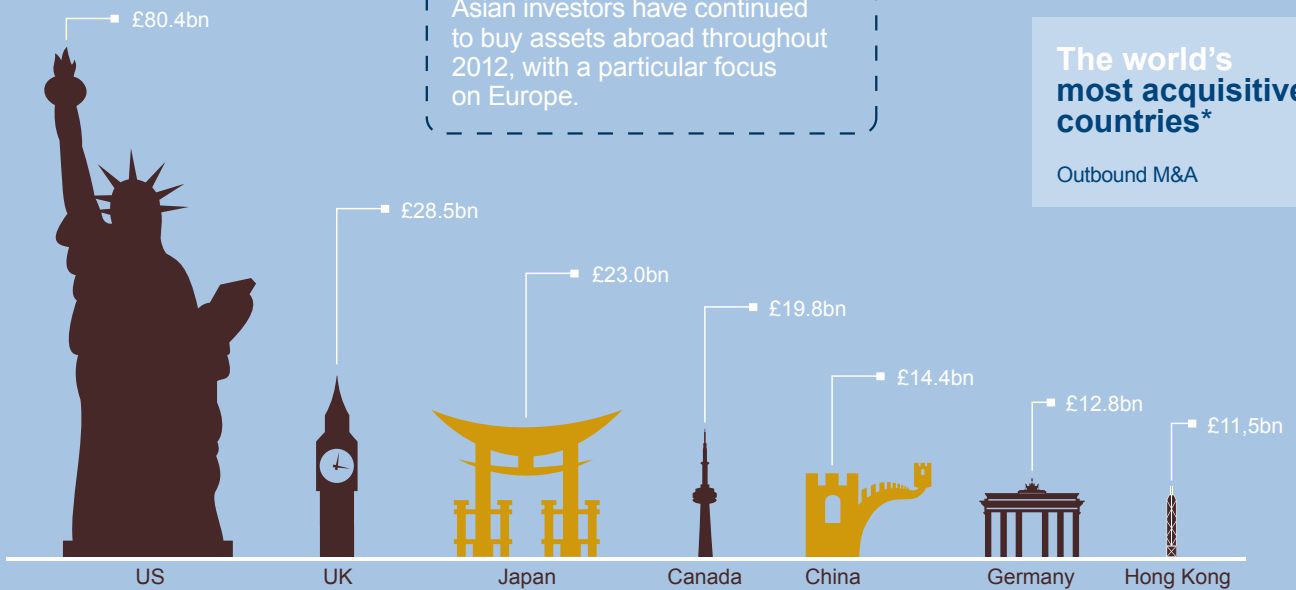


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In 2011 Japan became the world's third most acquisitive nation; Asian investors have continued to buy assets abroad throughout 2012, with a particular focus on Europe.

The world's most acquisitive countries*

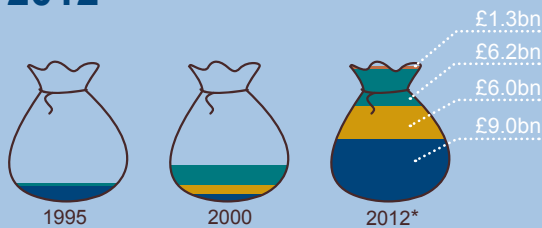
Outbound M&A



2

Japan overseas acquisitions

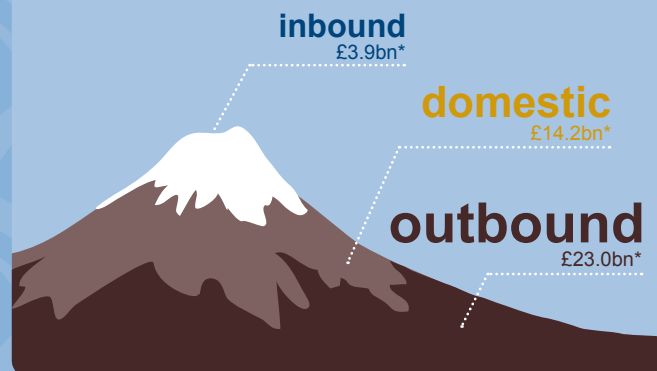
95-2012



■ North America ■ Europe
■ Asia Pacific ■ South America

3

Japan M&A



*Value for the LTM (Last twelve months to end of October 2012). Mid-market transactions defined as £50m -£1bn.

Japan a global investor

M&A was once regarded as cheating in Japan but weary of relentless decline in their home market and the effect of the strong yen eroding export margins, a new generation of Japanese management is emerging. As a result, Japanese companies have developed into global investors searching for acquisition opportunities abroad.

The tragic tsunami in 2011 crystallised attitudes. Japan had adapted in order to contend with low cost competition from China by developing some of the most efficient factory and production processes in the world, not least through automation in the Industrials sector. However, the shutdown of the Fukushima nuclear reactors, and the ensuing electricity shortages caused by the tsunami, forced many Japanese bosses to rethink domestic production lines and consider a shift overseas. In the 6 months that followed the tsunami, Japanese outbound M&A doubled in volume.

“Japanese management, weary of relentless decline in their home market and armed with a strong yen, are buying abroad”

Additional factors causing Japanese investors to look overseas include:

- predictions that Japan's population could shrink by 1/3 in the next 50 years offering little hope for domestic growth (source: Economist)
- the yen wreaking havoc on the competitiveness of Japanese exports, having doubled in value against the pound over the past 4 years
- neighbours (eg. South Korea) have kept their currency artificially weak in order to undercut Japanese exports

When Samsung of South Korea overtook Japan's Panasonic in the global shipment of plasma televisions in February 2012 it was an uncomfortable reminder of how tough life has become for Japanese exporters.

The resulting upside is that the strong yen has handed Japanese companies a powerful acquisition weapon, roughly doubling their buying power for outbound transactions at a time of falling valuations in Europe. Four years ago it took 250 yen to buy

one pound; now it costs just 120 yen. Many Japanese companies are cash rich after years of austerity in the so called 'lost decades', in addition, Japanese banks avoided the subprime crisis, enabling Japanese companies to borrow freely and relatively cheaply now. They have sizeable war chests to buy overseas – products, services, IP and even factories – at approximately half of the price. And they are taking advantage of it.

¥ has doubled against £ over 4 years.



Thinking fast and slow

Japanese buyers can take time to close deals as they need to be wholly convinced of the industrial logic for an acquisition and will commit time and resources to assessing the fit of a new business and the value it creates for the corporate 'mother-ship'. Reaching consensus across multiple layers of the company can extend the due diligence process (according to typical Western timetables) but once a decision is made by a Japanese buyer they will consider the financial implications quickly, make a bid and usually honour that price through to the close.

For product expertise Japanese acquirers will use their own employees' in-depth evaluation and understanding of an asset, in addition to insights from management teams, before they commit to buying. They might include their R&D department long before they require any financial information.

Japanese buyers require different information at different points in their decision making processes and Western vendors need to be ready to adapt to this.

“Japanese buyers require different information at different points in their decision making processes.”

When advising on cross-border Japanese transactions involving Western companies, DC Advisory has learnt to throttle the flow of information depending on what buyers require to make a decision. We advise against 'vanilla' auction processes or rigid due diligence timetables. Many successful deals are 'found in translation' when misunderstandings and sequencing issues are avoided or resolved through clear communication, interaction and translation.

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Talking heads

“We are a European corporate finance advisor with unparalleled connectivity and experience in Japan, China and across Asia.”

Richard Madden



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“Running a rigid process or a Western timeline rarely suits the Japanese; successful deals are found in translation.”

Tosh Kojima



Scan to watch video



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Thinking fast and slow

A diligent approach

The Japanese are renowned for the depth of their diligence, but buyers in the UK, continental Europe and Asia are also adopting a more diligent approach to transactions as they become more considered about the industrial logic behind a deal, often extending the transaction timetable.

The financial alchemy in the boom and the reliance on leverage to enhance returns has been replaced by a more strategic approach where the value must come from

the industrial fit or the inherent strength of the target. The landscape is calmer and bidders more cautious. However, in the mid-market there is little evidence of a retrenchment from either the private equity firms or trade buyers in terms of deal activity.

The fact that deals are taking longer because of a *Japanisation* of the process is arguably a positive development. Deals done for the right reasons without reliance on over-leverage are

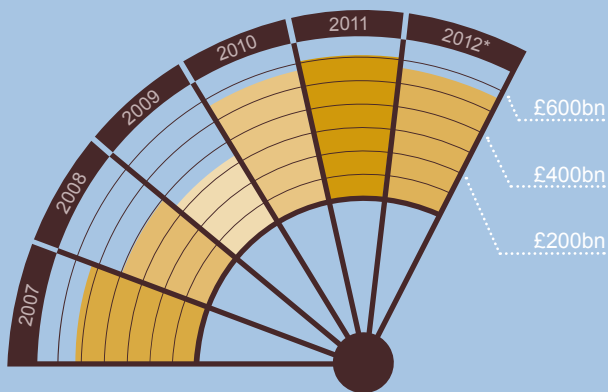
more likely to create long term value and this will help to restore global confidence in the M&A market amongst both participants and investors.

Many Japanese companies that have completed one successful outbound deal have gone on to do their second and third. This virtuous cycle is growing in ever increasing circles in Japan where companies have shifted their approach to M&A significantly in the last 18 months. As a

result, Japanese businesses are likely to continue buying overseas for as long as the yen remains strong and assets with tangible and intangible IP are for sale.

“Deals are taking longer to close in our experience and vendors are being more selective”

Value of mid-market M&A over time



Global PE v Global Trade

Year	Value (£bn)
2012*	£488.5bn
2011	£511.1bn
2010	£474.7bn
2009	£300.4bn
2008	£325.3bn
2007	£408.3bn



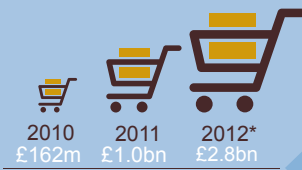
*Value for the LTM (Last twelve months to end of October 2012). Mid-market transactions defined as £50m -£1bn.

The view from
the middle kingdom



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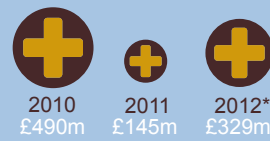
China means 'the middle kingdom' in Chinese and for many centuries the Chinese have believed that they live in the middle of the world with the West at the edge. And who's to say they're wrong? The recent rise and rise of China is seen by many as the natural way back to the centre.



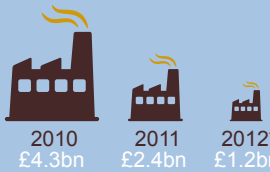
Consumer



Financial Services



Healthcare



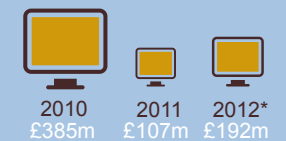
Industrials



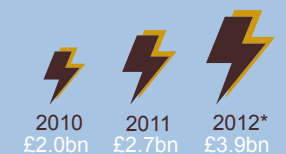
Resources



Services



TMT

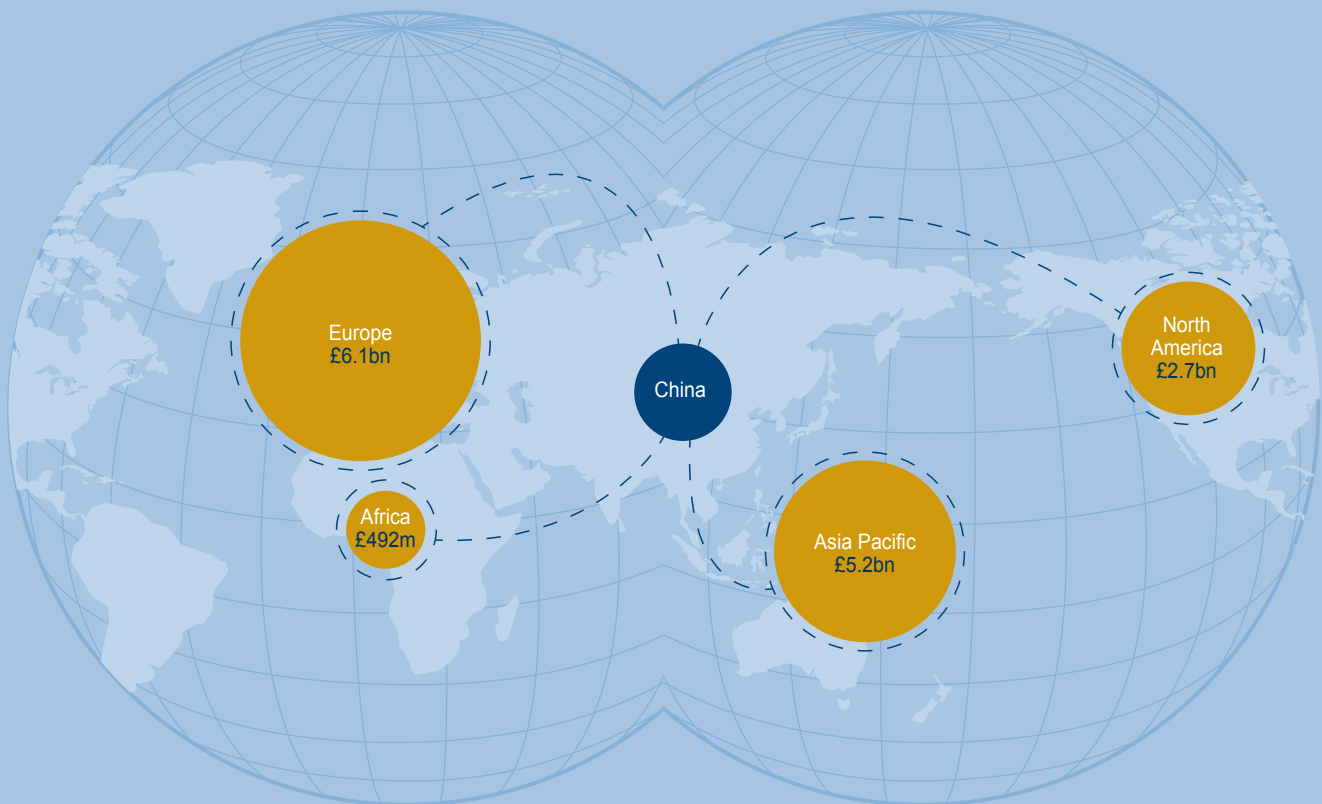


Utilities

'Total Chinese outbound M&A'

*Value for the LTM (Last twelve months to end of October 2012). Mid-market transactions defined as £50m -£1bn.

China's overseas acquisitions*



China's primary interest today is the potential of its domestic market. Current Chinese outbound M&A activity is testament to China's determination to develop technologically and build its social infrastructure to sustain domestic growth. China is attempting a huge shift from an order-taker – producing goods on-demand for the global market – to an innovator, producing leading technology and infrastructure for both domestic and global markets.

China's strong central state control of the economy is set out clearly in 5 year plans. With each day that passes China is also becoming more open and entrepreneurial. This combination of political and entrepreneurial zeal works in very powerful ways and we are seeing a wave of Chinese transactions in the prioritised industrial sectors of the 11th

5 year plan: airport infrastructure technology, High Speed Rail (HSR), automotive, bulk chemicals and mining.

“China's determination to develop technologically is resulting in a wave of outbound transactions.”

Consider HSR as an example of what China can deliver in terms of sheer scale and speed. HSR was only introduced to China in April 2007 and after a huge building boom, the world's longest HSR network has been built with 9,676 km of routes in service. With significant funding from the Chinese government a further 17,000 km of high-speed lines are under construction. The Beijing-Shanghai HSR opened in June 2011, reducing the 1,318 km journey between the largest cities in China to under 5 hours.

China's domestic market remains, however, the fastest growing and largest in the world for HSR systems. This is driving a lot of M&A transactions and a flow of European assets to China. China's initial high speed trains were imported or built under technology transfer agreements with foreign train-makers including Siemens, Bombardier and Kawasaki. Chinese engineers then re-designed internal train components and built indigenous trains that can reach speeds of up to 380 km/h. Foreign train makers continue to sell certain components but no longer supply train sets because China has procured the technology and processes for domestic production rather than importing finished products. There were even plans to build an HSR line from Beijing to London but the pace and scope of China's HSR expansion slowed sharply in July 2011 after

a fatal high-speed accident near Wenzhou, followed by global reports of corruption. Against this backlash, Chinese is now pursuing a different strategy. China's CNR recently secured a small but important components order from Siemens which attests to China's determination to enter strictly regulated Western markets and improve their advanced workmanship and safety know-how. This comes with the added benefit of driving advances in its own rail technologies – China's domestic market remains as the fastest growing and largest in the world for HSR systems, newly revised respect for the Western technologies will drive a lot of M&A transactions and a flow of European assets to China.

Talking head

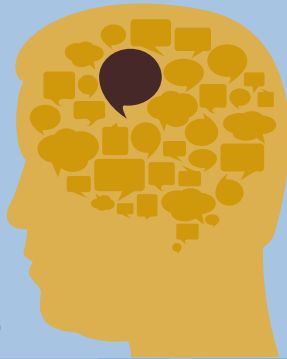
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“Chinese overseas acquisitions are often driven by commercial and political motives.”

Tosh Kojima



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Aerospace technology takes off

The development of China's airport infrastructure is another astonishing boom story with plans underway to open 70 new airports in the next 3 years and expand 100 existing ones, bringing the total to 230 airports. Europe has become China's favourite hunting ground for the technology and infrastructure to facilitate this type of break-neck development.

construction, as well as in more traditional heavy goods like material handling equipment.

The benefits are mutual; while Chinese companies scour foreign markets for new technologies (e.g. Avic & Cirrus / FACC) Europe is welcoming Chinese buyers as a means of gaining access to their huge growth market.

Europe is a global leader and global standard-setter in areas such as airport design and



230
airports
in the next 3 years

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Future growth

The 12th 5 year plan was approved in March 2011 with the aim of creating sustainable growth in China through increased domestic consumption and improved social infrastructure.

It provides the roadmap for the next hot sectors that will drive China's outbound M&A: energy (nuclear/solar), biotech (drugs/devices), new materials (precious metals), IT (broadband network/security

infrastructure), high-end equipment (aerospace/telecoms), clean energy / vehicles. The significant increase in outbound transactions from China to Europe has resulted in greater numbers of Chinese companies hiring European buy-side advisors, for the first time in many cases. DC Advisory has seen Chinese deal flow increase significantly and now has the biggest pipeline of deals in China that it has ever recorded.



The new Chinese leadership

Few Western observers appreciate the potential impact of the new Chinese leadership on state-owned enterprises (SOEs). SOE's dominate much of China's economy, and Chinese companies represent 15% of the Fortune 500 today, most of which are state owned. The boards and management teams of SOEs are not picked by AGM or institutional investors - they are tightly controlled by the Party's all-powerful Organisation Department.

China adopted gradualism and decentralisation to expand and manage its market-based economy and SOEs have been

the most important catalysts. In 1978 Deng Xiaoping boldly opened up China through commercial reform and Zhu Rongji continued to modernise SOEs through the 1990s. On the agenda for the incoming government (Xi Jinping will take power in March 2013 as PRC President, with incoming premier Li Keqiang at his side), is restructuring SOEs and separating their operations from government administration. A myriad of key reforms have been suggested including opening up large SOEs to private ownership, a move intended to boost competitiveness and the quality of management and governance.

Insiders believe that Xi Jinping will be a cautious reformer based on his history in the party in four different provinces over the last three decades (Fujian, Hebei, Shaanxi and Zhejiang). However, his new premier Li (who holds a PhD in Economics) might prove to be a savvy realist and complement Xi Jinping, by acting as a stealthy reformer.

“Key reforms have been suggested including opening up large SOEs to private ownership.”

In terms of the leadership's impact on European M&A, slow reform, or no reform, is likely to benefit European sellers and sustain the strong flow of outbound transactions. Following a stand-still period leading up to the 18th Congress of the Communist Party, all of DC Advisory's Chinese SOE deals are back on track. We are already seeing a renewed political determination and hunger for growth that is driving outbound M&A now, and for the foreseeable future.