Crowe Horwath

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The Global Corporate Advisor

The Corporate Finance newsletter of Crowe Horwath International

你好(Hello) from China and welcome to the July issue of The Global Corporate Advisor, brought to you this month by the East Asian team in China and Japan.

This month, we've included an overview of East Asia's M&A landscape. We also provide insight into some of the many transactions GCA was involved in during the first half of 2013 – from Australia to Brazil and many places in between. Our advisors have been hard at work on cross-border and high profile domestic transactions, conducting buy-and sell-side due diligence for organizations in a wide range of industries including aerospace engineering, agriculture, education, manufacturing, mining, real estate and technology.

And from our Rome office, cross-border tax and transfer pricing specialist Gaetano Pizzitola examines the potential effects of the OECD's new Base Erosion and Profit Shifting (BEPS) Action Plan, a global roadmap that will allow governments to combat perceived tax structuring abuses.

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Contact Us

The GCA team is here to respond to your needs relating to M&A transaction support, valuations and M&A advisory services. If there is a topic you would like us to cover in future issues of the GCA newsletter, don't hesitate to contact Peter Varley, Chairman of GCA at peter.varley@crowecw.co.uk. Alternatively, please contact your local member of the GCA team to discuss your ideas.

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The Asian M&A Landscape

By Antony Lam, China and Yuji Kutsuzawa, Japan

In this article, we provide our team's observations on how the global landscape is affecting M&A activity in major East Asian markets.

China

Industry data published by China Venture Investment Consulting Group indicated dramatic changes in M&A activity in China in the first half of 2013.

Completed Q1 M&A deals involving Chinese entities amounted to US$47 billion, representing 32% growth over Q4/2012 and 47% growth compared to Q1/2012. A key contributor to this growth was the acquisition of Nexen Inc., a Canadian oil and gas company, by the China National Offshore Oil Corporation for US$15.1 billion.

The total Q2 value of completed M&A deals in China dropped to US$25.36 billion, a decrease of 46% over Q1 and a 19% decrease over the same quarter last year. This is also the lowest quarterly figure in the last two years. In terms of total number of completed deals, Q1/2013 (490 deals) and Q2/2013 (410 deals) were at a two-year low.

Due to the slowing down and tightening of IPO approval process in China, we saw more private equity firms engaging in M&A activities now to provide exits for their investments made in previous years. There were also more foreign companies looking for Chinese M&A targets with matured sales and distribution channels in order to have an immediate access to the Chinese market.

China's manufacturing, energy, mining, finance and IT industries account for more than 50% of the total number of M&A deals completed in the first two quarters of 2013.

In terms of value of M&A deals completed, the energy and mining sector is still the largest contributor, accounting for about 48% and 25% of total value in Q1 and Q2 respectively.

In Q1/2013, the finance and food and drinks sectors accounted for approximately 31% of total M&A value. In Q2/2013, the media, finance, internet, IT and manufacturing industries accounted for about 48% of total M&A value.

The outlook for M&A activities in China remains unclear. There could be a pick up in the market following the low value of deals in Q2/2013. However, signs of a further slowdown in China's economy may see deal flow remain limited.

Japan

The first two quarters of 2013 saw the Japanese yen go through a strong correction phase. Acquisitions of foreign companies by Japanese firms decreased, but investments in Japan by foreign companies, particularly those based in China, South Korea and Taiwan, increased rapidly.

	No. of cases	Percentage change (year on year)
Domestic	560	+5.3%
Outbound	189	–10.8%
Inbound	55	+48.6%
TOTAL	**804**	**+2.9%**

Figure 1: Japan's M&A market in the first half of 2013. M&A transactions totaled ¥2,565 billion (approximately US$25.6 billion). Source: RECOF MARR online, Jan–May 2013.

Despite the increased interest from other Asian countries, Japan's overall M&A transaction amount decreased substantially, mainly due to the decline of large-scale natural resources projects.

Japan's domestic M&A market grew steadily, reflecting the scale of restructuring in Japan's food and retail sales industries, and the absence of effective succession planning structures in small to medium enterprises. Due to the country's falling birth rate, it has become increasingly difficult for SME owners to ensure the company passes to their children, and many choose to sell the business rather than pass it on in the traditional manner.

The weak yen reduced M&A investment by Japanese companies in other Asian countries.

Crowe Horwath Japan believes that to help overcome the heavy competition in the global market, large Japanese companies will continue to aggressively seek out and form business alliances with foreign companies that have a strong market presence in their home countries.

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GCA Corporate Transactions Overview

Crowe Horwath's Global Corporate Advisors team members have played a central role in enabling clients to assess and complete significant transactions worldwide. Here we provide a digest of recent deals by country.

Australia

In June 2013, Crowe Horwath in Brisbane issued an independent expert report for an off-market takeover offer from Cirrus Business Investments for all the shares in Careers Australia Group. Careers Australia Group provides training and education to more than 10,000 students a year from 16 education facilities across Australia. Cirrus is Careers Australia Group's largest shareholder and is backed by White Cloud Capital Fund Limited.

As the independent expert, Crowe Horwath concluded that the A$0.66 per share cash offer was not fair or reasonable and credited a valuation range of A$0.85 to A$0.96 per share. Cirrus is currently engaged in a bidding battle with Crescent Capital Partners, a private equity firm. Cirrus lifted its offer to A$0.87 per share, a 32% increase on its original offer.

Brazil

Crowe Horwath Brazil provided buy-side due diligence for Nelson Global Products, a US company that designs, manufactures and markets vehicle parts, on its US$20 million acquisition of Brazil-based Metalurgica ENVALL, a producer of agricultural machinery parts.

We provided buy-side due diligence for FIP PCMB, a Brazilian private equity fund, for its acquisition of Companhia Porto Cais Mauá, a real estate company that owns and is managing one of southern Brazil's largest real estate projects.

In June 2013, our team provided buy-side due diligence for NSG Capital, one of Brazil's largest private equity companies, on its acquisition of holding company FINPAR. We also provided buy-side due diligence for Maxima Private Equity FIP, a private equity fund, on its acquisition of MARSANS Brasil, Brazil's third-largest travel agency.

In July 2013, Crowe Horwath Brazil advised private-equity company Bricknell on its acquisition of 55% of stock in RIBA Motos, a Brazilian manufacturer of electric motorcycles.

Our corporate finance team is currently assisting US-based Benetech Brasil, a subsidiary of Benetech Inc, with its management restructure and performance improvement project.

In other news, Crowe Horwath has joined the Brazilian Private Equity & Venture Capital Association (ABVCAP), Brazil's most recognized association for private equity firms and venture capital developer. We are proud to be sponsoring ABVCAP's next Venture Forum in Belo Horizonte in August 2013. Crowe Horwath will also replace two Big 4 firms as lead trainers on ABVCAP's target-company advisory courses.

Germany

Crowe Horwath Germany provided post-acquisition support to one of the leading technology providers in the field of high pressure hydraulics after the business unit was carved out from the KION Group following the acquisition of the company's majority shareholding by a leading Chinese automotive and equipment manufacturing group. As part of our engagement, Crowe Horwath Germany prepared the consolidated IFRS opening balance sheet and we are now providing ongoing support to the company – preparing its monthly consolidated IFRS financial statements and group reporting. The client has subsidiaries in six countries on three continents and recorded sales exceeding €300 million in FY 2012.

In collaboration with our US colleagues, Crowe Horwath Germany delivered buy-side financial and tax due diligence services to a British American group that acquired the majority shareholding in a German consulting firm. The acquirer is a company that provides end-to-end enterprise mobility, managed services, printing and mobile data capture solutions to help organizations optimize their supply chain and field-based business processes. The German target was one of the early pioneers in successfully implementing global templates for SAP Track & Trace projects. Its customers include many of the world's leading pharmaceutical, tobacco and chemical companies.

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France

Crowe Horwath France recently assisted Aedian, an information and communications technology (ICT) services company based in France, with sell-side due diligence on a takeover bid initiated by Aubay, another French ICT services company. Crowe Horwath France offered a fairness opinion on the deal, which was valued at US$16.5 million (€12.6 million). The matter is ongoing.

In December 2012, Crowe Horwath France provided US-based chemical company Eurenco Inc. with a share valuation report on a subsidiary as part of an inter-group reorganization project.

Crowe Horwath France also assisted real estate company Foncière Développements Logements (FDL) on a share-exchange takeover bid with a target value of US$1.4 billion (€1.1 billion). The bid was initiated by Foncière des Régions (FdR), a holding company of real estate investment firms that own residential and commercial properties in eight countries. Crowe Horwath France issued a fairness opinion on the exchange parity proposed by FdR in exchange for FDL shares. The matter is ongoing.

Italy

In March 2013, Crowe Horwath Italy provided a buy-side valuation of local utility companies' gas distribution for one of the main Italian players in the sector.

In the first half of 2013, Crowe Horwath's Italian M&A team provided sell-side advice to Aeromeccanica Stranich, a provider of industrial ventilation and dust control technology. As a result, the shareholder of the company sold a minority of the shares to an Italian private equity firm for US$8M.

The team also provided sell-side advice to Sidemar, a producer of luxury silk clothing, on its purchase by Italian-based Perofil (licensor of Ermenegildo Zegna fashion house brand for underwear).

Between January and July 2013, Crowe Horwath provided sell-side advice to companies operating in a wide cross-section of industries including Malerba, a women's underwear manufacturer; wine producers La Meridiana; Cetra, a specialist in automotive and medical equipment; and Hascon Engineering, an air filtration system and ventilation manufacturer.

Singapore

In July 2013, Crowe Horwath Singapore provided buy-side financial due diligence and advisory services to a listed Malaysian company specializing in engineering services in the energy, oil and gas, semiconductor and marine industries. The company plans to acquire equity interest in a Singapore-based private company that provides precision-manufactured components to Singapore's aerospace sector.

In June, we provided buy-side due diligence services to a listed Japanese chemical manufacturer with annual turnover of more than US$5 billion. The chemical manufacturer plans to acquire a substantial shareholding in a group of companies involved in the waterproofing and marketing of construction materials and contract services in Southeast Asia.

In April 2013, Crowe Horwath Singapore provided buy-side due diligence services to a listed Japanese company specializing in overseas bridal services. The company plans to acquire a 50% equity interest in a Singapore-based group of companies specializing in food and beverage services.

Switzerland

Crowe Horwath Switzerland provided comprehensive buy-side corporate finance services to a private investor for the acquisition of Geneva-based franchises of Le Pain Quotidien SA, an international restaurant chain operating in many countries around the globe. Services included a valuation of the company, negotiation of financing terms with banks and key investors, and preparation of legal documents.

Crowe Horwath Switzerland also performed financial and tax due diligence for Genolier Swiss Medical Network, a SIX Swiss Exchange-listed network of private Swiss clinics, for its acquisition of Clinique de Valère in Sion.

United Arab Emirates

Crowe Horwath UAE is providing assistance to a well-known group holding company in relation to its proposed private placement for expansion of goldmine-related activities. The holding group is a family owned company, headquartered in the Dubai International Finance Centre. It has a portfolio of diverse businesses across a variety of sectors in the Middle East and North Africa, including companies involved in asset management, agriculture, real estate, logistics, commodities and technology. The group has operations in major locations including the UAE, Jordan, Switzerland and Turkey.

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United Kingdom

The Crowe Horwath UK team acted as the reporting accountant for UK-based Biofutures International plc on its acquisition of Platinum NanoChem and its £32.5 billion IPO raising following its placement on London Stock Exchange's AIM.

Based in Malaysia, Platinum NanoChem is a global nanotechnology company with an established revenue-generating business model to design, formulate, manufacture and market a range of IP-backed specialty chemicals and technologically advanced materials, including 'super material' graphene, from waste feedstock.

The enlarged group will work to capitalize on the global megatrend towards sustainability by supplying high-performance waste-based products into global markets and will also focus on the opportunities afforded by graphene-enhancement. The team's UK advisors joined forces with fellow Crowe Horwath members in Malaysia to complete the transaction.

Crowe Horwath UK also acted as reporting accountant on Fusionex International's £12 million placing and admission to London Stock Exchange's AIM. Headquartered in Malaysia, Fusionex International provides high-quality enterprise software and IT solutions to clients in Asia, Europe and the US.

Crowe Horwath teams in the UK and Malaysia collaborated on assurance work in both countries to ensure a seamless transaction. Fusionex International's IPO was London's largest technology IPO of 2012.

United States

In April 2013, Crowe Horwath US provided buy-side due diligence advice to Worthington Industries in its US$113.5 million acquisition of Kansas-based Palmer Manufacturing and Tanks, Inc. Palmer Manufacturing and Tanks, Inc. manufactures steel and fiberglass tanks and processing equipment for the oil and gas industry, as well as custom-manufactured fiberglass tanks for agricultural, chemical and general industrial applications.

During late 2012 and the first half of 2013, Crowe Horwath teams in the US and UK provided transaction support services to Leggett & Platt for its acquisition of US-based Folding Guard, a designer and manufacturer of loss prevention, storage, security and safety products; and David Hart Aerospace Pipes, a UK-based manufacturer of pipes and ducts for the aerospace industry. A member of the S&P 500, Leggett & Platt is a US$3.7 billion diversified manufacturer with locations in 18 countries. It conceives, designs and produces a variety of engineered components and products that can be found in most homes, offices and automobiles.

In late 2012, Crowe Horwath US assisted The Andersons, Inc. with its purchase of the majority of the grain and agronomy assets of Green Plains Grain Company, LLC, a subsidiary of Green Plains Renewable Energy, Inc. The purchase provided The Andersons, Inc. with seven facilities in Iowa and five in Tennessee, with a combined grain storage capacity of about 32 million bushels and more than 130 employees. Green Plains reported the sale price at US$133 million. The Andersons, Inc. is a US$5.3 billion diversified agriculture company. The company conducts business across North America in the grain, ethanol and plant nutrient sectors; railcar leasing; turf and cob products; and consumer retailing. Crowe Horwath US provided financial, tax, and information technology due diligence; pre-deal accretion analysis; information technology integration planning consultation; and a purchase price allocation study.

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Structuring Multinational M&A in Changing Times

By Gaetano Pizzitola, Italy

Globalization is compelling more entrepreneurs to look overseas for expansion and growth, following the path of large multinationals and early movers.

For decades, countries with low tax have been used as holding company locations for greenfield investments and M&A expansion abroad.

Treaty-protected countries have generally been preferred for M&A deals. Each region has had its preferred countries: Luxembourg and the Netherlands within the European Union; Mauritius for China and India; Singapore for the wider Asian region and so on. Participation exemption, foreign investors' protection, stability of legislative environment and exit strategy have been the key pillars on any foreign investment structuring from a tax standpoint.

These low-tax jurisdictions have also been popular for financing M&A investments, which generate double-dip benefits that either maximize return to equity investors or reduce the cost of external borrowing.

Similarly, IP companies have been used widely to consolidate ownership of intangibles in low-tax jurisdictions, and shelter income from taxation in high-tax jurisdictions.

Holding, financing and IP companies all share similar tax attributes: low or zero taxation, legislative stability, and certainty and protection of foreign investors. Small countries have attracted huge amounts of mobile capital but not much human and infrastructure resources. Capital investment management may not require the level of staff necessary to conduct manufacturing, service and sales activity. Low-tax entities have been structured as passive investment vehicles. Treaty shopping for locations has deteriorated the image of the tax professional community and multinational investors. Bad examples are easy targets for complaints, but a majority of investments are supported by sound business reasoning.

The global financial crisis of 2007–08 put these passive company structures in the political firing line. This began on 2 April 2009 at the London G20 meeting, which voiced concerns about the use of tax havens to avoid complying with internationally agreed tax standards.

The Moscow G20 meeting on 17–19 July 2013 saw the Organization for Economic Co-operation and Development (OECD) unveil its Base Erosion and Profit Sharing (BEPS) Action Plan for the next two-to-three years.[1]

The BEPS Action Plan identified 15 actions to "develop a new set of standards to prevent double non-taxation. Closer international co-operation will close gaps that, on paper, allow income to 'disappear' for tax purposes by using multiple deductions for the same expense and 'treaty-shopping'."

The Action Plan's goal is "aligning tax with substance – ensuring that taxable profits cannot be artificially shifted, through the transfer of intangibles (e.g. patents or copyrights), risks or capital, away from countries where the value is created."

The 15 items in the agenda are the digital economy, hybrid mismatch arrangements, strengthening controlled foreign company (CFC) rules, interest deductions, harmful tax practices, treaty abuse, permanent establishments, intangibles, risks and capital, high-risk transactions, BEPS data, mandatory disclosure rules, transfer pricing documentation, treaty-related disputes under the mutual agreement procedure, and developing a multilateral treaty.

This ambitious agenda plans to rebalance international tax rules to cope with the development of globalization and the digital economy. The framework of the League of Nations created after WW1 is now perceived by many as obsolete, which is a questionable assertion that will certainly stir wide debate in the business community.

From now on, the BEPS Action Plan means that any M&A structuring will have to take into account the increased level of risk and uncertainty created by foreign investments being targeted for tax audits by tax authorities from various countries, which may all try to take an extra slice of multinationals' profits.

We have already seen the Vodafone case in India. The US Senate used Apple, HP and Microsoft as bad examples of tax structures. Meanwhile Amazon is being challenged by the UK's public commission. Starbucks is under challenge in the UK and volunteered a US$30.6 million (£20 million) tax payment by foregoing certain tax reliefs. Google is facing large claims in France and Italy.

In such a political environment, M&A structuring will require a much more thorough and thoughtful process to identify the most efficient and safest strategies.

Good tax structuring will still pursue debt push-down, IP migration, profit maximization in low-tax jurisdictions, withholding tax optimization and exit strategies.

However, multinationals should carefully consider the reputation of targeted investment countries. The feasibility of an active management structure for financing, IP and investments will be necessary to prevent attacks on investment

1 http://www.oecd.org/tax/closing-tax-gaps-oecd-launches-action-plan-on-base-erosion-and-profit-shifting.htm.

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structures by tax authorities in one or more countries, within a few years of set up.

The above is true for public companies and private equity investments. Public companies will increasingly have to manage pressure from auditors with FIN 48–type accruals for tax risks. Private equity investments may face price discount claims at exit. The issue here is that tax due diligence may identify critical grey areas with the potential to drive down acquisition prices, including lack of substance, treaty shopping, abuse of law, business purpose, transfer pricing, permanent establishment, blacklisting and withholding taxes.

Business strategies and their documentation will be critical factors of success with any offshore tax structuring. As participation exemption methods are increasingly adopted in many countries, the use of local holding companies as foreign direct investments (FDIs) straight from the home country, rather than regional investments may be a good alternative to minimizing risks of treaty-shopping claims.

The adoption of regional-wide principal models may still be implemented but conversion to those structures will have to be deeply considered and carefully implemented to minimize risks posed by exit gain challenges, permanent establishment and transfer pricing.

Recourse to advance-ruling clearance and advance-pricing agreements will be increasingly beneficial to foreign investors to avoid aggressive challenges by tax inspectors.

Advisors will need to be attentive to matters such as how to balance using Special Purpose Vehicles for holding investments, equity funds and IP in low-tax jurisdictions, with the need to ensure an adequate level of substance. We believe there may be years of confusion and uncertainty on this point.

Substance will be an ongoing issue. The BEPS Action Plan specifically targets "the involvement of third countries in the bilateral framework established by treaty partners … in particular when done via shell companies that have little or no substance in terms of office space, tangible assets and employees".[2]

We hope the OECD will take a substance-over-form approach. To date, we have seen multinationals being unreasonably challenged by tax inspectors on this point. In one case in Switzerland, tax inspectors claimed that a multinational's foreign subsidiary was a shell company because it did not rent office space directly from landlords, but sub-rented it from other group companies using the same space. Tax inspectors also claimed that because the multinational only had a few employees or none on its payroll, the multinational's use of secondments and outsourcing did not provide an adequate level of substance for its operations.

Any multinational with a centralized business model may face an increase in tax authority claims that the model primarily exists to avoid tax, because the BEPS Action Plan also targets "tackling the use of intangibles, risks, capital and other high-risk transactions to shift profits".[3]

The iPhone and iPad are classic examples. These products are designed in Cupertino, California, and their success was driven by one single man. Years of investments were necessary to develop the products and Apple took significant risks to develop them by investing capital into low-tax countries. iPhones and iPads are manufactured in Asia and sold everywhere in the world. Should Apple stores be allocated most of the profits because customers purchase locally? What would happen if the iPhone and iPad suddenly stopped making profits? Would the US and the countries where stores and customers reside be happy to take the loss? Does anyone remember the PalmPilot? Which countries have welcomed and accepted PalmPilot losses?

This is precisely the challenge being presented to Amazon and Google by tax authorities. Their headquarters are in the US but they invest IP and capital in low-tax jurisdictions where profits from IP contribution to the value chain are taxed at a lower rate. However, if profits do not arise, the centralization of tax losses in one low-tax jurisdiction will conversely imply a high effective tax rate.

Meanwhile, in France and other European countries, Amazon has established logistics centers and customers purchase its products locally. Amazon has successfully exported this model to various countries. We do not perceive any major difference between Amazon's logistics centers and those established by older players which centralize their supply chains for product delivery.

Part of the problem is the complexity of a real substance-over-form approach – which is sometimes only a re-characterization of a form within another form – and what substance means in a business environment. Often, tax inspectors look for quantity and paper evidence, but in the modern global and digital economy, substance is not necessarily a matter of quantity. It is the quality of decision-making to manage operations. Intangibles, capital, and risk management do not require hundreds or thousands of employees. Control over the functions and risk is the key attribute of a substance-over-form analysis about the value chain and investment strategies implementation. Risks are taken by decision-makers rather than by the people executing strategies. Functions may be executed by different roles, such as a decision maker, an advisory service supplier or an agent executing instructions.

2 BEPS Action Plan Chapter 3, page 13
3 BEPS Action Plan Chapter 3, page 14

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In the current environment, M&A structuring through the use of passive vehicles will be even more critical for the above reasons. Multinationals and private equity investors may wish to take into account the need for the active management of functions as a protective measure to minimize the risk of challenge and advance-ruling clearances as tools for tax risk management, and seek appropriate professional advice to ensure that structures can withstand fiscal audits and challenges.

To structure a tax-effective investment, multinationals will need a qualitative analysis of the level of substance required to get to a safe harbor position.

Given that the current international tax climate contains much uncertainty, tax authorities worldwide are looking for extra cash to support public expenditure. As tax auditors are striving for profits, any strategy by multinationals to minimize profits locally will be increasingly scrutinized.

To defend profits from tax attack, these multinationals will need professional, case-by-case advice and implementation, together with an active management function. Rethinking and reassessing the sustainability of existing structures should be a top priority of every multinational's action plan.

For more information

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