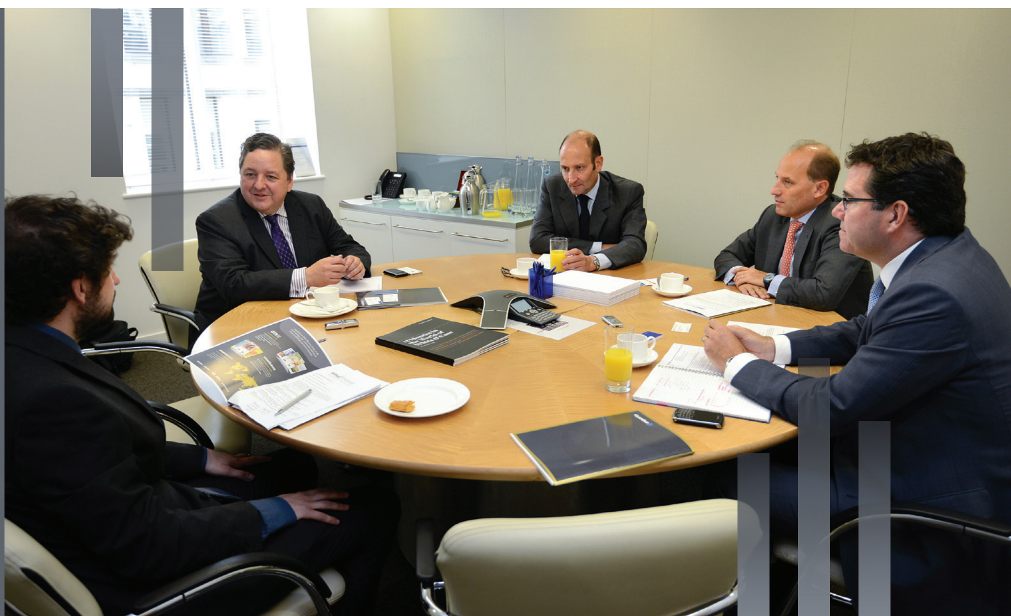
From left to right: Angelo Morganti, Jean Lafontaine, Ashley Ballard, Thomas Kolaja and Rod James.

"THE DISCIPLINE OF DEAL MAKING HAS COME BACK"

Although a feeling of confidence is returning to global markets, the first half of 2013 was slow for M&A bankers. Macroeconomic uncertainty led to reticence on the part of buyers and sellers and increased scrutiny of the most intricate details of a deal, with many transactions falling just short of the finishing line. In September, EMEA Finance brought together deal-makers at the headquarters of law firm White & Case to discuss their experiences.

At the table

- **Ashley Ballard,** Partner, *White & Case*
- **Thomas Kolaja,** Managing director, *Alvarez & Marsal*
- **Jean Lafontaine,** Managing director, financial institutions group, global banking, *Citibank*
- **Angelo Morganti,** Investment banking managing director, *Sberbank*
- **Rod James** *(chair)*, Senior reporter, *EMEA Finance*



EMEA Finance: How has the first half of 2013 been for the M&A market?

Morganti, Sberbank: 2013 hasn't been the easiest year so far. Activity in M&A has been slightly slower than we originally expected and this is probably driven by the macroeconomic picture and overall uncertainty in the capital markets. In terms of deals, there have been large and smaller transactions. Overall, I'd say that the pipeline is improving.

Lafontaine, Citibank: During 2013 there is more activity, more conversations and this should lead to an increase in transactions as well as the pipeline in the financial institutions sector across the spectrum of size. Having said that, it's really difficult to get deals finalised and executed at the current time as there is continued apprehension and risk aversion over executing deals with strategic implications or that could impact potential legacy at a time when the macroeconomic situation is better but still a little fragile. Conversations are intensifying and that is usually a prelude to seeing many more deals, hopefully in the next 12-18 months.

Ballard, White & Case: I'd agree with both of those observations. Given the remit of our discussion, I talked with a number of White & Case partners from across the CEEMEA region to gauge their views, which did demonstrate slight variations. In the first quarter of this year, particularly in the CIS, we saw a lot of activity as a firm and closed several high-profile transactions. This shows that there is activity and across certain sectors there are large deals, but across the region as a whole M&A is significantly down.

In Central Europe we are seeing an active lower mid-market – deals worth sub-US$100 million – and clients are getting financing to about 50% of deal value. So if you want to structure the deals you can, but getting deals away is incredibly difficult. There's a lot more lawyering involved than there was five years ago when there were many auction-run deals – there was more commercial negotiation than technical discussion. Clients are incredibly cautious about both spending too much money upfront and, when they start due diligence, having the wherewithal to pull out. One of our partners says it takes experienced deal-makers – the investment bankers or whoever is advising the client – and a lot of savvy to see the deal across the line.

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>
> **Thomas Kolaja**, Alvarez & Marsal

Kolaja, Alvarez & Marsal: We tend to look at smaller pockets of the overall M&A market, because we work largely with private-equity funds and also on the distressed base as a result of the restructuring work that we do.

On the private-equity side, particularly in Central Europe, we are seeing more exits and more interest in exits. That doesn't mean that private-equity funds aren't necessarily the buyers, but there seems to be a fair amount of fundraising going on and some firms that are planning to fundraise. So they need to clean up old portfolios to prove to general partners that they have the deal pipeline. As a result, transactions are perhaps more driven by the fundraising cycle than underlying economics.

On the distressed side we've found that there are more and more US and Western European investors taking serious looks at situations in Central Europe. I think this could signal one of two things. It could be that the crisis is bottoming out and is not going to get too much worse for Central Europe. Or on the other side it could suggest that countries like Poland and the Czech Republic are considered reasonably stable if you are going to put your money in emerging markets. But we are seeing funds that tend to be industrially focused – funds that are not usually in Central Europe – looking at larger transactions and taking them quite seriously.

EMEA Finance: So is Central Europe still viewed as a move down the yield curve when there are limited returns elsewhere?

Kolaja, Alvarez & Marsal: There are some people in London who say a move down the yield curve means moving into higher returns because of perceived higher risk. But the question is, where is the higher risk?

If you are looking at markets that are potentially going to grow faster than Western European markets, is that more

risky in a European context? Valuations for private-equity deals in Central Europe are astronomical compared to deals that you'd be looking at in Western Europe. You'd assume that if you are getting higher returns you'd be looking at lower valuations, but in fact people seem willing to pay top dollars to get into those deals.
Ballard, White & Case: For the right asset, though.
Kolaja, Alvarez & Marsal: It might also be driven by the constant discussion around regionally focused funds versus pan-European or global funds. The regionally focused funds have to invest in the region and there aren't that many deals to be done. So someone's going to get squeezed between a rock and a hard place if they actually have to close a deal. That might also be inflating the valuations.

EMEA Finance: I'd like to come back to the question of deal mortality. What are the mean reasons for buyer withdrawal?

Morganti, Sberbank: The mortality rate of deals has been quite high. Even as you get quite close to the finishing line there is a chance that a deal might fail.
Lafontaine, Citibank: I agree. In large part, I think this is due to continued dislocation between pricing expectations on the buy side and sell side. We have seen growing interest by financial investors as they consider this an opportune time to do deals at attractive valuations, but sellers feel they don't have to do deals at the wrong price. As a consequence, you find yourself in a situation where people spend a lot of time on due diligence to get the deal ready but at the end the deal doesn't get done.

I think that we are going to see deals go through multiple iterations before they ultimately conclude. It'll go through phase one, you'll get close to a deal, but then it will take months for people to come back to the table based on a revised valuation range which gets the parties closer to the levels where deals will get done.

EMEA Finance: Is there reluctance on the part of sellers in this market?

Lafontaine, Citibank: At the current time, we have seen that clients are sellers largely because they are required to be or because they have decided to allocate their capital differently in a changing regulatory environment for financial institutions. In this environment, management teams are addressing the simple key strategic questions: 'do I really need to be in a country or business line or am I going to be seen as a weak player if I'm selling an asset that I spent the years building up? Why am I there? And am I the right manager or owner of this asset? And can I really extract levels of return – financial or strategic – that are relevant to me?'

Everyone will define those terms in different ways, but teams are addressing these questions in more direct ways at the board level. However, as we previously discussed when there is a willing seller you don't always find the buyer because the timing is wrong or pricing expectations are very different. Recently, we have seen more situations like the one described – smaller situations that mostly involve getting rid of portfolio X in country Y. These deals don't make the significant headlines but I don't think there are significant headline deals in the financial services sector in the European growth markets over the next 12-18 months.
Ballard, White & Case: But in your space there are still deals that are being completed, though certainly at volumes a lot lower than they were a couple of years ago. In the FIG space, we advised Dexia when Sberbank bought DenizBank, driven by reorganisation in the parent company. UniCredit took the strategic decision that it was going to leave Kazakhstan. In both these cases, it's CIS money that is now at play.

EMEA Finance: Is this kind of intra-regional deal something that we are going to see more of?

Ballard, White & Case: Moving outside the FIG space, across industries, the M&A activity we're seeing in the CIS is primarily intra-CIS investment. There are investments being made by oligarchs and institutions in the region and certain more challenging jurisdictions in the Middle East. We're seeing investors who feel more comfortable than traditional Western investors for a whole variety of reasons, depending on which country you look at, and are still prepared to do those deals. These deals don't, perhaps, hit the front page of the *Financial Times*, but there is underlying activity and it's non-traditional, non-Western money going into these regions.
Morganti, Sberbank: I totally agree with that analysis of intra-regional activity.
Kolaja, Alvarez & Marsal: We are also seeing what I would call tycoons from Central and Eastern Europe trying to invest in Western Europe or elsewhere in the world. They're asking: 'How do I grow my empire throughout the region?' Or there might be some distressed assets in Western Europe, and we get calls from investors in Central and Eastern Europe who think they can get a good deal coming this way. That's certainly different to what we saw, say, 10 years ago.
Ballard, White & Case: But how many of those deals are actually closing?
Kolaja, Alvarez & Marsal: Yes, there's the valuation differential – the same type

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> **Ashley Ballard**, White & Case

of issues! But I think for the first time we are seeing those folks reach out to Western advisers to help close a lot of these transactions. There is a certain sophistication in the way these transactions are being conducted that has grown over the last decade.

"Well-functioning capital markets for equity and debt are the basic pre-requisite for a booming M&A market."

Angelo Morganti, Sberbank

EMEA Finance: How would you advise a buyer in a deal like that?

Kolaja, Alvarez & Marsal: One of the biggest issues is that a lot of buyers from the region – although they are very worldly – have not operated in other cultures very frequently. Therefore, despite the fact they claim to understand how different operating cultures work, in Germany or the UK or the US, they don't have the due familiarity and still rely on getting business done in the way they know. That generally hasn't worked very well for them when they do acquire assets in Western Europe or the US.

We will look at the failures and say, 'why didn't this investment work out?', and often it's a management culture-related issue that happened post-closing. Although transactions do close – if you have enough money and you are willing to agree to terms you can buy things.

Morganti, Sberbank: In the recent past I've been dealing within the CIS region, so the culture is very much the same. But when people are coming into the market we stress the importance of talking to a target's current management team, trying to retain that team, and also considering the opportunity to have a local partner that can help bridge the cultural differences between the buyer and the seller, and also provide support on any logistical, operational or administrative issues. But we've not seen many Western companies come into the CIS in the recent past – it's been mostly an intra-regional market.

Ballard, White & Case: Those of us who have advised on cross-border deals have been aware for a long time of the cultural differences. But as deals have become harder to get away because of underlying issues with the structure, there is tension in negotiations. When you add in the cultural differences, it requires a lot of skilful handling to keep both parties engaged and to avoid misunderstandings. That challenge has always been there, but I think perhaps it's more visible now.

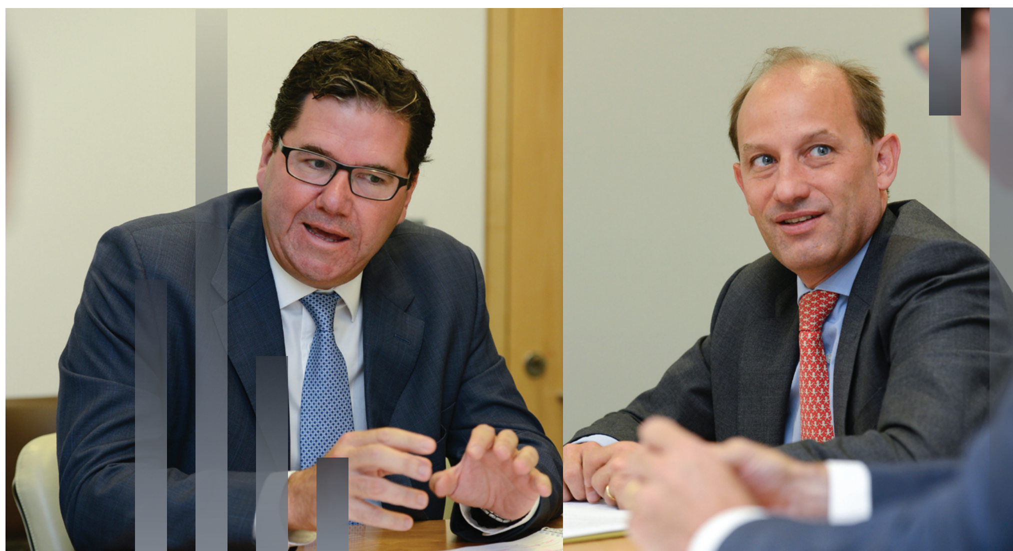
Kolaja, Alvarez & Marsal: I find that in deals I work on, that role of cultural translator is one of the main ones you play, far more than any technical role – especially in this situation where nobody is quite sure where the market is going. Very frequently it's because of cultural biases or past history that these problems start coming up. If you don't understand what both parties might have in terms of those biases, you are likely to hit a bump on the road.

Lafontaine, Citibank: But in addition to cultural differences, there is also a management-related point as many buyers are new to the region so there is a lot more time spent on due diligence due to the apprehension about getting deals done. Because of this apprehension, strategic deals are done with a great amount of diligence or at least a greater amount than has been seen in the past as boards ask a lot of questions. As an example, rather than doing six weeks of diligence it can be two and a half months – you've seen a lot of that in recent deals. We have also seen that teams spend more time on transaction structuring in order to implement protections for eventualities due to the economic times that we are going through.

Morganti, Sberbank: And then the week that you negotiate the SPA there's another level of detail and caution. Sometimes they are even being overly cautious.

Ballard, White & Case: This is being seen even with trophy assets, when running an auction process where a sell-side team knows they're going to get the deal away and it's just a question of what the price will be. And, more often than not, when you look back over the last 12 months those assets have gone for good prices.

On those deals, five years ago the process would have been expedited. The sell-side would have put an enormous amount of pressure on the buyer to do the transaction quickly and the buyer would have been more accustomed to moving quickly. Now, even on the sell-side, there is a willingness to allow the process to run and for due diligence to take place. In terms of deal-doing that's an interesting change, even though the headline price may be attractive at the end.



"There is continued apprehension and risk aversion over executing deals with strategic implications or that could impact potential legacy."

Jean Lafontaine, Citibank

EMEA Finance: Is this the situation right across the CEEMEA region? In Africa, for example?

Lafontaine, Citibank: I spent some time in Africa and we have a number of mandates there. Firstly, for a long time people have simplistically put frontier markets and emerging markets into one bucket when they are very different. This has changed recently as frontier markers have received more attention in the press. Now, Africa needs to be separated from the CIS, Turkey or Central and Eastern Europe. And even Central Europe has to be separated into a number of buckets. Africa is the last frontier and it is doing very well from a growth perspective, in any context that you want to look at it, although there are always detractors who will point out certain things. Having said that, people are looking at Africa like they were participating in the CEE or Asian growth story 15-plus years ago.

What we are seeing in Africa is that people who have risk tolerance and, more importantly, an understanding of the region can find it very simple to get deals done. Those that are new to the continent – private-equity players that are US or European-based or even Asian strategic investors – often understand the growth, but are spending a lot more time doing due diligence and getting a better understanding of the region or a particular country. In addition, they are finding deals getting done ahead of them because people who are doing the deals have an understanding of the risk, have a vision for where the country, continent and industry is going and are willing to make those investments. Africa is in a completely different place to where the CIS and Central Europe are at the current time.

Ballard, White & Case: Africa is traditionally resource-based or mineral extraction-based and with what we've seen over the last 5-10 years in terms of the growth of Asia, there is a lot of Asian money, sovereign wealth fund money, driven by the strategic need for resource security. Again, picking up on Jean's point, there's a willingness to do deals because there is a national imperative. Also, underlying it all, South African banks are investing throughout the continent. White & Case just advised a Nigerian bank making an acquisition of a Kenyan bank – those kinds of investments and consolidations are taking place.

EMEA Finance: On the whole, would you say that financing is easy to come by?

Kolaja, Alvarez & Marsal: I think it is easy to access, especially now. You're not talking about crazy multiples in terms of debt, but three or four times EBITDA doesn't seem to be too much of a problem. We are seeing in South and Central Europe, oddly, a huge interest in Greek banks to provide finance for deals in former Yugoslavia, trying to get their money out from Greece as quickly as possible. So there have been unexpected sources of finance.

For the most part banks are open for business in Central Europe. Also in Poland, which didn't get hit by the crisis. It's slowing down a little bit now, but for the most part things are pretty stable there, so Poland and the Czech Republic are a sort of bedrock in the region. There's not been any trouble getting financing for deals and good sponsors always get money.

Lafontaine, Citibank: I think deals to date have been relatively small and have been largely self-financed. Secondly, banks do have a greater willingness to lend money at the current time. They are under more constraints, but there is a growing willingness to finance deals that are well structured.

Kolaja, Alvarez & Marsal: From what I've seen on the restructuring side, all the lending done in Central Europe over the past, say, 20 years has been done on a bilateral basis. There have been very few syndicated loans and I'd say that most of the banks haven't learned much from the crisis. They continue on without inter-creditor agreements, just providing money to clients.

Some banks tend to be far more conservative and I would say Citi is the one that was most aggressive at dealing with problems at the beginning of the crisis. But a lot of other banks seem unwilling to say 'I'll take a bigger position in order to reduce the number of lenders in a bank group'. There's still a great willingness to pile in on a bilateral basis. The justification is usually 'Because the clients wanted it that way', as opposed to trying to de-risk. It's unfortunate that there hasn't been a bit more rigour in lending groups really focusing on syndicated loans or inter-creditor structures.

EMEA Finance: Is this a sentiment others agree with?

Morganti, Sberbank: I agree that banks are open to lending for good deals and leverage of three-four times EBITDA is what we are seeing. Banks are also taking their time to carry out due diligence, much like buyers. But lending through banks is the main if not the only source to get financing of deals in our region – deals get financed either through self-finance if they are small or bank loans and syndicated loans. I was trying to think of the last time I saw an M&A deal financed in the CIS region from public markets – through

bonds or with equity. I think the good news is that banks are open for business and looking for good opportunities to deploy their capital. The challenge is finding deals that match all the criteria of the banks because they are learning their lessons from unwise lending decisions of the past.

EMEA Finance: When advising a buyer, do you ever encourage a movement away from bank financing towards the markets?

Morganti, Sberbank: Of course we look at all the financing options, but right now the execution risk of funding an M&A deal out of bonds increases the overall risk significantly. So if there is bank financing available, you eliminate one of the risks because you want to avoid a situation in which you are close to closing a deal and all of a sudden the bond markets shut down. In this market situation, realistically, we encourage people to consider lending as the best option. And we see potential buyers looking more towards banks and not wanting to deal with bonds or equities.
Lafontaine, Citibank: Particularly in Russia you see a significant amount of bank financing because there's a huge amount of liquidity. Public markets will open up over time for the right deal at the right price.

EMEA Finance: What do you expect to happen in the next 12-18 months? Will we see an upturn in M&A?

Kolaja, Alvarez & Marsal: Clear blue skies, 100% growth, it's going to be great... I wish I could say that, but I could also say the exact opposite. I hope we see increased stability, I hope things start picking back up. I think that's the kind of signal we are getting but I wouldn't bet my life on it.
Morganti, Sberbank: I agree with Thomas – I would not bet my life on the chances of a strong recovery in the short term as we had too many bad surprises in the last few years. But we agree that in the next 12-18 months, the issues that have affected risk aversion and uncertainty should have been resolved.
The problem is we don't know if other issues might arise. If nothing new arises, the next 12-18 months should see the return to a more stable situation – capital markets will be functioning better and I believe that well-functioning capital markets for equity and debt are the basic pre-requisite for a booming M&A market. But the main concern is that there needs to be a removal of risk aversion. At the moment this is reflected strongly in the structuring and the due diligence, which clearly increases the difficulty of getting deals done.
Lafontaine, Citibank: I think that the discipline of deal making has come back and is going to be here for the next phase of the M&A cycle over the next 18, 24, 36 months... If you take the Asian crisis in the late 1990s as an example, it took approximately 10 years from start to finish for people to become comfortable again. This crisis started in 2007 and we are getting towards the point where people are feeling surer of stability. In this frame of mind, people feel more comfortable doing deals. There are many signs of stability – but are we at the bottom? Is it going to get worse? I think our houses have different perspectives on that. But once dealmakers feel the curve start going higher, people will be much more willing to do deals. That's not that far away, but the timeframe is very difficult to pinpoint.

There will be roadblocks as there always are. Ongoing macro-political situations could derail the situation at any time – Syria could cause an 18-month timeframe to double or stretch even further out. Again, capital markets need to be open and we need stability. It's close, but how close is it? In my mind we will see more activity over the next five years.
Kolaja, Alvarez & Marsal: Plus or minus three years!
Ballard, White & Case: We are cautiously optimistic. We're talking about the whole of CEEMEA so the reasons for stop-start growth differ depending on which sub-area you're looking at. With nearly all of those areas there are reasons to hope and expect that current blockages will be removed and it's possible that once deals start to be done, and people start to feel more comfortable, M&A will gain momentum. But likewise there's every reason to be cautious. Events could arise that mean deals don't happen. I still think that those trophy assets in the area people want to make investments – the insurance sector, telecoms, cable – will need to be got away, even though pricing is an issue. I don't think it will get any worse. ●