UK herald of slump in M&A

Global merger and acquisition (M&A) activity picked up last year but slumped in the UK as the euro zone crisis deepened, according to statistics compiled by Mergermarket.

The independent M&A intelligence service reported that $2.8 trillion of deals were completed worldwide in 2011, up 2.5% from $2.13 trillion in 2010 and the best total since 2008 when $2.40 trillion was recorded.

However, a breakdown of the quarterly totals shows a steady drop-off as the year progressed. In Q4 only $432bn of deals were completed, a 22.5% drop from Q3.

Private equity buyouts also recorded their strongest annual figure for three years with a total value of $277.7bn – an increase of 15.3% over 2010.

However, in the UK, traditionally Europe's biggest M&A market, although 1,015 deals were completed – more than 10% up on the 2010 figure – their total value only amounted to £75.1bn. This represents an 8.17% drop from 2010 and was the lowest annual figure recorded by Mergermarket since it began compiling data in 2001. Brewer SABMiller's £7.81bn acquisition of Australian rival Foster's accounted for more than 10% of the total.

Foreign M&A investment activity in the UK rose to £56.8bn – 75.6% of all UK M&A deals and the highest proportion ever recorded.

Student excluded

In accordance with the ACT's ethical code and disciplinary rules and further to an order of the disciplinary committee dated 7 November 2011, Isaac Mabwa is excluded from being a student and sitting any of the ACT's exams. In addition, following a resolution passed by Council on 8 December 2011, Mabwa is excluded from membership or from serving as a corporate representative. The ethical code and disciplinary rules are available at **www.treasurers.org/ethicalcode**

FTT costs multiplier to send FX through roof

Foreign exchange market transaction costs will rocket if the EU pushes ahead with plans to introduce a financial transaction tax (FTT), claims a report.

Research conducted by consultancy Oliver Wyman and commissioned by the global FX division of the Global Financial Markets Association (GFMA) found that costs would typically be an estimated three to seven times higher, but up to 18 times higher for the most traded part of the market. Given the tight margins in FX markets this would hit the real economy, with the increase largely passed on to end-users such as Europe's financial institutions and corporates.

The report, "Proposed EU Commission Financial Transaction Tax: Impact Analysis of Foreign Exchange Markets", suggests that the tax's primary impact of higher transaction costs, relocation of trading and a reduction in notional turnover would be accompanied by a secondary impact of a potential reduction in liquidity, leading to a widening of bid/ask spreads.

"The FX industry is an essential part of a stable and sustainable economy, underpinning international trade and investing," said James Kemp, managing director of GFMA's global FX division. "This study shows that the proposed tax would in effect penalise Europe's businesses for sensible risk management – by using FX products to manage currency fluctuations – and also threaten to impose further costs on the investment returns of pension funds and asset managers.

"In addition, the combination of direct costs and indirect costs, arising from reduced market liquidity and wider bid/ask spreads, means that raising €1 in tax is likely to cost users more than the amount of the tax itself." ■

Taskforce gets ACT expertise

ACT president James Douglas has been appointed to a taskforce set up by the government to look at boosting non-bank finance options for business.

As part of the government's credit easing initiatives, business minister Vince Cable commissioned the taskforce to examine the structural and behavioural barriers to the development of alternative debt markets in the UK, building on recent work that has been undertaken on this subject.

Douglas: SME funding mission

UK businesses have been heavily reliant on banks to raise finance. The majority of smaller and mid-sized businesses (SMEs) rely solely on bank loans to raise finance. Only around 10% of SMEs seek asset-based finance and fewer than 5% choose bond or mezzanine finance.

The taskforce will work with businesses, lenders, investors and providers of alternative finance to examine structural and behavioural barriers to raising non-bank finance. It will set out the steps needed to ensure businesses can access a wider range of alternative finance.

The taskforce held its first meeting in January and has been asked to report prior to Budget 2012. Led by Tim Breedon of Legal & General, other taskforce members include Helen Alexander of the CBI, Julian Franks of the London Business School, Brian Robertson of HSBC, Xavier Rolet of the London Stock Exchange, Christopher Rowlands (formerly of 3i), and Charles Roxburgh of McKinsey.

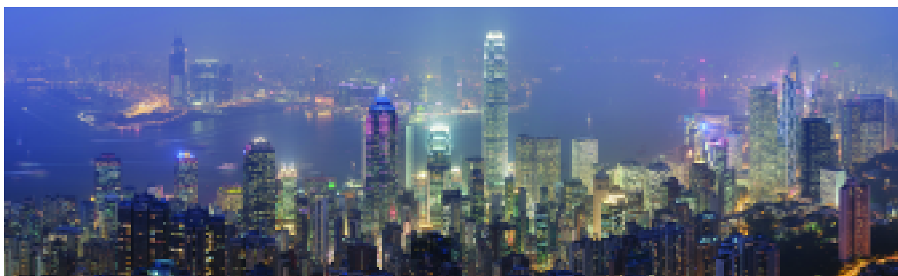
Banks welcome China coup

Chancellor George Osborne's initiative to establish London as a leading offshore trading centre for the Chinese renminbi has won an enthusiastic response from the banking sector.

At last month's Asia Financial Forum in Hong Kong, Osborne said the UK aimed to be "the home of Asian investment into Europe" and signed a deal that could establish closer currency links between Britain and China.

"China's importance as a global trading partner means more and more British businesses are looking to trade with the country, so any agreement which makes it easier to trade in the local currency is welcome news," said Sam Ford, Barclays' head of risk solutions.

He added: "We have seen increasing interest from British firms to use the renminbi to settle trade transactions. I suspect the announcement will only accelerate that trend due to the benefits to corporates when doing business in China." ■



Pearl River jewel: China's trade settled via Hong Kong in 2011 was triple the 2010 figure

Pension schemes split over liabilities

The UK's major pension schemes are evenly divided over whether pension liabilities should form part of their annual accounts and be subject to audit, reports KPMG.

The firm polled 250 major schemes with assets ranging from £100m to over £1bn and found an equal divergence of opinion for and against the change. Currently only scheme investments and transactions are included in scheme financial statements and subject to annual audit, with liabilities dealt with in the actuarial valuation.

Kevin Clark, associate partner in pensions audit at KPMG UK, said the split suggested "a flexible approach" from the Accounting Standards Board (ASB) would be welcome when it issues guidance on pension scheme accounting in a year's time.

The ASB's proposals, currently under development, will consider three options available under international accounting for dealing with actuarial liabilities. The options are to include them in the financial statements to create a balance sheet, to include them in the financial statements as notes, or to attach them to the financial statements as a separate report. ■

Credit choke looms for businesses

Credit availability to the corporate sector is stable to slightly improved, but the longer-term omens suggest it will become scarcer and more expensive, says the Bank of England.

The Bank's latest credit trends report covered the fourth quarter of 2011 and was based on a survey conducted between late November and mid-December.

The overall availability of credit to the corporate sector was broadly stable during the quarter, with a slight increase for medium-sized businesses. This is likely to be maintained in the first quarter of 2012, with a modest increase for small businesses too. But the Bank added that this more positive trend would be offset by the weak economic outlook and tighter wholesale funding conditions. Developments in the euro zone and the resulting impact on banks' funding conditions would also affect credit availability.

In the meantime, credit demand from small businesses fell sharply in Q4 and a further decrease was expected by lenders in Q1 2012. A smaller dip in demand was also anticipated from larger businesses.

The report noted that for corporates of all sizes, spreads on lending widened towards the end of 2011 and forecast the trend would continue in the current quarter, driven partly by the passing on of increased funding costs.

Separate Bank data showed that lending to private non-financial companies rose by £1.8bn in November 2011 compared with October, more than offsetting declines recorded in the previous two months.

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ACT Digest

Below is a round-up of the issues the ACT has been working on recently.

Key messages

The European Association of Corporate Treasurers (EACT) survey of bank relationships and funding conditions for corporates across Europe has been kept open to catch a few final responses. We still need a few more from the UK to keep up with the response rates from the national treasury associations on the continent.
Please take a few minutes to complete the survey at http://svy.mk/wUGZbl

■ Narrative reporting
The ACT has been a long-time supporter of good narrative reporting to supplement and explain the bare numbers appearing in accounts. It has therefore submitted a response to the BIS consultation on narrative reporting, a key element of which is to replace the current business review and director's report with a strategic report and an annual directors' statement.

■ Bank capital charge on derivatives
Under Basel III banks will have to hold much more capital to back credit exposures on derivatives not covered by collateral, making them more expensive for customers. In transposing Basel III into European law, the European Parliament has proposed a very welcome amendment to exclude derivative deals done with non-financial companies from this additional charge. The UK government does not intend to support this change, so the ACT will now be focusing on justifying the amendment to HM Treasury and the FSA.

■ Pensions threat
The ACT has responded to the European Insurance Occupational Pensions Authority's (EIOPA) consultation on EU proposals to regulate occupational pension funds as if they were insurance companies. The ACT response is that the approach would result in the final closure of all defined benefit pension schemes by requiring sponsor funding in excess of buyout valuation levels. Various analysts have put the extra funding required at up to £600bn. Those responsible for pension funds should make their views heard now and at every opportunity.

Black swan alert

Too many major organisations have archaic risk management practices that are no longer fit for purpose, according to research by PwC.

The paper, "Are black swans turning grey?", says major impact, catastrophic events are becoming more frequent. Upgraded risk management practices that explicitly focus on risk appetite are needed, and responsibility for this resides with the board.

Sykes: predictability of risk events falling

So-called black swan events include terrorist attacks, tsunamis and major oil spills. To combat them, businesses need to be more agile and innovative, which in turn will confer broader risk resistance, said PwC.

The paper notes that most major corporations now employ enterprise risk management, which can influence the personal behaviours and sense of responsibility that businesses need by encouraging a box-ticking, process-led approach. This could lead front-line staff to regard risk as separate from their own business decisions.

It adds that large organisations have already developed blind spots, from which high-impact risks can emerge to damage or even destroy the business.

"Many organisations currently have the wrong focus," said Richard Sykes, PwC's governance, risk and compliance leader. "They major on financial and operational risks and crucially regard risk and strategy as separate, rather than seeing risk taking as a key source of value creation. But the world where risk events could be predicted – and their impacts controlled – is fast disappearing."

The paper puts the case for comprehensive risk management, which, it argues, makes companies distinctive and more appealing to prospective clients, and gives competitive edge. Properly embedded, it helps protect corporate reputations and enhances intelligence, while providing a clear view of the board's attitude to integrity, risk and safety. ■

UK fraud figures soar

Reported fraud cases against UK businesses showed a steep rise last year, surpassing the £2bn level for the first time, according to BDO.

The accountancy firm collects annual data from all reported fraud cases where the sum involved exceeds £50,000. Between December 2010 and November 2011 a total of 413 cases with an average value of £5m were recorded, against 372 cases with an average value of £3.7m a year earlier. At just under £2.1bn the total figure was up 50% from the £1.4bn recorded in 2010, and seven times higher than the £331m recorded by the first UK FraudTrack report in 2003.

There were mixed fortunes for specific sectors. Tougher anti-fraud measures were reflected in fewer cases in the financial services and insurance sector, which accounted for 27% of all reported fraud cases last year, against 56% in 2010. By contrast, the retail sector accounted for 12% of cases, against only 2% a year earlier.

Bevan: risk is not just external

BDO's head of fraud, Simon Bevan, said: "The fact that reported fraud is up is worrying but not at all surprising. When the economic climate is difficult there is even more focus on the bottom line and driving out unnecessary costs, so fraud is more likely to be uncovered.

"But organisations need to be much more proactive in preventing fraud.

"Too often risk teams are either too externally focused or fail to look at fraud from a financial point of view." ■

Brighter than you think

IN THE FOURTH QUARTER OF 2011 UK PRIVATE EQUITY INVESTMENT ACTIVITY WAS, SAYS **JIM KEELING**, RATHER LIKE AN ICE HOCKEY MATCH – A GAME OF THREE THIRDS, WITH AN APPARENTLY THRIVING SMALLER BUY-OUT SECTOR, FALTERING LARGER DEALS AND AN ALL BUT MORIBUND MARKET FOR DEVELOPMENT CAPITAL.

The really striking feature of the fourth quarter of 2011 was the rise and rise of smaller buy-outs – those of less than €150m. It's the sort of observation you might have expected in 2006 or 2007 but, no, here I am in 2012 reviewing the last quarter of 2011.

But if all is well for smaller buy-outs, the picture is radically different both for their larger cousins and for early stage or development capital deals. You might say it looks like a game not of two halves but of three thirds, so the game the market seems to be playing is ice hockey, which for obscure reasons takes place in thirds.

Take a look at the historic statistics. At the end of the third quarter of 2011, there was an "uplifting" story for smaller UK buy-outs (of less than €150m enterprise value), which continued up to the end of the year. With 105 smaller management buy-outs at a total value of €4.6bn, 2011 trumped 2010, which was itself ahead of 2009. And, while activity was not at the heady (most would say overheated) levels of 1999 and 2007, it compares well with 2001–03; on the current trend, it should quickly return to 2004–06 levels. So things look quite rosy for the UK private equity practitioners who occupy this space – surely an unexpected result, given the prevailing economic gloom.

The story for larger UK buy-outs (€150m or above) is not so heartening. The pick-up of 2010 has gone into reverse. Both volumes and values are down, at 24 deals for a total of €11bn for the year, producing a gloomy, at best stuttering trend.

The picture is similar for UK early stage and expansion capital deals. The result for 2011 fell to a lower level, both in terms of volume (140 deals) and value (€1.2bn), than any of the preceding 12 years. The outlook for early stage and expansion deals, as for larger buy-outs, still seems bleak.

Some weeks before the historic statistics were available, private equity researcher Unquote found the market practitioners it surveyed broadly optimistic on the market for smaller deals: three times as many thought activity would rise as thought it would fall.

The picture for larger deals was almost the reverse, with roughly twice as many respondents reckoning deal activity would fall (and, given the current trend, that means will fall further) than thinking it would rise.

The survey went on to look at leverage. Respondents' views were split fairly evenly between those who thought there was enough debt available and those who thought there wasn't. Interestingly, the proportion of deals entirely funded by equity took a significant upturn, from 17% to 27%, suggesting that private equity executives are losing patience with any perceived or real lack of bank debt and so are just getting on with deals. Certainly, in order for an equity funder to be taken seriously in the current market, it is almost a prerequisite that they say they are prepared to fund proposed transactions 100% themselves if necessary.

Almost half of respondents viewed values as having stabilised. This might reflect cost cutting, which is expected to continue through reducing staffing levels, or it might simply demonstrate the operational strength of underlying businesses – as the head of one fund recently commented, 60% of its portfolio companies continued to trade ahead of the prior year.

Perhaps the most telling survey question, though, was the final one, even though it was not private equity-specific. The overwhelming response to the question "Do you believe that Europe's leaders are doing enough to restore some investor confidence in the euro zone?" was "No". This is the feature of the current environment that could throw all historic trends and predictions off track, although it should also be remembered that turmoil and adversity always create opportunity for nimble operators.

In the meantime, despite anything you might read in the news, all is not doom and gloom for dealmakers. Indeed, considering that a large proportion of UK private equity dealmakers – whether principals, investors or advisers – are involved in deals of less than €150m, you could just as easily conclude that the outlook for 2012 is bright.

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This article is an edited extract of Corbett Keeling's regular quarterly commentary on UK private equity investment activity and was originally published in Unquote.