

May 2011

The Leading Edge

Keeping you informed
on transaction matters



Welcome to the sixth edition of *The Leading Edge*, keeping you informed on transaction matters.

I am pleased to provide you with the sixth edition of *The Leading Edge* which has a clear focus on providing insight into trends in the transaction arena in FY12 and delivering optimum deal satisfaction and best practice integration strategies.

Results from our latest *Capital Confidence Barometer* highlight that growth is now a priority, and appropriately, insights from our 2011 corporate *development survey* assist in optimising growth strategies by identifying common key success factors in integration while also highlighting the potential pitfalls around transition of ownerships.

Despite growing optimism in the economy, working capital management should still be a priority for businesses, big and small. Whether exiting or acquiring, better working capital management offers extraordinary opportunities to improve the upside on your end of the deal. We lift the lid on working capital management, discussing the value involved and where to find it.

For some corporates the impact of the downturn may be all but a distant memory; however the world is now facing a different battle, one with Mother Nature. We turn to our Queensland Partner, Grant Murdoch, who touches on how the disasters in the area have bonded communities and businesses across the State and left a legacy of civic pride, community strength and more meaningful and enduring partnerships.

Further away from home we hear from our Transaction Advisory Services Managing Partner in Greater China, Bob Partridge, touch on the new security review mechanism that has been introduced for foreign-invested M&As in China. He looks at what extra precautions Australasian deal makers should be looking to take before attempting to enter this growing market.

As always we hope you find our articles interesting and informative and welcome your feedback or questions.

Graeme Browning
Oceania Managing Partner, Transaction Advisory Services
May 2011

Contents

Under the radar - Why working capital should be higher up on the transaction agenda	1
Ripe for the picking? - Capital Confidence Barometer	4
After the honeymoon - The avoidable mistakes behind many integrations	7
Taking the reins - How to mitigate risks during a straight transition of ownership	10
Disaster recovery - The relentless pace of the global transactions market	12
No pain, no gain - The impact of a new security review mechanism for foreign-invested M&As in China	14
On the edge	16
Contacts	17

Under the radar

Why working capital should be higher up on the transaction agenda

Whether exiting or acquiring, better working capital management offers extraordinary opportunities to improve the upside on your end of the deal. Wayne Boulton, Advisory Partner, Ernst & Young lifts the lid on working capital management, discussing the value involved and where to find it.

Working capital is the classic middle child in any large business. Lacking the gravitas of the eldest or the currency of the youngest, it goes largely unnoticed, around the three or four mark on the executive agenda for most of the year. And, when organisations swing into transaction mode, it often sinks even lower on the priority list.

This is a mistake. When it comes to stripping cash out of a business you're exiting, extracting value from an acquisition or even pumping up your equity before you buy, nothing gets a faster or more impressive result than improving working capital.

This is often a surprise to the executives involved. A private-equity owned company had been running a new transaction for 12 months before cash flow became heavily impacted by a new tax. Having been assured by the CFO "You're not going to find a dime in my business", one of our working capital teams extracted \$45 million within four months.

This windfall came from mundane, but expensive, errors. The company was billing customers a month later than its competitors and paying its suppliers too early, with identical payment terms across its supply chain. All it needed to do was bring its billing in line with industry standards, stratify its supplier base by value and negotiate longer terms of payment with smaller suppliers.

Sometimes you don't even have to change the process. A healthcare provider recently took out \$30 million in 90 days by simply establishing a weekly dashboard and running awareness sessions. Once the general managers became aware of the money leaking out of the organisation, the gaps were swiftly plugged.

In both cases, the fix was easy, fast and permanent - almost too simple.

One of our working capital teams extracted \$45 million within four months.

Hidden in the detail

The first issue that prevents companies from getting working capital right is hidden in the detail - under the executive radar. For example, an education services provider had a problem with its debtors. At first, the issue went unnoticed. But when \$5 million turned into \$10 million, the CFO blew the whistle and demanded an investigation. It turned out the provider billed its international students

through overseas agents, but there was no process to manage debt collection from these organisations: no standard letter, call or escalation - no one was chasing the debt. Not surprisingly, the Asian agents were just sitting on the cash, mildly surprised their Australian customer didn't appear to be interested in collecting it.

In another case, a review discovered that allowing EBA employees to set their own shifts resulted in 10% higher wages costs, with staff working the system to produce as many shifts as possible on time and a half.

For every one of these real life examples, there are many, many more still going undetected. In fact, this type of basic error is astonishingly common. Because, if you're operating at the helicopter level - as every CFO should - it's hard to see the glitches at the process level.

What executives fail to grasp is that, while the working capital fix is usually simple, its problems are invisible. Individually, they are too insignificant for executive attention. Collectively, they could fund your next acquisition.

For example, if you're carrying too much inventory, you could be sitting on tens of millions of dollars. In one case, a mine site audit discovered someone had ordered 12,000 units of a cleaning product, which turned out to be 45 years' worth of stock. This one instance of over-ordering landed the company with \$15 million in excessive inventory.

We believe, if the oil and gas sector tightened up its working capital practices, it could free up as much as \$5 billion.



Who owns the process?

If the first issue is the level of detail required to spot a cash leak, the second is ownership: your organisation can be riddled with working capital problems across multiple operational silos. The processes that drive your inventory and accounts sit in different parts of the business and are often decentralised. Accountability and ownership are spread to the four corners of your business - which is why it's rare to find a head of working capital.

Pay constant attention

This brings us to the third and final issue: managing your working capital requires constant vigilance and attention. It's the never ending story - not a set and forget - flowing with the peaks and troughs of your business and a relentless flow of emerging issues. You need to have someone paying attention all the time, not just when things get tough.

The Global Financial Crisis made corporate Australia pay unusually close attention to cash flow. And, since then, the lack lustre conditions in most sectors, especially media, entertainment, retail and telecommunications, mean that many companies have stuck with the changes. However, this has not been the case in the mining, oil and gas sectors, which relaxed as soon as cash flow pressures reduced on the back of rising commodity prices. In these sectors, management attention has now moved to improving sales and profits - at the expense of carefully managing cash.

This trend was clearly demonstrated in Ernst & Young's annual look at the working capital of the ASX 200. Overall, it appears that, for the first time in three years, the cost of inventory and payments in and out of

Australian companies deteriorated in 2010. But, if you strip the mining, oil and gas sectors out of the analysis, the overall index would have continued to improve.

The reality is, 60% continued with tight working capital practices. And most of the 40% that drove the fall was the resources industry. Last year, the value of working capital among resources companies climbed 2% to \$20.1 billion. For oil and gas companies alone, the increase in the value of total working capital of sales rose almost 3% - the biggest jump of any sector. By comparison, utilities fell by 0.5%.

We believe, if the oil and gas sector tightened up its working capital practices, it could free up as much as \$5 billion. However this will require a deep review. You may need to make structural changes to your business processes and you will certainly have to raise awareness to get your entire business focussed on the end goal.

In our experience, by simply improving existing operations and relying on existing IT systems, most companies can expect to reduce their existing working capital by 10-30%. You get another magnitude of uplift through automation, which delivers greater visibility and control, enabling you to take out human error and completely reconfigure the processes.

Both approaches require cultural change. You have to get buy-in from the business and make sure you're rewarding the right behaviours. For example, sellers usually have revenue targets, but you also need

to incentivise them to drive good customer payment terms. Otherwise, you'll find sellers trading payment terms to win business or increase margins. This may look like a good deal, but may actually cost more money than it brings in over the long-term.

Similarly, you need to review how you measure warehouse performance. Are you simply looking for stock availability? If so, your inventory will almost certainly be too high. And, for mining companies in particular, where a single tyre retails at \$300,000, high inventories can trap millions of dollars.

Another hot spot for working capital inefficiencies is customer terms of payment. Most B2B operations vary their payment terms, with the biggest customers getting the best deal. But, once these terms are set, they are rarely reviewed. We frequently find small customers, who used to spend far more with the client, still retaining generous terms of payment. This isn't just bad for cash flow, it's also bad for business. Most industries are notoriously porous around commercial terms. You don't want your biggest customer discovering the corner store is on better terms than they are.

It's also important to reset your re-order points based on current demand. One toy wholesaler used to order 100,000 units of a popular toy every time inventory hit a certain mark, knowing that the product would be almost sold out before the new stock arrived. After 12 months of insane popularity, demand plummeted, but the re-order point remained in place, leaving the company with a room full of toys no child would be seen dead with.

Most companies have better discipline around sourcing contracts, often negotiating solid supplier agreements with great terms. The problem is, these terms don't always make it into the system. Quite often, companies don't check to make sure the new agreement is being honoured. Typically, accounts payable don't see a copy of the contract, just the terms in the system. And, even if the right terms are in there, helpful accounts payable staff frequently override the system to comply with whatever opportunistic demands your suppliers put on the bottom of their invoices.

This is not to suggest you should push your suppliers too far. One company took the issue to the extreme, pushing terms from 30 to 60 days, and then paying four weeks after that. After six months, their suppliers had enough and universally put their prices up - wiping out the original cash benefit, as well as generating considerable supply chain risk.

If you know where to look and how to fix them, plugging working capital leaks can free up funds to support acquisitive growth, generate immediate value from new acquisitions and take cash out of an organisation you're about to sell. But, until working capital becomes a genuine and constant priority, you will continue to have millions of dollars sliding under the radar.

Ripe for the picking?

Capital Confidence Barometer

Ernst & Young's Capital Confidence Barometer is a unique and ongoing study of corporate confidence in the changing market. Conducted by the Economist Intelligence Unit the survey seeks the opinion of senior executives from large companies across more than 40 industries around the world.

Here we share the key highlights from our fourth study in the series. We take a look at the Australasian story where growth is now a priority, with smaller players looking at organic investment, demergers back in play and corporates honing in on emerging markets.

Despite a healthy 29% of businesses looking at M&A opportunities, Australasian respondents are less likely to acquire than the previous year. However this trend is likely to be short lived with more than half of Australasian respondents saying credit conditions have improved in the past six months and 40% saying that access to finance is not an issue.

The story is a little different for mid caps and smaller businesses, with many still needing to refinance and those who don't are primarily focused on paying down debt or organic growth. M&A activity is likely pick up in this space throughout 2011 and most probably in the form of script based mergers with peers.

Although there continues to be a gap between buyer and seller price expectations and a flow-on effect creating concerns around a shortage of quality deal opportunities, we expect this to close in the longer term. M&A activity will also be bolstered with demergers back in play, continued inbound investment especially from China and India and with larger corporates honing in on emerging markets.

Australasian respondents were considerably more focused on acquisitions in emerging markets than our global counterparts (36% Australasia vs 26% Global), and from the previous year (36% April 2011 vs 26% October 2010) and it is likely Australasian respondents are looking to our nearest neighbours in Asia for growth opportunities.

The rise of the demerger is evident; 20% of Australasian respondents say divestment is likely in the next 6 months, slightly up from October last year, and the trend for joint ventures has inclined consistently throughout our barometers.

Australasian businesses are also focused on building sustainable improvements into their business operations. Optimising capital structure is a key focus area, increasing to 41% from 26% in October.

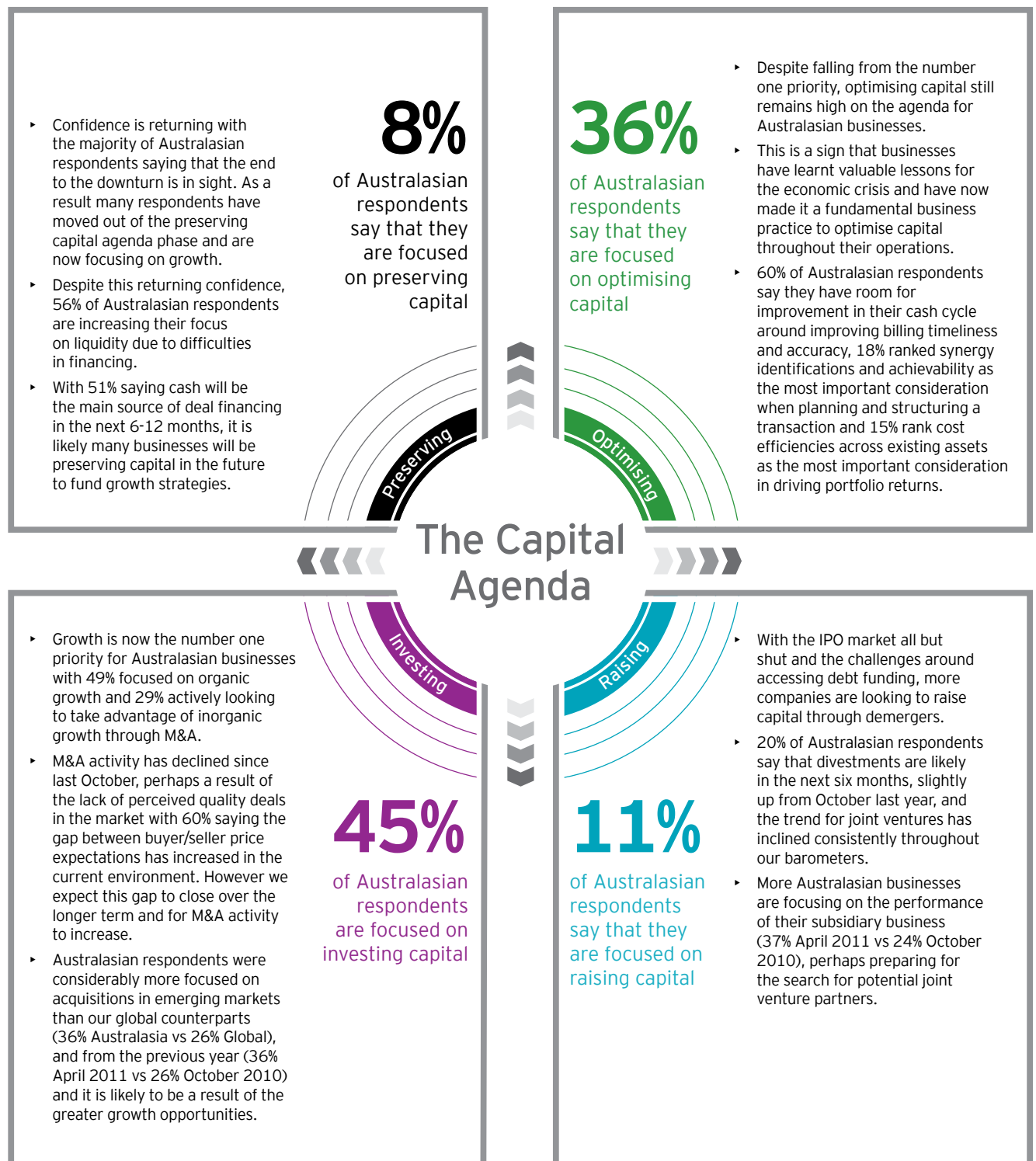
If businesses haven't already, it will be important to recalibrate debt and equity levels to the new operating environment, maximising value and minimising the average cost of capital.

The *Capital Confidence Barometer* will help you identify the market challenges that may emerge tomorrow; our Capital Agenda can help you prepare for those challenges today.

Understanding your capital agenda

A strong Capital Agenda needs to be at the heart of all strategic boardroom and management decisions. The findings of our *Capital Confidence Barometer* provide useful insights into the ways companies are optimising, investing, preserving and raising capital.

For the first time since the inception of the barometer we asked survey participants on which capital management issues their company is placing the most attention and resources.



Even though the economic outlook is starting to brighten, it will be vital to have patience...



The outlook

The indicators suggest that economic conditions in Australasia, and Australia in particular, will continue to improve. This will flow into confidence levels, but it is unlikely there will be a repeat of the dramatic increases that were witnessed in previous barometers. External factors such as rising inflation, the high dollar, continued political instability in the Middle East, austerity and tax regimes and the impact of natural disasters (especially the Christchurch earth quake for the New Zealand economy) will keep executives level headed.

Liquidity in Australasia will continue to be an issue with access to debt continuing to be a challenge. Mid cap and smaller companies will continue to look inwards around how they can raise capital for investments. This will be in the form of cost reduction campaigns, demergers and business optimisation particularly around working capital management.

Growth will continue to be a big ticket item. Larger caps will continue to seek opportunities in emerging markets, while others will look at organic growth through expanding into new customer segments, investing in new products, services and also in technology and research development.

M&A activity is likely to progressively increase. Private Equity is returning to the market place and will continue to lead divestment activity by becoming more competitive on the buy side. Transaction values will remain high with more transformational deal activity taking place among major companies.

The Australasian economy will continue to reap the benefits through its strong exposure to Asian industrialisation and the relative absence of the financial sector and government debt problems found elsewhere.

However, in this environment where corporate cash flow generation, dividend income and market valuations

are volatile, companies should remain focused on building sustainable business models.

Even though the economic outlook is starting to brighten, it will be vital to have patience, be selective and choose opportunistic investments that are ripe for the picking. This is a multi-speed economy and companies in different market capitalisations, sectors and regions are recovering at different speeds, and are impacted by different factors.

To read the full Capital Confidence Barometer report visit www.ey.com.au

After the honeymoon

The avoidable mistakes behind many integrations

In the euphoria of closing a deal, it's easy to forget that the hardest work is yet to come. Simon Moore, Oceania Operational Transaction Services Leader, Ernst & Young, reflects on the insights from a recent series of post-deal transaction reviews as to what really drives integration success or failure.

In the lead up to a transaction, acquirers put a huge amount of effort into quantifying its strategic rationale. Yet, the moment the papers are signed, the honeymoon is over. Once an acquisition is up and running, there is a tendency to assume the deal is performing as planned. Yet, without clear measures and controls, management can fail to see the integration value slipping away - until it's too late.

This was exactly what happened in a large international engineering firm. Managers believed their recent acquisition was a complete success. However, post-deal analysis revealed the deal was delivering value 35% below plan. Issues included: a lack of broad participation in assessing deal synergies, no assignment of accountability for synergy-focused integration, as well as failure to accurately assess deal costs and dis-synergies. After dealing with its initial shock, the company is now taking significant steps to transform its deal capabilities and processes.

This situation is extremely common. In a recent study that included detailed examinations of deal performance

around the world, we found that many integrations fail to live up to their promise. Sometimes this is due to shifting fundamentals, but in many more cases the shortfalls are largely avoidable. For example, regularly using formal processes within different stages of deal execution can more than double the level of satisfaction with deal performance. In fact, the best way to prevent costly problems and enhance deal value is by taking a disciplined approach to transaction planning and integration that covers all three phases of the acquisition process: pre-deal planning; day 1 readiness and value-based execution.

Pre-deal planning: a focus on value

Unlocking greater value from acquisitions begins with greater upfront rigor. Involving key business functions early will set the stage for greater continuity of the entire deal process. It is not enough to identify synergies and then simply hand over the integration process to the business to deliver them.

Five of the most critical pre-deal steps are outlined on the following page.

Critical pre-deal steps

1	Focus on future value	Traditional due diligence approaches often place inordinate weighting on the past performance of assets. Ernst & Young's 2011 Corporate Development Study found that, where due diligence effort looks forward and is well aligned with the opportunity analysis, satisfaction with the transaction outcome can be up to seven times higher.
2	Look closely at synergies	All too often, value analysis stops at the obvious cost synergies rather than seeking less obvious upsides from all sources. For example, revenue and balance sheet synergies may assist the buyer in new markets, new geographies or entirely new business lines - creating products or services that will be welcomed by existing customers.
3	Beware dis-synergies	Transactions often trigger dis-synergies - potential drains on value. For example, the assets might create potential competition with existing business units. New products may cannibalise existing offerings or turn off existing customers. Deals can also create value drains by reducing management focus on core business or introducing tax inefficiencies; for example, through tax leakage from cross-border funds flows.
4	Develop a value delivery plan well before close	To achieve the most valuable synergies, the work often needs to start well before the deal is signed. Alongside due diligence, you need to develop a comprehensive value realisation plan, citing specific milestones, metrics, and clear accountability for results. This plan will help managers assess how quickly and effectively you are capitalising on deal value.
5	Clearly assign resources and accountability	Before the deal team moves on to the next opportunity, they must go through a clear handover-process to the business units handling the integration. Unless your business units understand the deal fundamentals, value drivers and assumptions that went into the strategic rationale driving your purchase, synergy delivery will almost certainly fail. We find that deal satisfaction increases significantly when business unit teams and vital central support functions, such as tax, HR and IT, are included into the deal teams before close. No one is in a better position than these teams to determine whether the hoped-for benefits are attainable, and early involvement also helps to secure buy-in.



Day 1 readiness: realising immediate value

Your value delivery plan should mean you're ready to start realising synergies from Day 1. At this point, deal success depends largely on the quality of the plan and the people assigned to its execution. You need to focus on: accountability, communicating formal responsibilities and monitoring timelines.

Ideally, you need a list of each synergy, along with its forecasted value and a rating of the likelihood of achieving it: "unproven", "possible" or "probable". Then you can update your progress against the full set of synergies - and their potential value - and prioritise your efforts.

Without this level of rigor, opportunities will fall through the cracks. A major industrial company recently took on a number of maritime support vessels as part of an acquisition, delegating their management to an employee retained from the seller. It wasn't until the company assessed performance over a year after the acquisition, that it learned the assets were being hugely under-utilised. Maintenance and deployment of the vessels was far from optimal. And, even though the company itself often hired such vessels for its own use, its related entities were not being encouraged to use the services of this captive provider.

The problem was, while the deal team and corporate executive had been aware of these opportunities, they had not been communicated effectively to the manager. It's not enough to have a plan, it has to be communicated clearly to all

stakeholders. People want to know what lies ahead, especially in times of change. Effective communication not only ensures value is delivered, but prevents dis-synergies arising from individuals feeling they are being kept in the dark. A planned approach to communication, both internally and externally, forces management to proactively address issues rather than reacting to negative consequences.

Value-based execution: post-deal tracking, analysis and review

After the deal is done, management often attention shifts. But this is the time when it should be focused on delivering deal value. Driving value must start early and not get put on hold. This usually requires the involvement of a full-time integration team. Don't expect the people running the new asset to add integration to their day jobs. Our study found that having an integration team on board for at least 12 months is associated with significantly higher deal satisfaction (41% vs 71%). The same trend is true for companies that actively use and monitor integration metrics (26% vs 49%).

It's vital to establish integration milestones, monitor continuously and have the flexibility to make corrections mid-course. To this end, the process should always feature feedback loops to respond to evolving conditions. At one company, the focus had been on achieving full integration with the existing enterprise resource planning system. But, once the actual integration was underway, it became clear that a far more critical task for IT was to update and integrate customer files. Adequate

feedback mechanisms enabled the company to re-prioritise activities in accordance with actual conditions.

To determine whether you need a mid-course correction, a transaction value assessment is required at the key milestones - usually 6 months, 1 year or 18 months after a deal is closed. This is a rigorous, objective assessment of how the company is performing against the deal model approved by the board or executive management. In particular, the review assesses performance against pre-deal strategic objectives and synergy assumptions.

Integration success factors

The success or failure of your integration depends on early preparation, taking a planned, disciplined approach to value realisation and ensuring business units and core functions support this plan. You must also be prepared and have the resources to review and challenge progress at various milestones to ensure the value delivery process is on track.

This will almost certainly require a dedicated, full time integration team focused on the strategic rationale of the deal for at least the first 12 months. This team will get a firm handle on the levers of deal value creation and risks, put in place a comprehensive plan and organise the right resources to execute it. Only then, with a team focused on by tracking, measuring and assessing deal performance, can you feel secure your integration will deliver the potential you saw when you closed the deal.

Taking the reins

How to mitigate risks during a straight transition of ownership

Even if your acquisition doesn't require integration, ownership transitions can be fraught with risk - especially in the case of mining or industrial assets. Julie Hood, Partner, Operational Transaction Services, Ernst & Young, discusses what it takes to deliver a successful and risk-free transition in these challenging sectors.

There is a myth that transactions are only truly risky when they involve integration - that merely changing the legal ownership of a standalone operation or asset is relatively simple. Nothing could be further from the truth, especially in the highly regulated world of mining or industrial assets.

Even if an asset is still in the exploration or development stage, transition requires you to complete over 300 activities in a ten week period immediately pre- and post-completion. If your asset is operational, the workload can double.

This is because transition is both a strategic and a practical issue. At the governance level, executives and directors have a responsibility to mitigate risk when transferring ownership of a resources or industrial business. In other words, you have to be ready to act on a set of health, safety and environment (HS&E), regulatory, finance and control responsibilities that take effect on legal Day 1.

At the practical level, becoming fully compliant with regulatory transition requirements, involves consulting with and advising all the relevant regulators and processing all the licence and permit transfers. In terms of financial control, as a starting point, you need to organise insurance policy transfers and supplier novations, not to mention delegations of authorities and bank accounts.

And that's just the tip of the iceberg. Risk assessments and mitigation strategies are required across the business. So, you

need to review control framework/policies, minuting deficiencies and creating an action plan. Often, you need to set up control tests for user groups in priority areas such as payroll or intellectual property access.

Even if you're buying an asset that hasn't come on line yet, you still have to go back through the history and understand what you are getting. A lot of these facilities take so long to build and commission that you'll need the full history of plans, including how the infrastructure was built, commissioned and signed off. It gets very complicated.

Secure your people - don't leave it to chance

There is also the human capital risk. Often one of the biggest issues in a transition is around continued loyalty. You can't just assume people will want to come across. Quite frequently they don't. In many cases, the selling company has spent years looking after the careers of key individuals. Some of the most senior people may be doing their time in a non-attractive asset, knowing this is part of a master plan. When the new buyer arrives, these people think 'this is not part of my career track' and leave.

To avoid disruption, you have to address this very early in the transaction. That means sending in a team to physically check out which way executives and managers are going to jump. Then you can make sure they do the right thing. This isn't a problem - people are usually very professional and want to be part of

a successful transition. But you must lock them in from a legal perspective. It's essential to have secondment arrangements in place so key managers don't leave during transition.

In all of this, communications and human capital strategies are key to getting it right. Unless you tell people what's going on, they will assume something different (usually the worst).

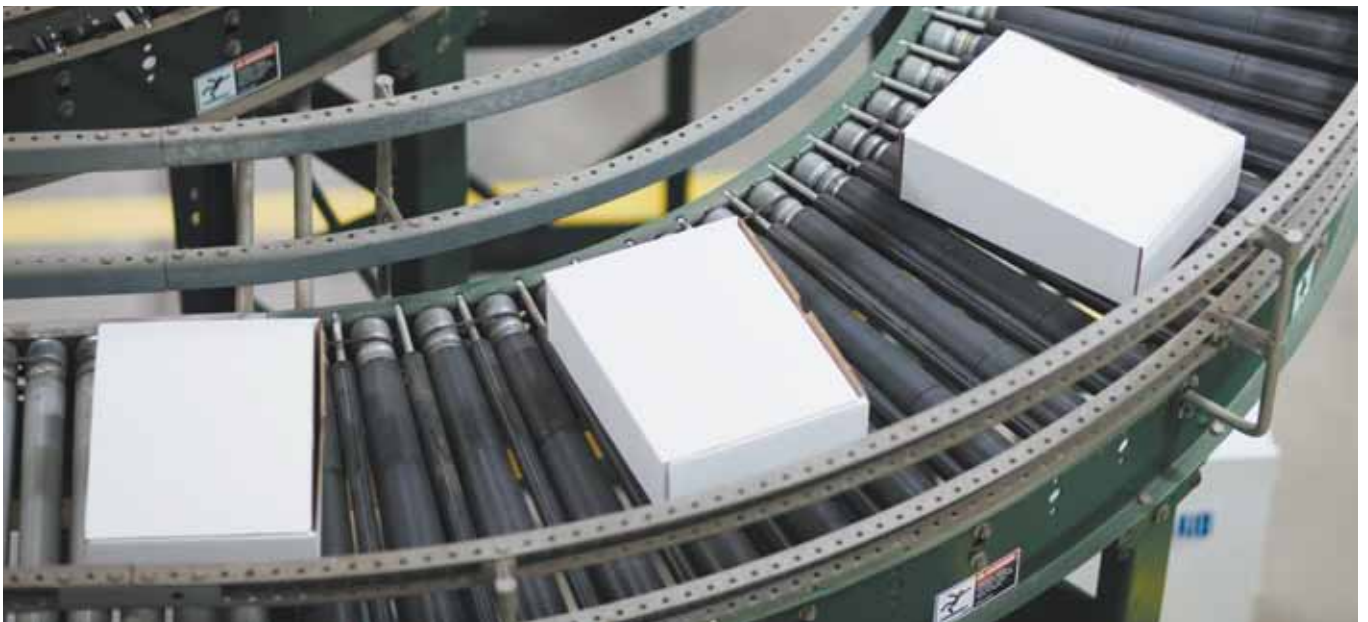
Get your operating environment up to standard

If your assets are operational, you have another can of worms to deal with.

In operational assets, preparing for legal Day 1 is about understanding what you're buying, how it works and what to do if things go wrong. Some people liken it to a property inspection: what are you really buying and does it work as advertised? It's not a bad analogy, but in the case of a mining or industrial asset, it's not a house you're buying, it's a bomb shelter. Because, if it doesn't work, the consequences are catastrophic.

When you're dealing with hazardous operating environments you have to get it right. The cost of a single incident is simply too great, in terms of lives and reputation, let alone the dollar impact. If you have to shut the plant down, even one lost day of output can cost millions.

Often, when a business is deciding to sell, they stay operational, and maintain what they have to, but they won't spend any extra. You need to figure out if the asset is being run to your standards and take



early preventative action. Bear in mind, even if an incident would have happened anyway, if it happens just after you take the reins, it's your reputation on the line.

Avoiding this sort of risk can be astonishingly complex. You've got to understand what you need to run and continue to support the facility before Day 1. It can be difficult - down to historical maintenance and health, safety and environment information. This can mean tens of thousands of documents, some of which have never been finished or updated. The plant you're buying was built on working drawings, which get changed and marked up all the time. Sometimes, the final set of working drawings is never produced. You have to go back to seller to say "you need to complete this". All this has to be sorted through and seamlessly transitioned. It's a big exercise - but it's worth it.

Imagine a valve blows in the first week. No one is hurt, but you have to shut down a portion of the plant. Here's the question: Can you shut down the rest of the facility quickly and trigger everything to make it safe? Your transition team will have done their job if you have the right engineers (with the right competency paperwork), a sound incident recovery plan, and access to the appropriate drawings.

A less dramatic, but equally important question is maintenance. How often are different pieces of equipment replaced? If it's a three year replacement, you need three years' worth of documentation for each item. Can you actually get a replacement? Some entities have their

own 'recipe' for a bespoke piece of equipment. And finally, how will you track and monitor the maintenance regime?

Accessing the 'unofficial' knowledge

To get the answers to all these questions, you usually have to go beyond standard documentation and target the knowledge in people's heads - and the unofficial documents on their C: drives. This is especially true when it comes to future projects. When projects are on the drawing board, the keys to their success

right people on site, asking appropriate questions of the right people at the right time. And you can only do this once or twice.

This is important. Sellers won't put up with constant site visits by hundreds of people. Having a tightly controlled approach is essential - for both buyer and seller. It de-risks the entire process - making sure the business still keeps operating and maintaining good relationships with key personnel. You don't want to annoy the people

Having a tightly controlled approach is essential - for both buyer and seller.

are often in people's heads. People know what's next for the asset, but they may not have documented it - you don't want to lose that.

This is why we run collaborative working sessions with key operational people, like engineers. The sessions first identify all the written data we need. Then we go to the next step: making sure we understand what they understand. Our discussions tease out where we may have knowledge gaps and unforeseen risks.

You have to be extremely targeted about the way you run and who you invite to these sessions. You need to get the

you'll be relying on to manage operations on Day 1.

Getting it right

Getting it right takes exceptional project management, and the discipline not to get lost in the minutia. You can't do it all - you have to prioritise. We aim to get about 80% locked in and understood, and then deal with the remaining 20% on Day 1. That way, our clients can take the reins with confidence, knowing they'll have a smooth ride for at least the first 100 days.



Disaster recovery

The relentless pace of the global transactions market

After only a short hiatus, transactions activity in Queensland is back to business as usual. Transactions Partner, Grant Murdoch, Ernst & Young Queensland, reflects on the relentless pace of the global transactions market, the experience of working through the floods and the long-term effects of the disaster.

When one of our Brisbane transactions team was faced with a flooded house, a dying laptop and no way to get to our offices, he made his way to Wesley Hospital. Despite being almost cut off by the flood waters - with only pedestrian access - the generator-powered hospital was continuing to care for nearly 300 patients, with marooned staff sleeping in vacant wards. The hospital very kindly welcomed my colleague and allowed him to work in an empty office.

At one level, it was a prime example of the extraordinary generosity we saw across the State, as neighbours of all kinds pitched in to support each other. At another, it demonstrated the relentless force of the global transactions market, which doesn't slow for anything - not even natural disasters.

Thanks to our neighbours and clients - many of whom offered their offices for our people to work on other companies projects - Ernst & Young remained operational in Brisbane. Other transactions teams simply evacuated, catching the last flights out to set up an emergency office in Sydney as the flood waters rose.

The result was that, despite the terrible toll the floods took on lives, property and infrastructure, after only a short pause, the transactions market has already returned to business as usual. Even the uplift in IPO activity before Christmas is still with us. While many listings were temporarily deferred, they are getting back on track.

As Queensland begins the huge task of rebuilding, we are all aware of the likely impact the flood damage will have in terms of slowing GDP growth, and increasing inflation, in 2011. Some sectors have been particularly hard hit, especially tourism, mining services and the small business community.

While in no way detracting from this immediate pain, I believe, in the longer-term, Queensland will ultimately draw strength from its ordeal.

At every level, there were lessons learnt. From a transactions perspective the biggest was the importance of having a back-up plan. If the unthinkable happens, you must be able to resume business as usual, because the global market doesn't wait for local crises.



On another prosaic note, the rebuilding program gives our State an opportunity to reset its infrastructure priorities and address bottlenecks sooner than would otherwise have been possible. Rebuilding will similarly lead to improved, smarter infrastructure for many institutions in our education sector.

More importantly, the public response, with the mud army of volunteers, has bonded communities across the State. I believe the experience will leave a legacy of civic pride and community strength that Queensland will be able to draw on for years to come.

This is also true in commerce. The way businesses supported each other during the floods has cemented contractual relationships into more meaningful and enduring partnerships. Such partnerships are fertile ground for the collaboration that drives innovation - they will invigorate our business environment.

The crisis has also made many companies rethink their own community service policies. For example, at Ernst & Young, we were aware that, during the crisis, many people were torn between their

loyalty to our clients and their need to help in the community. We therefore granted the entire company two paid volunteer days in March, so people who worked through to meet financial deadlines, could still make a personal contribution to the rebuilding efforts.

Ultimately, the floods reminded us what is important and instilled a 'can do' attitude in business and the community - strengths that will serve us well as Queensland rebuilds.

If the unthinkable happens, you must be able to resume business as usual, because the global market doesn't wait for local crises.

No pain, no gain

The impact of a new security review mechanism for foreign-invested M&As in China

A State Council Notice introducing a new security review mechanism for foreign-invested M&As is catching the attention of Australasian executives interested in Chinese deals. However, before escalating their level of concern, deal-makers might consider where this latest Notice fits in the bigger picture of Chinese foreign direct investment (FDI) reform. Bob Partridge, Managing Partner, Transaction Advisory Services, Ernst & Young in Greater China shares his views.



Effective from 12 March 2011, the Notice suggests that all foreign investors should inform the Chinese Ministry of Commerce (MOFCOM) when acquiring a Chinese domestic enterprise. MOFCOM will then decide whether to initiate an M&A security review. M&A security reviews will be required for foreign-invested acquisitions of both military enterprises and 'key domestic enterprises', including (but not limited to) those in the following sectors: agriculture, energy and resources, infrastructure, transportation, technology and major equipment manufacturing.

Despite - or possibly because of - a statement by the country's economic planner, that these new rules won't affect China's 'openness or its efforts to attract foreign investors', the Notice was followed by a flurry of commentary raising concerns about the possibility of Chinese protectionism.

However, those concerned are failing to grasp three salient points.

First, China is simply following international precedent. For years, most developed countries, including Australia and New Zealand, have had M&A security reviews in place to protect their own national security related interests.

Second, while the regulations around the definition of 'national security' or what qualifies as a 'key sector' require some clarification, this uncertainty may not be real cause for concern. Some laws in China start life with broad terms.

It's not until we see a track record of judicial action that we really know how a new law is going to be enforced.

Third, if China is genuinely interested in protectionism, it already has a multitude of mechanisms that could be used for this purpose. The new security review - with all its transparency and public fanfare - seems an uncharacteristically blunt instrument.

This is not to suggest the new rules are a cause for celebration. They will certainly add a further layer of complexity to China's foreign investment approval regime, in some cases perhaps adding at least 20 days and new risks to be assessed in an already lengthy courtship. One of the many challenging aspects of the new rules is that they allow domestic competitors, customers, suppliers, government authorities, and industrial associations to ask MOFCOM to conduct a national security review into a business's transaction.

To play it safe, Australasian deal-makers need to assume any transaction could be reviewed on national security grounds and plan for implications of this. A review could prove detrimental to planned closing timetables and deal-makers need to prepare for this eventuality and develop a strategy for engaging with officials. Deal-makers should also consider whether they are prepared to carve out any sensitive parts of the transaction to accelerate the deal.

These are all sensible precautions. But they do not mean a transaction will founder. The new rules do not necessarily increase the risk of foreign-invested M&As being prohibited. Until we see how the regulators evaluate the first set of test cases, all we can realistically do is hope for the best and prepare for the worst. Until we see the new rules in action, there is no need to sound the alarm.

strengthening and evenness of their enforcement. If this occurs, it will be a game changing moment for the one of world's fastest growing economies.

Right now, IP is top of the risk agenda for any Chinese entrant with significant proprietary knowhow. This potentially impacts China's inbound investment, and may also eventually impact Chinese companies with outbound investment

China is simply following international precedent.

In the meantime, deal-makers should take comfort from the fact that the announcement represents a further attempt by the Chinese authorities to institute a formal system of foreign investment oversight.

Continued reform of the FDI environment in any emerging market can only be a positive. Indeed, this Notice may clear the way for the next near-term step for China: further efforts to enforce intellectual property (IP) rights.

To continue to be attractive for foreign investment, this seems the next big puzzle piece to get in place. While China does have IP regulations, foreign investors are interested to see further

plans. These entities will surely expect protection in any markets they are entering, yet this may be an issue if comfort over this area is a significant issue for investors into their own country.

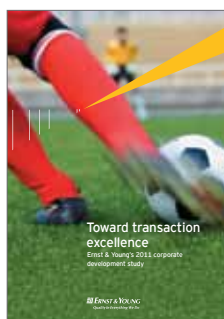
In the near-term, there's no doubt the Notice will add complexity and uncertainty to Australasian M&As in China. However, history may eventually record it as a necessary step in the reform of China's FDI environment. If it proves to be a stepping stone towards China further addressing IP security, it may well be worth the discomfort of uncertainty in the short term.

On the edge
Visit www.ey.com/au
to read more



Capital Confidence Barometer

The *Capital Confidence Barometer* is a unique, ongoing study that measures corporate transaction confidence in a changing market. The results from our fourth Australasian barometer informed by 96 respondents, show that growth is now a priority, with small players looking at organic investment, demergers back in play and corporates honing in on emerging markets.



Toward transaction excellence: Ernst & Young's 2011 corporate development study

The performance gap between traditional- and leading-edge practices in corporate development is growing. More and more businesses are introducing greater rigor into the evaluation and continuous improvement of corporate development activities. Ernst & Young's *2011 corporate development study* provides an insight into an array of leading processes and practices that are leading to heightened value as measured by deal satisfaction.



Make it or break it: Driving value through integration

Companies invest substantial amounts of capital in acquisitions and, with restrictions on the availability of capital, there is significant pressure for transactions to deliver maximum value. Yet detailed examination of deal performance shows that too many integrations - and therefore the transactions themselves - fail to live up to their promised expectations. This report combines insights gained from a series of recent post-deal transaction reviews and results from our *2011 corporate development study*.

Contacts

If you have any questions regarding the content of this newsletter or would like more information about Ernst & Young's Transaction Advisory Services practice, please speak to your usual Ernst & Young contact or email any of the leaders listed below.

Graeme Browning

Oceania Managing Partner
Transaction Advisory Services
graeme.browning@au.ey.com

Geographic Leadership Team

David Clanchy

New South Wales Leader
david.clanchy@au.ey.com

Roger Walsh

Victoria Leader
roger.walsh@au.ey.com

Justin Walsh

Queensland Leader
justin.walsh@au.ey.com

Angus Blackwood

South Australia Leader
angus.blackwood@au.ey.com

Mike Anghie

Western Australia Leader
michael.anghie@au.ey.com

Andrew Taylor

New Zealand Leader
andrew.taylor@nz.ey.com

Services Leadership Team

Vince Smith

Restructuring Leader
vince.smith@au.ey.com

Mike Anghie

Mergers and Acquisitions Leader
michael.anghie@au.ey.com

Bill Banks

Infrastructure Advisory Leader
bill.banks@au.ey.com

Marcus Willison

Real Estate Advisory Services Leader
marcus.willison@au.ey.com

Simon Moore

Operational Transaction Services Leader
simon.moore@au.ey.com

Stephen Lomas

Transaction Support Leader
stephen.lomas@au.ey.com

Don Green

Transaction Tax Leader
don.green@au.ey.com

Stuart Bright

Valuations and Business
Modelling Leader
stuart.bright@au.ey.com

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 Transaction Advisory Services

How organizations manage their capital agenda today will define their competitive position tomorrow. We work with our clients to help them make better and more informed decisions about how they strategically manage capital and transactions in a changing world. Whether you're preserving, optimizing, raising or investing capital, Ernst & Young's Transaction Advisory Services bring together a unique combination of skills, insight and experience to deliver tailored advice attuned to your needs - helping you drive competitive advantage and increased shareholder returns through improved decision making across all aspects of your capital agenda.

© 2011 Ernst & Young, Australia. All Rights Reserved.
SCORE Retrieval File No. AU00001048

This communication provides general information which is current as at the time of production. The information contained in this communication does not constitute advice and should not be relied on as such. Professional advice should be sought prior to any action being taken in reliance on any of the information. Ernst & Young disclaims all responsibility and liability (including, without limitation, for any direct or indirect or consequential costs, loss or damage or loss of profits) arising from anything done or omitted to be done by any party in reliance, whether wholly or partially, on any of the information. Any party that relies on the information does so at its own risk.

Liability limited by a scheme approved under Professional Standards Legislation.