Crowe Horwath.

The Global Corporate Advisor

June 2015

The Corporate Finance newsletter of Crowe Horwath International

Welcome to the June issue of The Global Corporate Advisor.

From France we have an article on financial due diligence addressing the civil aviation industry, where the two large players are increasingly reliant on aircraft manufacturing supply chain. As tier I and tier II suppliers try to reach critical size to support their financing needs, M&A activity has increased considerably.

The article from India on REITs examines the need for these instruments and discusses the key points of the Indian REIT structure.

Our Frankfurt office has reviewed the status of the M&A market in the D-A-CH region year-to-date 2015 and the outlook for the rest of the year. Some sectors are doing better than others, despite a slight slowdown in the deal activity in Q2 2015.

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

Financial Due Diligence Process for the Aircraft Manufacturing Supply Chain Sector

by Marc de Prémare and Julien Latrubesse, Paris

The global aircraft manufacturing sector has grown substantially in the past 30 years, with an average growth of approximately 5% a year. Orders for new aircraft are currently at their highest level, driven as much by the renewal needs of ageing fleets in Europe and North America as by growing new and emerging markets. The civil aviation manufacture market is massively dominated by Boeing and Airbus, which have a quasi-equal market share (official data for 2013 places Airbus at the first rank with a 51% of market share and 53% in annual net orders).

To ensure increased manufacturing pace, Airbus and Boeing are continuously adapting their business model to rely more and more on the whole aircraft manufacturing supply chain – a situation known for years in the automotive industry. This creates significant capital expenditure and working capital needs.

Consequently, cross border M&A activity has accelerated to support the financing needs of tier I and tier II suppliers trying to reach critical size. With their dominance of the market, manufacturers prefer to deal only with suppliers who have the necessary scale and knowledge to support heavy technological investments. As a result, private equity firms, industry leaders and national funds, for whom civil aviation is a strategic activity, are becoming increasingly active in funding M&A operations in the aircraft manufacturing supply chain worldwide.

Addressing the civil aviation industry during the financial due diligence process requires specific focus due to the specific situation described above. GCA has gained knowledge on key drivers of civil aviation due diligence process, providing high quality services to a large range of customers.

Figure 1 Orders Boeing - Airbus 1989 - 2013

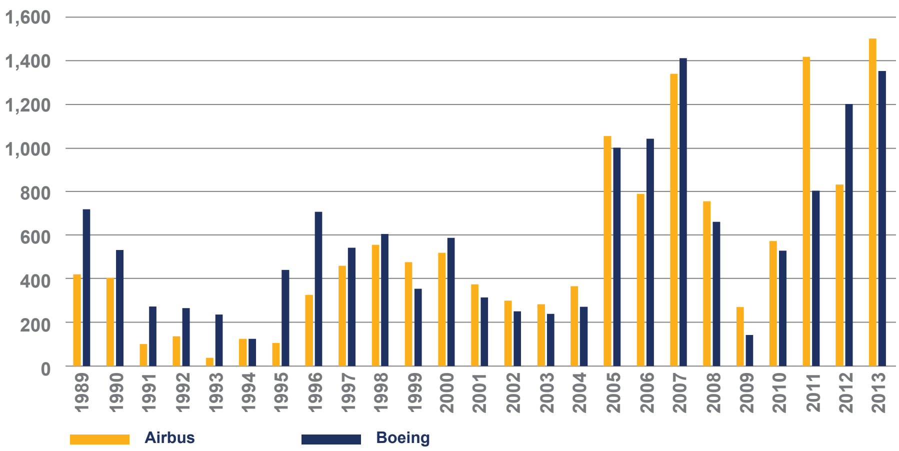
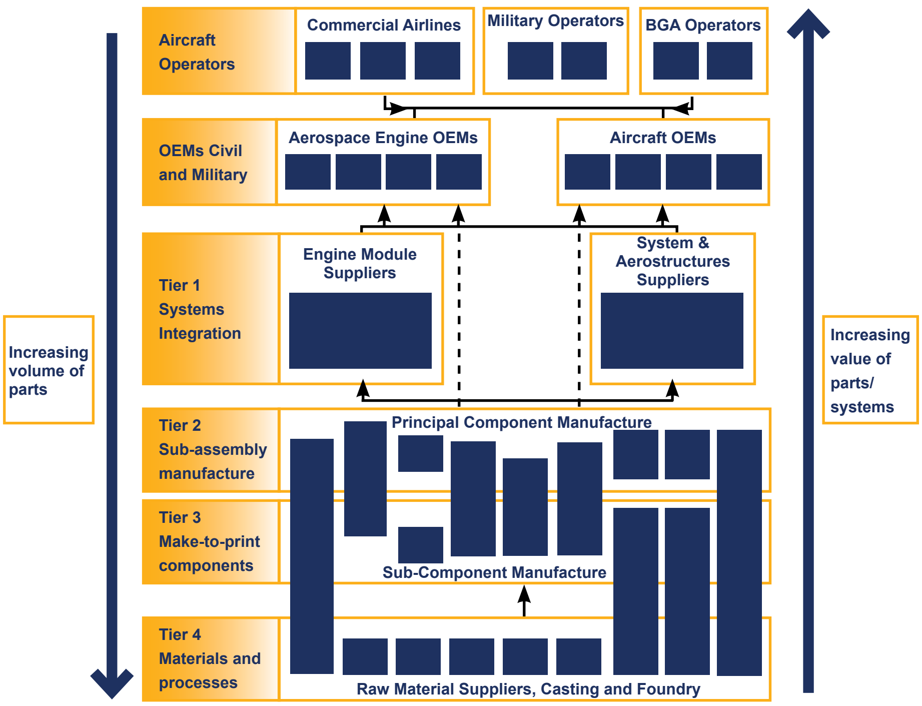


Figure 2 The Aerospace Supply Chain



Source: ICF International

Figure 3

Contract by Contract Analysis - Example

Initial Data				Opening 2013				Fiscal Year 2013				Fiscal Year 2014			
	Begining	Ending		%		EBITDA %		%	% EBITDA			%	% EBITDA		
	Date	Date	**Sales**	Completion	Sales	EBITDA	**(k€)**	Completion	Sales	EBITDA	**(k€)**	Completion	Sales	EBITDA	**(k€)**
Contract 1	2011	2014	**1,500**	30%	450	30%	**135**	70%	600	15%	**23**	100%	450	15%	**68**
Contract 2	2012	2015	**1,400**	10%	140	35%	**49**	30%	280	40%	**119**	65%	490	40%	**196**
Contract 3	2012	2017	**2,100**	5%	105	30%	**32**	15%	210	30%	**63**	40%	525	40%	**242**
Contract 4	2013	2020	**2,500**	0%	0	40%	**0**	5%	125	30%	**38**	12%	175	30%	**53**
Total			**7,500**		**695**		**216**		**1,215**		**242**		**1,640**		**558**

We review three key drivers in the process with a focus on how due diligence work can reduce uncertainties and improve buyer understanding of targeted business.

Key driver 1

Long-term agreements and using percentage of completion analysis relying on the judgment of the management

Most business in civil aviation supply is done using long-term agreements (LTA) that impact forecast profitability and business strategy. The percentage of completion method is mainly used to record profitability and requires estimate of costs and profits over the entire duration of the arrangement, including estimates of resources and costs necessary to complete the agreement. The percentage of completion method attempts to recognize revenues and gross profit during the applicable periods of construction. This method is also used to estimate potential losses that should be reserved on the entire project.

How can financial due diligence address key driver 1: Financial due diligence work will be oriented toward the understanding of milestones for each long-term agreement, with business oriented interviews with the management and the project manager. Thus, due diligence combining both financial and commercial understanding of these long-term contracts is essential to appreciate the percentage of completion and expected gain/loss on each project:

- Revenue breakdown table by contract can be provided in the due diligence report, including very detailed information about contract dates, actual revenue, budgeted revenue and percentage of completion.
- Margin analysis can be performed on each long-term contract and charts containing margin rates and expected revenue by project can be provided to understand the margins on completion.
- Projects with negative margins at completion receive special focus and are often considered restated by sellers in normative EBITDA calculation.

Key driver 2

Highlighting trends using contract-by-contract analysis

Global business analysis is almost impossible due to the fact that each long-term agreement has its own cycle and specific lengths that can disrupt global analysis, depending on the period analyzed. Indeed, highlighting trends is made difficult and discrepancies could appear in a short-time length with, for example, contract 1 being at end of its life and contract 2, 3 or 4 just starting to build.

How financial due diligence can address key driver 2: The financial due diligence has to include a contract-by-contract analysis, which is the only way to appreciate global business trends. Information gathered on each contract will be related to commercial, financial and technological fields and contracts can be classified by maturity progress to highlight those trends. Deep due diligence work, which focuses on a contract by contract analysis, is essential to understand business trends.

The chart in Figure 3 illustrates how the financial due diligence analysis can be provided, with an example of four contracts at different maturity levels. The contribution of the contracts to sales and EBITDA varies significantly depending on the degree of maturity of each contract and any change in the profitability estimate has a dramatic impact on EBITDA:

- Contract 1 is the main contributor to sales in FY2012 and FY2013. However, its contribution to EBITDA is high in 2012 and very small in FY2013 because an adjustment of its global profitability estimate occurred in FY 2013.
- Contract 2 and contract 3 are well-monitored and executed contracts with alignment between their contribution to sales and their contribution to EBITDA because the estimated profitability was confirmed at the time of execution. They even trigger additional profitability at the end when final commercial and technological milestones are reached without unpleasant surprises.
- Contract 4 has a small impact on the financials but it is nevertheless a key focus area for financial due diligence to assess the accuracy of management estimates and the future profitability of the company.

Key driver 3

Working capital requirements

A business ruled by long-term agreements implies a significant gap between expenses engaged and cash collection. Thus, working capital requirement and cash planning are central topics that need to be fully addressed by the financial due diligence work. Cash flows are not regular and it is of utmost importance to identify at which cash phase each contract is.

Cash collection under long-term agreements are ruled by specific milestones that have to be addressed by companies:

- Most LTAs include down payment once signed. This down payment does not represent a significant amount in the total contract; this, in turn, places companies with important cash needs in a position of having to finance the required investment to realize the LTA project. Thus, most of the internal and external expenses, especially with more mature contracts, will be engaged based on the company's own resources.

- Remaining payments are spread out through the duration of the LTA and subject to commercial/technological acceptance from customers – a fact that can widely delay cash collection. Thus, cash collection is subject to third party acceptance, and any technical disagreement would heavily weigh on the company's working capital.

- Even when fully executed, contracts still trigger financial commitment, especially because the supplier usually provides bank guarantees to its customers, which often have to be waived 12 to 24 months later.

How financial due diligence can address key driver 3: A sharp understanding of the payment cycle will be brought by deep due diligence work

Figure 4 Sales Contribution by contracts (%) - FY12, FY13, FY14

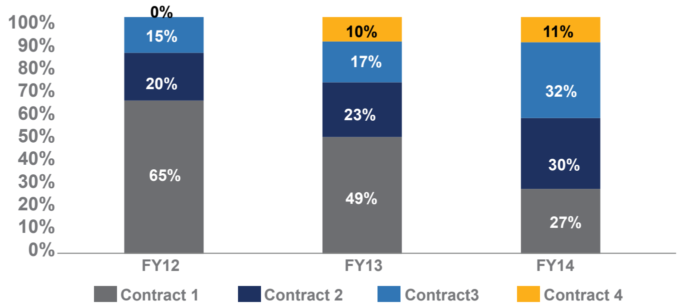
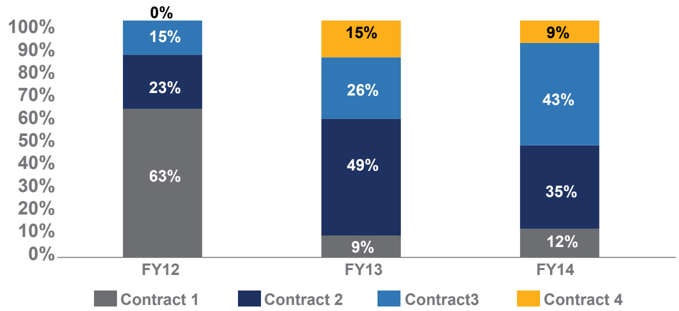


Figure 5 EBITDA Contribution by contracts (%) - FY12, FY13, FY14



with a retrospective and prospective analysis of working capital needs.

- The company's capacity of facing previous and forecasted working capital peaks is a strong part of the analysis, where forecasted working capital table and forecasted cash flow statement are provided.

- Moreover, most companies engaged in such long-term agreement business use factoring facilities to ease the cash constraints mentioned above. Financial due diligence provides a full analysis of factoring contracts, the accounting positions and the factors in debt.

  A factoring neutral analysis of the working capital requirement is also performed to reflect the real cash generation capacity of the target company.

- Finally, long-term agreements often include a bank guarantee as a mandatory coverage for customers. Bank guarantees shall be analyzed by the financial due diligence team and banks can be asked for direct confirmation on the amounts involved. These bank guarantees usually also require cash deposits.

Conclusion

As described above, the financial due diligence process in the aircraft manufacturing supply chain sector includes specific items that have to be addressed in order to fully understand targeted company businesses and reduce uncertainty regarding forecasted business and working capital requirement.

Financial analysis has to be fully business oriented, and a deep understanding of long-term flows and cycles of the long term contracts business is a necessary prerequisite for the financial due diligence team.

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Real Estate Investment Trusts in India

by Sanjay Bansal, New Delhi

Real Estate Investment Trusts (REITs) have been globally accepted as an avenue for retail investors to own commercial real estate, while avoiding the cost or illiquidity associated with direct investment in physical assets. There are 500 REITs in 22 countries globally, which include nine emerging real estate markets. More than $800 billion has been invested in these REITs globally. REIT IPO volumes accounted for 72% of real estate IPOs from January 2013 to June 2014, tripling from 24% in 2006-07.

In the US, REITs were introduced as an investment vehicle as early as 1960. Today, the country is home to some the world's largest REITs. Simon Property Group, listed in New York has a market cap of over $60 billion. They have also recently found success in Asia with the listing of large REITs on the Hong Kong and Tokyo exchanges. For example, IREIT Global, was listed in Singapore in August 2014, while Nippon Reit Investment Corporation was listed on the Tokyo Stock Exchange in April 2015. The recent introduction of REIT regulations in India provides the opportunity for companies to list their REITs in India; on a more practical level, some further clarity and time will be needed for real action to occur.

Figure 6

Country	Year of Introduction	Number of REITS
Australia	1985	52
Canada	1994	49
France	2003	33
Germany	2007	3
Hong Kong	2003	12
Japan	2000	46
Singapore	1999	37
United Kingdom	2007	22
United States	1960	231

Source: European Public Real Estate Association (EPRA)

The need for REITs in India can't be overstated

The need for development of a REITs ecosystem in India has been very evident. Real estate developers in India are in need of an alternate source of long-term capital as they are struggling to control and service project and corporate debt amid strained cash flows, low and inconsistent sales and increased input costs. Bank debt is not easily available and interest rates on real estate loans have gone up significantly to over 15% in the last 3 years; private sector lending to the real estate sector is often at 18-24%.

Private equity inflow in commercial real estate dropped from $1.9 billion in 2007 to less than $1 billion in 2013. The PE investment in commercial real estate is expected to remain subdued, notwithstanding a rebound in 2014 – in that year, PE investments into real estate aggregated $1.3 billion (INR 8,110 crore); besides, investors such as Blackstone and Brookfield Partners invested heavily in existing leased stock (likely as an aggregation of quality assets leading up to a REIT offering). With other sources of funding such as capital markets and external commercial borrowing also not easily available, REITs can emerge as a much needed option for developers. With a stable political regime at the center and focus on reviving economic growth, access to capital for development of real estate is a priority.

Introduction of REITs

in India has been a long drawn process, but recent policy actions have laid the path to implementation

India has been contemplating the introduction of REITs for over two decades now. The Securities and Exchange Board of India (SEBI) introduced REITs via a new investment vehicle, Real Estate Mutual Funds (REMFs) in 1996, which did not see much success due to various tax related and other issues. However, with a stronger political and regulatory will towards establishment of a REITs regime in India, SEBI released a revised set of draft REIT Regulations for public comments in September 2013. These regulations were approved by SEBI after a few modifications and the final regulations released on September 26, 2014. In February 2015, the Indian government in its budget for the year 2015-16 announced a few specific tax provisions that were essential to a REIT offering.

- Rationalization of capital gains regime: the sponsor will be given the same treatment on offloading of units at the time of listing as would have been available to him if he had offloaded his shareholding of special purpose vehicle (SPV) at the stage of direct listing

- Pass through status for rental income: The rental income arising from real estate assets directly held by the REIT would be allowed to pass through and to be taxed in the hands of the unit holders of the REIT

In May 2015, REITs received further boost with the Indian finance minister announcing exemption for REITs from minimum alternate tax (MAT). In May, the government also incorporated REITs under Foreign Exchange Management Act (FEMA) as an eligible financial instrument, clearing the path for foreign investors to invest in REITs. These are all beneficial.

A challenge remains in terms of stamp duty costs on transfer of properties into an SPV for a REIT offering; stamp duty is a state subject and needs resolution particularly in states with high stamp duty rates.

Figure 7 Proposed structure for REITs

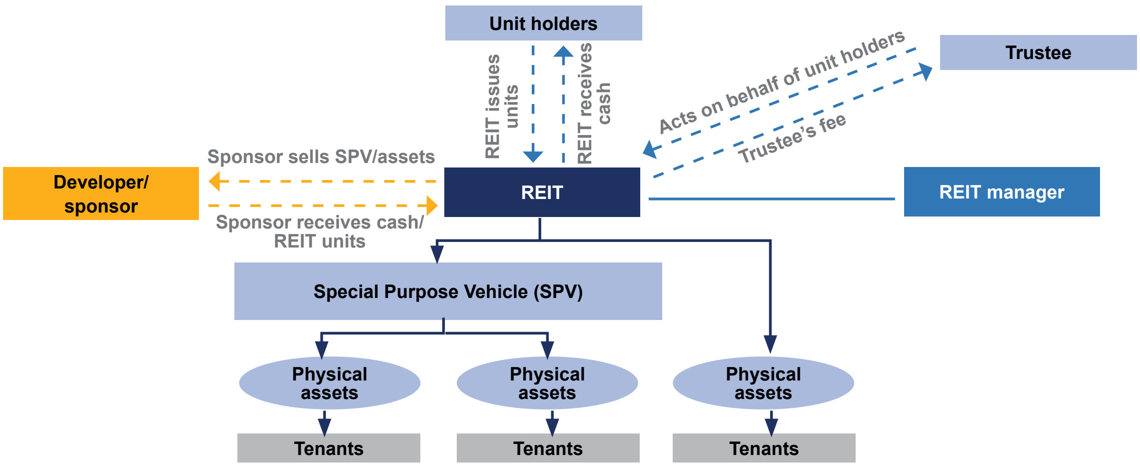
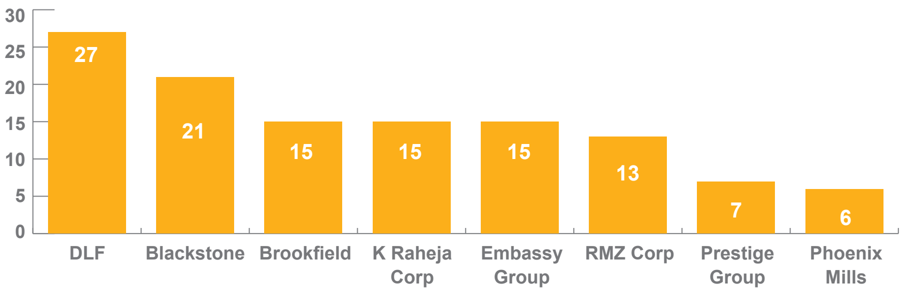


Figure 8 Key features of the Indian REIT structure:

Structure	• The REIT shall be set up as a trust under the provisions of the Indian Trusts Act, 1882 • The REIT shall have parties such as trustee (registered with SEBI), sponsor, manager and principal valuer.
Sponsor role and obligations	• A REIT can have upto three sponsors with a consolidated minimum net worth of INR 200 million. • The sponsor's primary responsibility pertains to setting up of the REIT. • The sponsor is required to hold at least 25% of total units of the REIT prior to initial offer to be maintained for a period of three years. • A holding of 15% of total units to be maintained by the sponsors after three years.
Offer of units	• After registration, the REIT shall raise funds initially through an initial offer and once listed, may subsequently raise funds through follow-on offers. • For making an initial offer, the size of the underlying assets should be at least INR 10 billion. • Minimum initial offer size of INR 2,500 million and minimum public float of 25%. • Minimum unit size of INR 100,000 with a minimum subscription on two units.
Investment guidelines	• REITs can invest in the properties directly or through special purpose vehicles (SPV), wherein such SPV hold not less than 90% of their assets directly in such properties. • 80% of the value of the assets of the REIT is to be invested in 'completed' and 'rent yielding properties'.
Income and distribution	• At least 75% of the REIT revenues, other than gains arising from disposal of properties, are to be from rental, leasing and letting real estate assets. • A REIT shall distribute not less than 90% of the net distributable cash flows, to its investors, at least on a half yearly basis.

Figure 9 India's largest commercials space owners (million square feet)



[1] *Source: Knight Frank, October 2014*

The Indian REIT Regulations have been drafted keeping in mind global standards on REITs and similar guidelines are mandated for investment and distribution of income.

Conclusion

Immense market potential ready to explode into action

India's REIT market could be as large as USD 96 billion through 1,408 million square feet of REIT-able space across offices, retail and warehouses. Office real estate is expected to be the largest market for REITs at USD 52 billion from 425 million square feet of REIT-able space[1].

Large developers and Institutional investors have already begun accumulating rental assets to potentially create REITs. In May 2015, DLF announced plans to launch its first REIT by the end of FY16. Canadian asset management firm Brookfield, Embassy Group and Blackstone Group are also amongst players which could be the first to launch their REITs in India.

As the procedural and taxation related matters gain greater clarity and resolution, we can expect very rapid activity in this space in the next few years.

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Development of the M&A Market in the D-A-CH Region Year-to-Date 2015

by Gerald Hespelt, Frankfurt

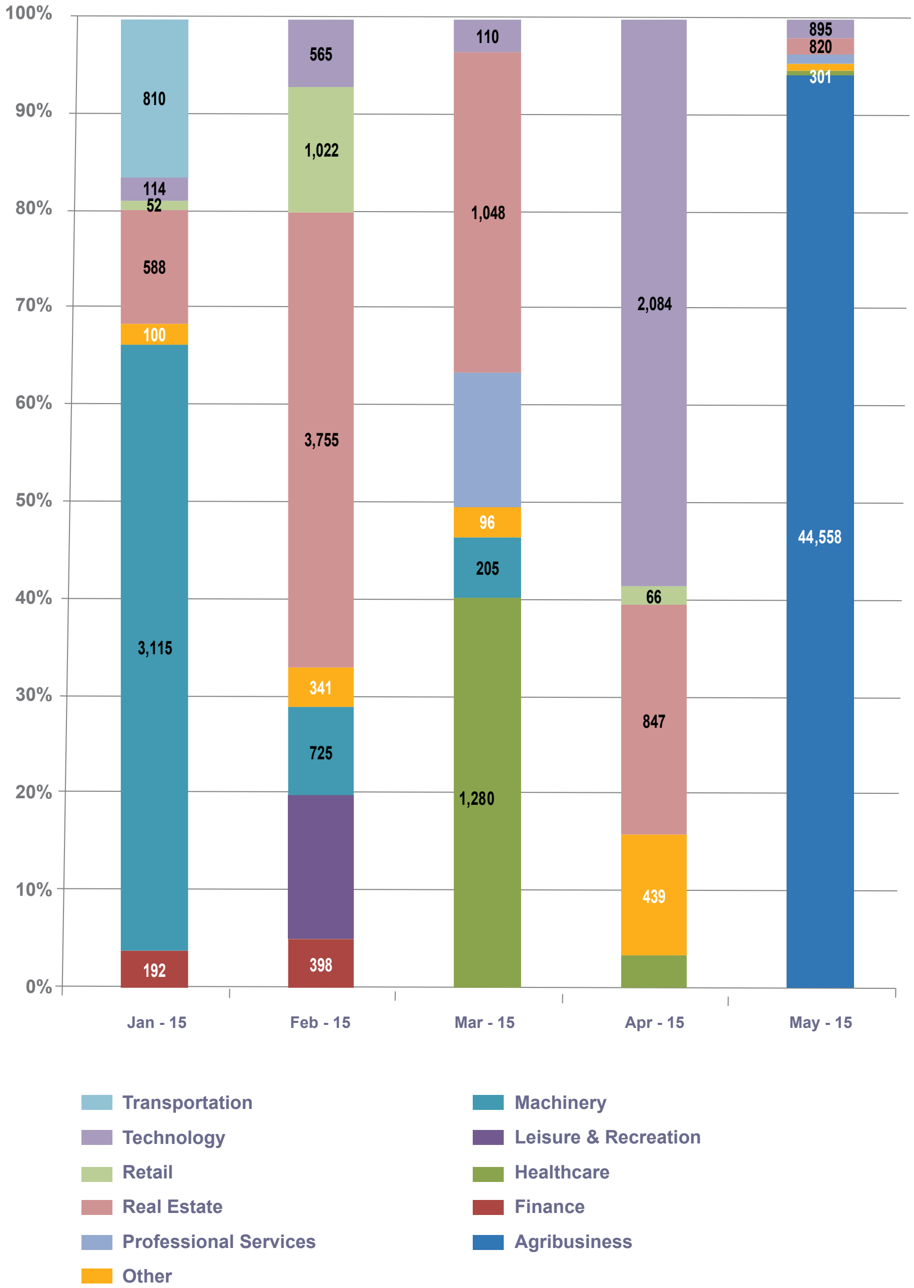
The M&A market in the D-A-CH region saw a very strong 2014, with approximately 2,000 deals and a deal volume of $200 billion. The number of deals closed in Germany amounted to approximately 1,000, with a deal volume of $104.6 billion. Switzerland saw extremely strong growth with a deal volume of $36.6 billion in 2014, which was double the volume in 2013. The same applies to Austria, which had 136 deals with a deal volume of $16.6 billion in 2014.

The German M&A market had a very good start in the first quarter of 2015. However, the positive growth trend since 2011 seems to have currently stopped. At the moment it's not possible to judge if this development is only temporary. According to the latest finance market report of the economic think tank ZEW, the outlook has slightly declined since October 2014, perhaps resulting from the latest turmoil in the equity and debt capital markets, as well as some disappointing economic statistics.

According to the M&A Panel in the June issue of the Finance magazine, deal activity has increased in almost all industries since February 2015. Overall, deal activity has increased in 15 out of the 17 industries analyzed.

Sectors seeing the strongest M&A activity are software and IT, commerce and e-commerce, pharmaceuticals and healthcare. M&A activity declined in the energy/mining sectors and has stagnated in the media industry. Small cap deals are expected to show the highest growth in deal signing during the coming three to eight months, while mid and large cap deals are expected to show slightly declined activity.

Figure 10 Top 10 deals by industry and month ($ million)



Source: Dealogic Ltd, Finance magazine

The overall positive development in the M&A market is supported not only by a very positive financing environment for strategic buyers, but also for private equity investors. Availability and loan conditions are still very good. However, the sentiment among private equity investors declined sharply in Q1 2015, mainly due to high valuation of targets. Multiples have reached high 2008 pre-crisis level. Due to this, the percentage of private equity investors who see themselves on the sell side rather than on the buy side has increased to 50% among those interviewed by the German Private Equity and Venture Capital Association BVK, in cooperation with the newspaper Handelsblatt. Another consequence of high company valuations and tough competition for quality targets is the increase in time needed to prepare and complete a deal.

In the first five months of 2015 D-A-CH targeted M&A deals amounted to approximately $70 billion. This development was highly influenced by the $44.6 billion pending acquisition of Swiss Syngenta AG (Agribusiness) by Monsanto Co. in May 2015. Whereas Switzerland targeted M&A more than doubled year-on-year, Germany targeted M&A fell to $20.2 billion in YTD 2015. This was a 59% year-on-year drop and the lowest YTD total since 1998. Austria targeted M&A deals also showed a decline in YTD 2015.

Real estate was the top targeted industry in three out of the five months by volume for German M&A with deals worth $4.9 billion. The top deals in real estate were the acquisition of a $561 million property portfolio by Deutsche Wohnen AG and the acquisition of a $ 518 million property portfolio in Berlin and Munich by Tristan Capital Partners. The biggest deals took place in the machinery and technology industries. The three top deals included the $1,900 million offer for the remaining 75.7% stake in DMG Mori Seiki AG by DMG Mori Seiki Co. Ltd., the $1,215 million acquisition of wind turbine manufacturer Senvion SE by Centerbridge Partners LP and the $2,052 million bid for access solutions and services company DORMA Holding GmbH & Co. KgaA by its Swiss competitor KABA Holding AG.

In Austria targeted M&A, the top deals were in the real estate and forestry and paper industries. However, the largest announced deal – the $2,841 million takeover bid for real estate company, Conwert Immobilien Invest by Deutsche Wohnen – failed. Other large deals in Austria included the $462 million acquisition of real estate company Immofinanz Immobilien Anlagen AG by CA Immobilien Anlagen AG and O1 Group Ltd, and the $341 million acquisition of Duropack by DS Smith.

Apart from the Syngenta deal, two other large Switzerland targeted M&A deals took place in YTD 2015. They were the $1,200 million acquisition of Covis Pharma SARL by Concordia Healthcare Corp and the $1,189 million acquisition of Infront Sports & Media by the Chinese Dalian Wanda Group Corp.

Despite the slight decline in deal activity in Q2 2015, positive and robust development of the M&A market is still expected in the German speaking region in 2015. However, financial and political uncertainties in certain regions of the world could have a stronger than expected negative impact on the M&A market in the coming months.

Sources: Finance M&A Panel June 2015, Dealogic ltd. (Data as of June 6, 2015 and January 8, 2015), Handelsblatt (22 May 2015) ZEW Finanzmarktreport June 2015, ZEW M&A Report April 2015

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