The basics of M&A in Turkey

Anthony Wilson & Güneş Söğütlüoğlu
8 October 2012
M&A

• **Mergers**
  – The combining of two businesses or groups. Legally only one survives. The business of the other is “merged into it.” Yapı Kredi + Koçbank.

• **Acquisitions**
  – “Hostile Takeover” – an acquisition of the business which goes against the wishes of the current management and board of directors. *None in Turkey so far.*
  – “Friendly Takeover” – an acquisition which is supported by the management and board. *What we normally see.*
Why there was limited investment before 2005:

- Inflation rate (CPI)
- Annual change in TL/US$ exchange rate
Total M&A activity / GDP (%)

Source: IMF, WEO
INTRODUCING
THE
PLAYERS
M&A Transactions

- Initial Review & Strategy Setting
- Finding Potential Investors
- Due Diligence
- Negotiation
- Transaction Closing
The Selling Shareholders
Selling shareholders

- Owner reaching retirement  **MAX PRICE**
- Owner needs more capital, to continue expansion  **PRICE / GOOD PARTNER**
- Owner believes the business needs multinational input:  **PRICE /GOOD PARTNER**
  - Export markets
  - Brand names
  - Technical expertise
- Owner thinks “it’s time to get out” – market timing  **MAX PRICE**
- Holding companies changing strategy  **MAX PRICE**
- The State: privatisations (Özelleştirme İdaresi Başkanlığı)  **MAX PRICE**
The Investors
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Introducing the players:

• The strategic investor:
  – Usually multinational companies, but may show strong national characteristics
  – Invest in their own sector
  – Seeking new markets to sustain corporate growth
  – Long-term investors
  – Usually want majority ownership (control)
  – “Need Board approval”
GDP growth rates: 2010 and 2011

Source: IMF: change in GDP at constant prices
## World GDP rankings: Turkey on the way up . . . .

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Source: IMF past actuals, Goldman Sachs projection
Typical Englishwoman
Typical Turk
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Philosophy:
Marriage is for life. Divorce unlikely. But he might murder you.
Introducing the players (continued):

• The private equity fund manager

  – KKR, Texas Pacific Group, CVCI
  – Turkven, Carlyle, Abraaj, ADN Capital, İş Girişim,
  – May well be happy with a minority shareholding.
  – Wants you to stay.
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Philosophy:
Before you marry him he’s already planning the divorce.
Introducing the players (continued):

- The (traditional) fund manager:

  “The business schools reward difficult complex behavior more than simple behavior, but simple behavior is more effective”.

  “When you combine ignorance and leverage, you get some pretty interesting results”.

  “You only have to do a very few things right in your life so long as you don't do too many things wrong.”

  “If past history was all there was to the game, the richest people would be librarians”.

(Warren Buffett – “The sage of Omaha” – Berkshire Hathaway Chairman)  
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The dating agencies:

- **The investment banker (M&A Advisor)**

- **Major banks:**
  - Often have no legal entity in Turkey
  - International team for major deals

- **Local banks/boutiques/Big 4:**
  - Focus on small/medium deals
  - Local network and contacts
  - Cheaper!

(Metin Ar - Garanti Yatırım)
Valuation — in one minute
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Value: 30 m TL
Valuation in one minute

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\[ \text{Value} = 6 \times \text{EBITDA} \]
Valuation in one minute

Value: 30 m TL

Bank borrowing: 10 m TL

Value of shareholders’ equity: 20 m TL

= 6 x EBITDA
Valuation in one minute

Value of equity = Value of operations - debt

20 m TL = 30 m TL - 10 m TL

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Valuation in one minute

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Value of equity = 6 x EBITDA - debt

Value of equity = Multiple of EBITDA - debt
Leverage in one minute

Value of equity = Multiple of EBITDA - debt

20 = 6 \times 5 - 10

20 = 6 \times 15 - 70
THE BANKERS
M&A Transactions

- Initial Review & Strategy Setting
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The bankers

- Risk & reward ("Greed vs. Fear")

  "The Great Moderation"
  The more stability seems assured, the more it is put at risk: "During the years of the so-called Great Moderation, investors came to regard equity as unnecessary. What need of shock-absorbers if the road ahead was smooth?"

  Tony Jackson, FT, July 2009
The bankers

- Independent thinking vs. Safety in numbers

- "When the music stops, in terms of liquidity, things will be complicated. But as long as the music is playing, you’ve got to get up and dance. We’re still dancing" – July 2007, Chuck Prince, Citibank CEO (until 2 November 2007).
The bankers

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LIBOR + 3% (2010)  →  LIBOR + 8% (2012)
What the bankers don’t want:

Financial mismanagement:
Do I Look Nice ??
Does the company look nice?

- Does your *sector* look nice?
- High growth potential?
- Shareholders reputable and trustable?
- Strong management team, committed to the business? *Not* just one strong guy?
- Clear objectives and business plan?
- Do you have maintainable profits? Where do they come from?
- Are you dependent on one/a few main customers?
Do your financials look nice?

- No out-of-book transactions?
  - “Look at my management accounts, not my statutory accounts.”
  - “Why should we trust this guy? We know he’s a tax evader.”
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  - Other businesses you also own
  - Carve-outs within the company
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• Lack of past profitability?
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- Note: focus on normalised EBITDA
  - Excluding one-odd items
  - IFRS or near-to-IFRS
  - Not a 2-minute exercise to calculate it.
Will the Tax Office spoil the Romance??
Summary of Tax Considerations

1. Tax Liabilities of the Target
2. Dealing with Tax Issues
3. Tax Structuring
Summary of Tax Considerations

1. Tax Liabilities of the Target
   - Tax Attributes
     • Taxable Income
     • Tax Losses
     • Carry Forward VAT
     • Tax Incentives
   - Tax Exposures
     • Concerns the Buyer
   - Tax Upsides
     • Tax Planning
Summary of Tax Considerations

2. Dealing with Tax Issues
   - Price Adjustments
   - Share Purchase Agreement
     • Stamp Duty
     • Reps & Warranties
     • Escrow Accounts – Statute of limitations
     • Conditions Precedent
   - Shareholders Agreement
   - Deal breakers and collapse of deal
Summary of Tax Considerations

3. Tax Structuring
   - Acquisition
     - Carve-outs
     - Seller’s Considerations
     - Financing Alternatives – Equity vs Debt
     - Deal costs
   - Operations
     - Cash Repatriation – Management Fees, Interest, Dividend, Royalty
     - Management Incentive Plans
   - Exit
     - Capital Gains
You own Hurricane Rüzgar Enerji A.Ş. You want to sell it.

Who might buy it??

Details:
It has one location, with eight power units each 2.5 MW (total 20 MW) capacity.

Last year was the first year of operation. EBITDA was expected to be TL 6m but actually it was only TL 4 m because the wind was less than expected.

The cost of investment was TL 50m. Bank borrowings are TL 10m.