Corporate deal makers head to emerging markets

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As both companies and countries in the West and Japan stumble under debt and fear, a new enthusiasm for deals has already emerged this year in India, China and other developing countries.

Swollen with cash from fast-growing economies, many emerging-market companies are on the prowl for acquisitions. At the same time, their counterparts in the West — desperate for growth and often seeing few prospects at home — are opening their wallets to move into developing countries, trying to get at resources, new customers or both.

On Monday, the British insurance company Prudential said it would buy the Asian assets of the American International Group for $35.5 billion, a deal that would make Prudential's earnings from Asia more than half the company's overall profits.

A.I.A., as the Asian unit is known, has its headquarters in Hong Kong and does business in China, India and throughout Southeast Asia.

So far this year, the Indian telecommunications company Bharti Airtel has bid $9 billion for the African assets of the Kuwaiti company Zain, a deal that would create the world's first emerging- market telecommunications giant; Royal Dutch Shell has struck a joint venture with the Brazilian ethanol giant Cosan worth $12 billion; and Reliance Industries of India is pursuing the chemical company LyondellBasell Industries in a $14.5 billion deal.

Enthusiasts of emerging markets say the flurry of activity is part of a fundamental shift in global business. With economies in the West expected to be sluggish for years to come, the younger populations and less tapped-out consumers of developing countries have become a magnet for Western business and are helping to create the world's next big multinationals.

"This will be the century" of the emerging market, Goldman Sachs's chief financial officer, David Viniar, told investors in February.

If so, it may be a volatile one. Emerging markets have looked promising before, only to burn Western bankers, investors and corporations with political, social and financial surprises — like the Asian currency collapse of the late 1990s and Russia's re-appropriation of some privatized assets in recent years. That is one reason Prudential's stock took a beating Tuesday, dropping about 20 percent, as analysts and investors asked whether the company had overpaid and underestimated the risks of a China slowdown or currency swing.

But despite the risks, deal makers predict more activity in the developing world. In some industries, emerging-market companies may be the only options for growth or a fat takeover price.

In emerging markets, "there are companies for sale, including raw-materials companies, and there are companies with cash," said David Simpson, the head of global mergers and acquisitions at KPMG. The firm "absolutely" sees a further increase in emerging-market deals, Mr. Simpson said.

After two years of bench-sitting during the global economic crisis, merger professionals are dusting off their uniforms, particularly if they are far from the financial markets of New York, London and Hong Kong.

"There is likely to be a lot of activity in and out of emerging markets," and between emerging market countries like China and Brazil, said Oliver C. Brahmst, the head of mergers and

acquisitions for the Americas at the law firm White & Case. In particular, emerging markets like India and Brazil have large domestic banks capable of financing deals, he said, while Brazil's currency has strengthened and both China and India are on the hunt for natural resources.

Of the $395 billion in deals announced this year through March 3, $135 billion — or 34 percent — had a target or an acquirer (or both) in an emerging market, according to Thomson Reuters data. That does not include the Prudential-A.I.A. deal because A.I.A. is based in Hong Kong, which Thomson Reuters considers part of the developed world. If the Prudential-A.I.A. deal were included, emerging market deals would shoot up to 43 percent of this year's total.

That is up from $97.6 billion, or 15 percent of all deals through March 3, 2007, the latest merger boom year.

Some of the rise in the importance of emerging markets is a result of the drying up of deals in the West, as companies and banks grow cautious about adding debt to their balance sheets. And while optimism toward emerging-market deals is palpable, and the macroeconomic signs are positive, the reality for deal makers may not be so rosy. Deals in emerging markets often run into surprises like onerous government intervention or corporate management that, at the last minute, changes terms or tactics.

It was American political sensitivities that scuttled the Chinese oil company Cnooc's $18.5 billion bid for the California oil firm Unocal in 2005. The British cellphone operator Vodafone's $11 billion purchase of India's Hutchison Essar came with a surprise $2 billion bill from the Indian tax authorities that still has not been resolved, almost three years after the deal was announced.

Bharti Airtel's pursuit of Zain is the third time the Indian company has tried to do a big deal in Africa. Bharti was rebuffed twice in its pursuit of the Johannesburg-based MTN Group, most recently after the South African government blocked a deal. It wanted the company to remain in South African hands.

And LyondellBasell's board has reportedly voted to turn down Reliance Industries' latest offer.

Businesses in emerging markets are frequently dominated by the individuals who run them, said Andrew Bell, head of global mergers and acquisitions at HSBC Group. That can help and hurt deal-making, he said. "You have someone with a vision and a drive who wants to get things done," he said, but that top executive may not have a team of senior managers capable of pushing through the decisions.

"I don't think that challenge has been properly solved," Mr. Bell said, so completing deals in emerging markets is "going to be slow and painful."

Many would-be deal makers may be advised to go cautiously, given the poor track record of recent mergers and acquisitions involving emerging market companies, analysts say.

The Tata Group, India's largest business conglomerate, made two big acquisitions in recent years — Jaguar Land Rover for $2.3 billion and Corus Steel for $12 billion — that have not lived up to expectations. Analysts said the group paid too much and bought as the last economic boom was cresting.

Many big acquisitions by Indian companies in recent years were "fueled by hubris and self-confidence and easy availability of capital," said Rajeev Chandrasekhar, an independent member of Parliament who started one of India's first mobile phone companies.

“A lot of them did these acquisitions thinking that the boom will last forever,” he said. “And that’s a mistake that not just the Indian companies made. It has been made repeatedly across the Western economies.”

Burned by those earlier experiences, Indian firms are thinking through mergers and acquisitions more carefully now, said Rana Kapoor, chief executive of Yes Bank in Mumbai. In one big shift, executives are focusing on buying firms that can help them sell to consumers in India and other emerging markets where consumption is growing, rather than firms focused on Western markets where demand is relatively weak.

Takeovers do not necessarily have to involve a company in an emerging market to be driven by such markets’ growth. The “next wave” of merger activity in Europe will be driven in part by a desire to grow in emerging markets, according to analysts at UBS.

Kraft Foods pursued a $19 billion takeover of Cadbury in part because of Cadbury’s presence in countries like India.

Some deal makers say the financial and economic imperatives to make cross-border deals are so strong that they will overcome the political obstacles that undid previous proposals, like the 2005 Cnooc-Unocal deal.

“The reality is, if you’re selling assets, you have to sell them to the people who have the money to pay for them,” said Jonathan B. Stone of the law firm Skadden, Arps, Slate, Meagher & Flom.

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