

# The Willis Index

# Willis

## Mergers and Acquisitions Newsletter

The quarterly newsletter of the International Mergers and Acquisitions Practice

Q4 2006

## Willis M&A Practice Launches Australian Operation

A new Mergers, Acquisitions & Reconstruction Practice has been launched in Australia and will form an integral part of Willis' Global M&A Practice. Specialist M&A services will be led by Josh Roach who recently returned to Sydney after a secondment to the UK M&A Practice in London. Josh was able to utilise his experience gained during his time in London on a live Australian transaction – the KKR acquisition of Brambles Industrial Services and Cleanaway.

The Practice will focus on the provision of due diligence and transactional insurance products and services arising from mergers, acquisitions, divestments, reconstructions and formal insolvencies. Clients will include Private Equity firms, Investment Banks, Professional firms and major corporations. The new structure combines Willis' market leading Global M&A Practice with Willis Australia's market leading Insolvency & Financial Risk Practice. The combined group will form a dedicated national network with

over 60 professionals available to service the transactional risk and insurance needs of clients across Australia and New Zealand.

Australia represents the essential next step in the development of an international M&A Practice at Willis. Utilising the exceptional insurance consultancy skills that already exist in Willis Australia as a platform, Josh will be able to immediately deliver a market leading service to our core clients.

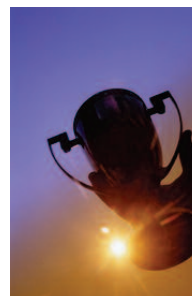
The combined MA&R Practice in Australia will be managed by Mike Looney, who has seen the insolvency profession evolve considerably over the last five years and is now heavily focused upon reconstructions, equity raisings and managed divestments. He commented: "We see many parallels in the respective needs of the M&A sector and we look forward to working closely with the Global M&A team to broaden our service offering."

## Industry Recognition

### Award Nomination

The Willis European M&A Practice was nominated for an award for Excellence in Advisory Services at the 2006 Private Equity News Awards. With the UK Practice winning the BVCA Real Deals award in April this nomination demonstrates that we have been able

to develop a consistent approach to our service delivery and reporting across Europe and can genuinely count ourselves as a leading insurance advisor to the private equity community.



### Willis Index Publications

The specialist divisions of Willis FINEX produce regular publications on the relevant issues affecting the insurance industry and the effect they have on various business sectors. To request editions of The Willis Index including Financial Institutions, Professional Indemnity, Directors' & Officers' Liability, Environmental Liability or Political Risks, please contact Amy Dawson at dawsonaca@willis.com.

**Willis voted European Commercial Broker of the Year 2006 for the second consecutive year**

**Willis voted Best & Most Innovative Insurance Broker 2006 for the second consecutive year**

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# Case Study

## Willis advises successful bidder on the largest management buy-out in Australia's history

In a transaction valued at approximately US\$1.35 billion and the largest management buy-out in Australia's history, the Willis Global M&A team was appointed to conduct insurance due diligence on the proposed acquisition of Cleanaway Australia and Brambles Industrial Services from Brambles Industries. Competing against a large number of other bidders, this was the purchaser's pioneering Australian acquisition.

### Deal Driver – the insurance perspective

#### Workers' Compensation

Workers' Compensation within Australia is mandatory and subject to individual state legislation. Due to premium volatility, many large organisations (who meet the eligibility criteria) elect to self-insure this risk as it facilitates control and ownership and is often deemed to be the most financially viable alternative in the medium-to-long term.

Whilst financial viability may be a key consideration in the decision to self-insure, it must be noted that under state legislation, the legal liability for any self-insured claims relating to periods prior to divestment will, regardless of when the claim is made, reside with the vendor and not the divested business.

In this transaction, due to the number and geographical spread of employees, the vendor's Workers' Compensation programme was varied and complex and accounted for a significant proportion of the overall premium spend.

The Willis M&A Practice worked in conjunction with the Willis Workplace Risk Practice to develop a post acquisition programme which aimed to maximise premium efficiencies on an individual, state-by-state basis.

#### Key deliverables included:

- cost benefit analysis of programme alternatives
- identification of maintainable versus one-off costs
- forecasts of total cost of insurable risk
- detailed timescales to alternative programme establishment and inception
- benchmarked administration costs of managing outstanding claims
- sale and purchase agreement considerations to facilitate the cleanest exit.

By adopting a commercial approach and an understanding of the financial impacts of insurance to this transaction, the provision of the deliverables above enabled the purchaser to undertake more precise cash flow modelling and EBITDA calculations which in turn translated to a more finely tuned offer price.



## An Overview of Environmental Insurance Market in Australia

In any country, a sound understanding of environmental insurance is fundamental to the assessment and structuring of effective environmental risk management.



#### Environmental Legislation

Most environmental legislation in Australia is enacted at the state/territory rather than national/federal level, and therefore varies regionally. However, Commonwealth Legislation, notably the Environment Protection and Biodiversity Conservation Act 1999, also applies nationally. Common law principles, for example under the torts of nuisance and negligence, may also apply. Pollution and land contamination liabilities are typically administered via civil action rather than criminal penalties and sanctions, in order to encourage the clean up of contamination. Strict (i.e. non-fault) liability commonly applies for pollution offences, for example failure to obtain, and operate in accordance with, a permit, or where pollution causes serious environmental harm. At the national level, Commonwealth Legislation is administered and enforced by the Commonwealth Department of Environment and Heritage (DEH), whilst the policies and practice of each state/territory are co-ordinated through the National Environment Protection Council.

Environmental protection agencies within each state/territory are empowered to require an investigation to be undertaken where they have reason to believe the land may be contaminated. The need for an investigation can typically also be triggered by a change in lease or land use. A remediation order can then be

# Environmental Legislation and the Environmental Australia

Understanding of the applicable environmental legislation is  
and management of environmental risks, and the  
environmental insurance cover.



served if such investigations indicate that the land represents a "significant risk of harm" to the environment. Whilst, as in many countries, primary responsibility for contamination rests with the original polluter, owners (including mortgagees in possession) can also be held liable even if they were not responsible for the contamination. The authority will typically pursue the investigation and, if necessary, remediation of a site through "voluntary" agreements, however this does not rule out the possibility of the authority requiring further remediation if residual contamination presents a risk in the future.

## Environmental Insurance

As in the UK, traditional insurance products available in Australia such as public liability policies provide limited, if any, cover for pollution, at best offering cover for third party claims arising from "sudden and unforeseen" pollution events. Public Liability cover for operations representing a relatively "high" environmental risk is likely to be subject to a total pollution exclusion. Such cover is therefore clearly inappropriate for the majority of environmental risks, particularly those associated with historic contamination which is often the key concern during transactions. The uptake of environmental insurance products is not as prevalent in Australia as it has been in Europe and the USA. In 2003, a survey

conducted on behalf of the Australian Government found that an overall lack of major exposures, absence of past litigation and claims history, and the low volumes of merger and acquisition activity at that time were considered to be key reasons (DEH, 2003). As in the UK, the market exists primarily as a deal facilitation tool for mergers and acquisitions.

That said, industry sectors such as mining, waste management, engineering, construction and energy have purchased environmental insurance cover for operational risks in recent years. Australia is certainly viewed as a potential growth market by environmental insurers, with increasing interest in the use of environmental insurance products being evident, both for risk finance and risk transfer solutions. Whilst AIG is currently the only insurer with a local environmental underwriting presence in Australia, other environmental insurers are able to offer cover through their London offices. As these insurers all have offices in Australia, policies can be issued locally if required.

Reference: The Materiality of Environmental Risk to Australia's Financial Sector. Report prepared by Ernst & Young for Commonwealth Department of Environment and Heritage, 2003.

# Portfolio Initiatives

The ultimate aim of a Private Equity Fund Manager is to deliver a profitable exit from the individual investments, generally three to five years after the original investment. Delivery of positive returns increasingly includes working with management toward ensuring the correct business strategy is undertaken and where possible leveraging the purchasing power of the wider portfolio of investee companies achieving synergies and cost savings.

Insurance is an area where portfolio leverage can achieve synergies and cost savings. Small-to-medium (SME) companies are the most likely to derive the most benefit from participating in a portfolio programme. The extent of any synergies and savings can be affected by the make up of the portfolio, (e.g.), industry sector, territories, as well as the relationship between the General Partner (GP) and 'local' management of each investee company. Is the GP prepared to mandate or purely sponsor initiatives to their portfolio companies? Does it make sense to include all portfolio companies in the same initiative?

Synergies can include improved and standardised insurance coverage, increased limits of coverage, common risk management/control initiatives and – of most interest to financially sensitive GP's – actual cost savings can be derived from reduced premiums, deductibles and risk management efficiencies.

However, there are insurance lines which are more readily commoditised, for instance Directors & Officers (D&O), Umbrella/Excess Liability, Keyman and in certain instances Motor.

Of these, D&O often has the highest profile with GP's and in the majority of cases companies will purchase a D&O policy due to the personal impact on the individual Directors of both the GP and the local management who will be keen to protect their personal assets in the event of a claim.



Willis has designed a D&O programme specifically for Private Equity Funds and their respective portfolio companies. The beneficial aspects include:

- short-form application process; a full proposal form does not need to be completed
- pre-determined premium levels for limit of liability up to £10,000,000. Higher limits are available on request
- automatic cover for new portfolio companies for 30 days
- major Shareholder Claims Cover – i.e. no major shareholder exclusion
- reinstatement of limit for all non-executive directors
- pre-agreed run-off premiums for periods up to six years
- 12 month automatic cover for retired directors
- coverage for Insured versus Insured claims
- 24 month policies available
- automatic cover to renewal for all 'buy and build' acquisitions at no additional premium.

*“...savings can be derived from reduced premiums, deductibles and risk management efficiencies.”*

In many instances GP's are, understandably, reluctant to impose time-consuming exercises upon their investee company's management unless a benefit can obviously be derived. In respect of D&O, Willis are able to obtain a pre-agreed premium without demanding excessive amounts of information from the GP's or investee company management, although current premiums and limits purchased will be necessary for comparison purposes.

Should benefits, as mentioned above, be achieved, it is then up to the individual companies to participate in any portfolio policy, unless their inclusion is mandated by the GP's. Where there is a strong preference for the existing broker relationship to be maintained, a wholesale programme can be created allowing the local broker to access the Willis brokered facility.

The ultimate portfolio initiative would involve a capitalised captive, rent-a-captive or protected cell company, which all enable profit to be retained and redistributed internally, thus creating additional value.

Willis' flagship portfolio insurance programme is structured for an investment fund, predominantly focused on the retail sector. This sponsored programme involves 20 companies in the UK and Europe and is across all classes of insurance. Significant synergies and savings were delivered whilst the portfolio companies retained their individual identities and stand-alone insurance programmes with coverage unaffected by any exit of the investment fund.

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## New Joiners

### **Ben Cooper** **Portfolio Director, M&A London**

Ben has worked in the insurance industry for 17 years in both direct and reinsurance aspects of the insurance market. His experience in the direct market has involved account management and business development, including a three-year position in the USA, managing and placing international and domestic insurance programmes on behalf of major international clients. Five years as an international reinsurance and wholesale property broker with one of Lloyd's largest independently owned reinsurance brokers provided an extensive understanding of the international insurance market. Ben has the knowledge and experience required to structure and implement portfolio insurance programmes designed to achieve cost reduction, enhanced coverage and streamlined administration.



### **Jon Armstrong** **Project Manager, M&A London**

Having started his career with a major Lloyd's broker in Manchester, Jon has now worked in the London commercial insurance market for over 13 years. Primarily responsible for planning the high level strategy and placement of bespoke local, pan-European and global programmes, Jon has gained a deep technical knowledge complimented by industry experience gained from from a client base comprising most sectors. Jon's technical and sector knowledge ensures a thorough understanding and diligence of all transactions he is involved in.

### **Richard Spotswood** **Project Executive, M&A London**

Following University, Richard began his insurance career in the Royal & Sun Alliance Graduate Programme. Following positions as both a Liability Claims Handler and a Professional Indemnity Underwriter, Richard joined the Willis M&A practice in October 2006. He has a particular focus on the legal side of insurance and is currently undertaking a part-time LLB.

# Global Political Risk



This quarter we have included an expert from the Q4 Willis Political Risk Index. The Political Risk Practice specialises in structuring insurance products to mitigate the risks of trading with, or investing in, volatile emerging markets. The Index was developed in conjunction with Oxford Analytica, the international consulting firm and includes expert contributors who are political and economic analysts based at universities and research institutes ranging from Oxford University and the University of London's School of Oriental and African Studies to the University of Natal in South Africa, the Carnegie Endowment for International Peace in Russia, Chatham House, and the Institute of Southeast Asian Studies in Singapore.

## Developments this Quarter

It has been an unsettled quarter worldwide. Hostilities with Israel resulted in economic losses totalling several billion dollars in Lebanon; Thailand suffered a military coup; BHP Billiton declared force majeure on copper contracts due to mine strikes in Chile;

Castro's ill health highlighted succession issues in Cuba; a tax dispute threatened oil investors in Chad (Chevron and Petronas were at one point ordered to leave the country); violent strikes caused business interruption in Hungary; terrorists struck Turkey with several bomb attacks, claiming foreign victims in the resort town of Marmaris; mining companies found themselves facing tens of millions of dollars in unexpected tax bills in Uzbekistan; a foreign-owned oil rig was seized by the Iranian military following a contract dispute; and Russia threatened license cancellations for Total, BP, and most dramatically, Shell's \$20 billion Sakhalin project.

This quarter also saw the five-year anniversary of the September 11th terrorist attacks on New York and Washington. Terrorism certainly looms larger in the minds of business people today. But this perception is somewhat at odds with the statistical reality: the number of international terrorist incidents per year is roughly the same now as it has been for the past three decades. In fact, there are now roughly 300 incidents of international terrorism each year, but this was also true during the 1970s and 1980s. (Indeed, the year that still holds the record for the highest number of incidents, at more than 400, is, perhaps surprisingly, 1985.)

Businesses and diplomatic institutions are now the primary targets of international terrorist attacks; but again, this was already the case well before September 11th. (The major change since September 11th is actually a reduction in the number of incidents targeting airlines and airports, presumably due to tighter security.)

Measured in terms of deaths, international terrorism does claim many more victims per year – roughly 500 per year, as against 200 per year during the 1990s. But these deaths are dwarfed by the number of casualties of national terrorism, arising from local conflicts in places such as Colombia and Sri Lanka. These types of domestic terrorist incidents have caused and continue to cause roughly ten times the number of deaths per year as those caused by the high-profile international attacks that dominate media coverage.

In one sense, however, the perception of a growing terrorist threat is justified. That is because the number of so-called "highcasualty terrorist bombings," single incidents which claim more than 15 lives, has soared on a global level, from roughly 150 deaths per year in the 1990s to nearly 1,500 deaths in only the past six months. On a global level, since September 11th

the increase in the number of these incidents has been steady and almost continuous. Most of this violence is confined to four countries: Iraq, Pakistan, Russia and Israel. But in a sense, the greater concern about terrorism is understandable, even if the global incident count has not increased: by claiming more lives in single incidents, terrorism has become more terrifying.

Across the globe, the pattern in our ratings this quarter was one of divergence. Risks in those countries already rated at high risk levels continued to worsen; risks in those countries with attractive political risk environments continued to improve. Zimbabwe, Cote d'Ivoire, Cuba and Pakistan are risky and getting worse. Romania, Bulgaria, Ghana and Gabon are relatively stable and getting better. In Uzbekistan last quarter we rated expropriation risks "very high" on a worsening outlook; this quarter international mining investors felt the brunt of this, as Newmont Mining ordered its expatriate employees to leave the country after being hit with an unexpected \$48 million tax claim (the investment itself is valued at \$94 million). Thus we have increased the risk rating still further. The story elsewhere in Central Asia, however, was not all negative, as, for instance, anticipated oil revenues in Kazakhstan improved the sovereign default rating.

Indeed, in much of the world, high commodity prices are solidifying budgets and current account balances for commodity exporting states, while the ready availability of international finance is minimising the pain for those forced to import increasingly expensive oil. Even Russia, with its seemingly arbitrary regulatory actions against oil investors, is a mixed story, as high oil prices continue to reduce transfer and sovereign default risks. Despite the high-profile actions against Shell, at present we do not see expropriation risks in Russia spreading outside strategic sectors.

It is possible that the easy availability of global finance may be masking some significant economic imbalances, so this positive picture could change fairly quickly. In addition, we continue to monitor worsening violence risks, notably in Iran, Ecuador, Ethiopia, Nigeria, the Democratic Republic of Congo, Tajikistan, the Cote d'Ivoire and Pakistan.

# Meet the Team



## Josh Roach National Manager, M&A Practice, Australia & New Zealand


With qualifications in Civil Engineering and Commerce, Josh joined Willis in 2002, prior to which he worked for a global engineering consultancy firm where he specialised in offshore Project Feasibility and Financial Modelling. Josh now heads the Mergers & Acquisition Practice of Willis

Australia, with responsibility for the delivery of due diligence and transactional product services to both corporate and private equity clientele.


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Willis Mergers & Acquisitions Practice performed insurance due diligence on the acquisition of




by




**October 2006**  
This announcement appears as a matter of record only

Willis Mergers & Acquisitions Practice performed insurance due diligence on the management buy-out of




creative in bodycare

by




**October 2006**  
This announcement appears as a matter of record only

Willis Mergers & Acquisitions Practice performed insurance due diligence on the acquisition of



by



**September 2006**  
This announcement appears as a matter of record only

Willis Mergers & Acquisitions Practice performed insurance due diligence on the £27,000,000 investment in

Commercial First

by

Lloyds TSB Development Capital

**September 2006**  
This announcement appears as a matter of record only

Willis Mergers & Acquisitions Practice performed insurance due diligence on the £30,000,000 secondary management buy-out of




by

Lead Equity Provider




**August 2006**  
This announcement appears as a matter of record only

Willis Mergers & Acquisitions Practice performed insurance due diligence on the £26,000,000 acquisition of




by




**August 2006**  
This announcement appears as a matter of record only

Willis Mergers & Acquisitions Practice performed insurance due diligence on the acquisition of



by




**July 2006**  
This announcement appears as a matter of record only

Willis Mergers & Acquisitions Practice performed insurance due diligence on the £29,000,000 management buy-out of

Avance Group plc

by



**July 2006**  
This announcement appears as a matter of record only

Willis Mergers & Acquisitions Practice performed insurance due diligence on the £571,000,000 acquisition of a portfolio of pubs from


Punch Taverns

by



**June 2006**  
This announcement appears as a matter of record only

Willis Mergers & Acquisitions Practice performed insurance due diligence on the acquisition of




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INVESTITORI ASSOCIATI

**June 2006**  
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Willis Mergers & Acquisitions Practice performed insurance due diligence on the approx. US\$1,350,000,000 management buy-out of




by




**June 2006**  
This announcement appears as a matter of record only

Willis Mergers & Acquisitions Practice performed insurance due diligence on the £550,000,000 acquisition of



by



**May 2006**  
This announcement appears as a matter of record only