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Economic Review

Acquisition terminated, blessing in disguise

As American International Group (AIG) rejected the request to cut the takeover price , Prudential on Wednesday announced it terminated the deal to buy American International Assurance (AIA), AIG's Asian insurance unit. The biggest-ever takeover in the insurance sector turned out to be a failure.

Early this year AIG planned to spin off AIA through a public listing in HK. It was unexpected that Prudential, who coveted the development potential of AIA in Asia, suddenly came out and agreed to buy AIA for US\$35.5B, including US\$25B in cash and the rest in securities linked to its shares, which was equivalent to over 11.7% of Prudential's shares.

The market was not bullish towards the deal as Prudential shares dropped by 19% in the two days after it announced the purchase, while the Financial Services Authority (FSA), the regulator in the UK, also questioned the capital level of Prudential. Later Prudential announced a rights issue to raise capital, namely 11 new shares for every 2 existing shares, yet investors' response was also lukewarm as they believed Prudential was paying too high a price. Seeing that this would be unlikely to be passed in the shareholders meeting on June 7, Prudential asked for a price cut, expecting to lower the takeover price to \$30,375M, with cash reducing to \$23B. However, after a 7-hour discussion by AIG's board of directors on Monday, the proposal was voted down with 10 affirmative votes and 41 dissenting votes. The affirmative vote of Robert Benmosche, President of Prudential, didn't help either. After being rejected by AIG, Prudential on Wednesday announced the termination of its proposed acquisition.

From the share prices of Prudential and AIG, one could see the market views on whether the purchase price was too high or not. Within the two days after the acquisition was announced, Prudential shares plunged 19%. However, the news that the acquisition might fail had boosted Prudential shares to rise by 6.3% against the market on Tuesday, while AIG shares closed down by about 3%. Tidjane Thiam, CEO of Prudential, also conceded that the price was too high, but it's simply because the listing of AIA had been in full swing, and Prudential offered higher premiums so as to win the bid.

The wrong decision on acquisition would cost Prudential a lot. The cost is estimated to total \$450M, including a termination fee of £152.569M (\$224M). Other losers would be the investment banks which assisted the acquisition, including Credit Suisse, HSBC and JPMorgan, who would suffer a substantial loss of consultancy fees and underwriting revenue due to the failure of the acquisition. As for the US government, who had rescued AIG by spending \$123B in exchange for 80% stake, it originally expected to recover the loss of no less than \$25B, yet the dream wouldn't come true. Even if AIG restarted the listing, the amount of capital to be raised would be only \$15B. Therefore, the US taxpayers would also be losers.

Prudential issued a statement saying that originally it intended to buy AIA because of the potential of the Asian insurance industry, while amid a falling market, the request for a price cut was reasonable. Despite the termination of the acquisition, Prudential would still allocate the capital to the most profitable products and regions, and would still stay bullish on Asian market. There was a strong sense of bitterness throughout the statement.

As for Prudential, the termination of the purchase might be a blessing in disguise. At least it would not bear heavy debts due to a high takeover price. In particular, businesses of Prudential and AIA overlapped in many aspects, so the synergy effects might not be as evident as imagined. AIG refused to cut the price, showing its confidence in the outlook of AIA. Despite the lower income from the AIA listing, AIG could retain the goose that would lay golden eggs and wait for a better offer.

Prudential bet on the wrong note and lost £450M. Whether anyone would take the blame for it and step down would be another matter.