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ROUNDTABLE

INBOUND US M&A

An air of uncertainty has surrounded the weakened US economy. In the last year, several high-profile brands have been sold to foreign investors, breeding speculation that the nation is 'up for sale' and sparking a protectionist debate. Favourable exchange rates and economic conditions have allowed foreign buyers to be more aggressive, but there are many reasons why savvy investors are seeking entry into the world's largest economy.

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THE PANELLISTS

Mike Lux
Executive-in-Charge, Crowe Chizek
T: +1 (312) 899 7006
E: mlux@crowechizek.com
www.crowechizek.com

Michael Lux is the executive-in-charge of the transaction services practice at Crowe Chizek and Company LLC. He has provided professional services to clients on deals ranging in size from $5m to $500m. Services include due diligence investigations, developing financial projections, business valuations, purchase price allocation, and deal structuring. Mr Lux has led and participated in due diligence investigations in the United States, Germany, the United Kingdom, Hong Kong, Canada, Denmark, Finland and Italy.

Richard Cicchillo, Jr.
Partner, Kilpatrick Stockton
T: +1 (404) 815 6111
E: rcicchillo@kilpatrickstockton.com
www.kilpatrickstockton.com

Rich Cicchillo chairs the Mergers, Acquisitions, and Securities team for Kilpatrick Stockton LLP. He works on a wide variety of corporate and commercial transactions, with a focus on domestic and international mergers, acquisitions and joint ventures. He joined Kilpatrick Stockton in October 1994 after completing a clerkship with Judge Ed Carnes of the US Court of Appeals for the Eleventh Circuit. Mr Cicchillo is fluent in French and is the attorney for the French Consulate in Atlanta.

Cherie Smith Homa
Head of Investment Banking,
KPMG Corporate Finance LLC
T: +1 (410) 949 8692
E: csmith@kpmg.com
www.kpmgcorporatefinance.com

Cherie Smith Homa joined KPMG Corporate Finance in 1994. She serves as Managing Director and Head of KPMG Corporate Finance's investment banking practice. Her corporate finance experience includes advising companies on sales and divestitures, acquisitions, capital raising, valuations and strategic assessments. Ms Homa has worked with family-owned, venture backed, middle market and large corporations, primarily in the services, media, and technology industries, with significant experience advising shareholders on their strategic alternatives and executing sale transactions.

Wayne Bradley
Partner, McKenna Long & Aldridge LLP
T: +1 (404) 527 4044
E: wbradley@mckennalong.com
www.mckennalong.com

Wayne Bradley serves as Co-Chair of the Corporate Department at McKenna Long & Aldridge LLP. He advises public and private companies in connection with a variety of strategic matters, including mergers, acquisitions, divestitures, joint ventures and strategic alliances. He also works with clients on corporate finance, commercial contracts, commercial lending, and internal investigation matters. Mr Bradley has particularly extensive experience representing non-U.S. companies in connection with their U.S. operations and transactions.

T. Patrick Hurley, Jr.
Managing Director, MidMarket Capital Advisors
T: +1 (215) 875 8201
E: phurley@mmadvisors.com
www.mmadvisors.com

T. Patrick Hurley, Jr. founded MidMarket Capital Advisors after serving as head of Fleet M&A Advisors Philadelphia office. He previously served as partner and director of M&A for Howard, Lawson & Company after joining the firm in 1979. He holds an MBA from Drexel University, a BBA from Temple University and is a NASD Registered Securities Principal. Mr Hurley is the former Chairman of the Association for Corporate Growth (ACG).

Donald H. Siegel
Partner, Posternak Blankstein & Lund LLP
T: +1 (617) 973 6147
E: dsiegel@pbl.com
www.pbl.com

Donald H. Siegel is a senior partner and founder of the Boston based law firm Posternak Blankstein & Lund. He has been representing private and public companies in financings and M&A transactions for over 35 years. His clients are in a broad range of industries including software, internet, consumer products, retailing, telecommunications, truck leasing, environmental services and manufacturing. He has represented buyers and sellers in a broad range of sale and acquisition transactions ranging from cash purchases to stock mergers.

Hector J. Cuellar
President, RSM EquiCo Capital Markets
T: +1 (888) 543 0711
E: hcuellar@rsmequico.com
www.rsmequico.com

Hector J. Cuellar is president of RSM EquiCo Capital Markets. Under his leadership, the firm has completed more than 150 M&A transactions, tripled its average deal size, almost doubled its number of cross-border transactions, generated billions of dollars in liquidity for its clients and been annually ranked among of the nation's top 20 M&A advisers. Mr Cuellar, who came to RSM from Banc of America Securities, has more than 25 years of experience in corporate and investment banking.

John S. Rovani
Managing Director, The McLean Group, LLC
T: +1 (703) 827 0246
E: jrovani@mcleanllc.com
www.mcleanllc.com

John Rovani is managing director of The McLean Group's Travel/Transportation and Hospitality Mergers and Acquisitions advisory practice in the firm's Washington, DC, area headquarters. His extensive dealmaking experience includes cross-border transactions across the US, UK, India, Spain and other countries. He earned his MBA degree from Vanderbilt University and a Bachelor's degree from The University of Massachusetts at Amherst. He is fluent in English and French and has working knowledge of Spanish.

The mainstream press seems to have latched onto the phrase "America is up for sale". Do you believe this sentiment is a fair reflection or an overstatement of the reality of foreign acquisitions in the US?

Homa: Catchphrases like this take on a life of their own and tend to overstate reality. The reality is that US asset markets are free and open – with some obvious national security exceptions. In the middle market, defined as transactions less than $500m, roughly 25 percent of US targets were reported to have been acquired by foreign buyers in the first half of 2008. This is substantially higher than 2004 when 15 percent of US targets were acquired by foreign buyers, but it is reflective of increased cross-border deal flow – in both directions – that come with an increasingly globalised economy.

Cicchillo: In many ways this media hype reflects broad uncertainty about the strength of the US economy following the credit crunch and the housing crisis. It is also consistent with the resurgence of protectionist sentiment in the US as we head into the presidential elections. The statistics suggest an increase in inbound acquisitions both in absolute dollar terms and as a percentage of overall foreign inbound investment. That may account for some of the press that we are seeing, particularly when you couple it with the huge accumulation of capital in sovereign wealth funds and oil and energy-producing countries, and the lower dollar that gives rise to the idea that the US is on the sale for cheap. But considered over a longer term, that is really not true.

Lux: It is an overstatement. For the past 20 to 25 years, foreign companies have been buying companies in the US. Some of the recent high profile stock sales to foreign investors, such as Merrill Lynch, have caused some in the press to make that statement.

Siegel: We continue to see a large number of transactions with domestic acquirers, as well as heightened interest from overseas buyers. I do not see America as being so much as up for sale, just that foreign capital is available for investment and favourable exchange rates make it easier for a foreign buyer to be an aggressive purchaser. This is especially true in the current environment – tight capital markets have made financing many deals in the US more difficult and resulted in lower prices. Foreign investors that have strategic reasons for coming to the US can offer more attractive deal terms to a seller. For privately held US companies the net after tax impact of the sale transaction, the pending administration change and the concern over potential increases in tax rates are factors that may drive them to accept a sale transaction in 2008, even at a lower perceived price.

Bradley: Clearly, there are bargains available, and the weak US dollar gives non-US buyers opportunities. But investors still must be careful to choose targets that fit well with their strategic plans and will not cause significant integration issues or other problems that will lead to later regrets.

Hurley: The statement is true in the sense that relative prices make it less expensive for many buyers from outside the US to acquire US companies. Americans are painfully aware of the strength of the euro, British pound, Canadian dollar and Chinese RMB. On the other hand, even though relative prices have declined in-market because of the credit crisis, demand for good quality companies remains high. The distressed company market seems to hold the attention of the press as the US struggles to sort through the excesses of the last cycle and economic swoon, but discretionary sellers will not mark-down the value of their companies. The market is less crowded and more attractive for strategic buyers because financial buyers have generally been sidelined for the moment.

Cuellar: I think this is a pretty fair assessment, especially considering the weakness of the US dollar. Though recently it has firmed up a bit, the currency remains very soft.

Rovani: Recent statistics show that US inbound and outbound M&A activities are beginning to rival each other. Conditions are certainly excellent for inbound M&A. There is no question that I cannot remember a better time to buy companies in the US. On a macroscopic basis, factors include the weak dollar, an increasingly price competitive labour market for sophisticated resources and the fact that the US traditionally leads recoveries from economic downturns. However, we believe that the media may be overstating the reality of foreign acquisitions in the US because we continue to see a great deal of interest in outbound, overseas M&A activity as well.

Can you outline the various factors that are drawing overseas buyers to US targets? What are their underlying motives?

Bradley: Certainly, one of the major reasons for the recent proliferation of foreign buyers in the US market is the relative weakness of the US dollar to the euro, the Canadian dollar and other currencies. Foreign buyers are seeing the advantageous exchange rates as an opportunity to gain geographic and industry diversification while being able to provide US sellers with higher purchase price multiples. Further, many foreign buyers believe that the current US economic downturn is bottoming, and as such, feel that US investments provide significant growth opportunity.

Cuellar: The greatest factor is relatively inexpensive entry into a large and very affluent market. Also, many companies, especially those with excessive euro-based production, are trying to rebalance by expanding their US-based production. And in certain industries, notably defence, the US not only offers the largest market but also the only one with attractive growth potential.

Lux: Among the factors drawing overseas buyers to US targets is the fact that a market which is normally very strong is weaker right now. Good companies are currently available at lower prices, due to the current economic environment. As a result, overseas buyers see quality assets at lower prices. Some think the weak dollar is triggering some of the trend, but I believe it is a small contributor. Intelligent companies do not pursue a transaction just because of the currency, since this can quickly flip the other way and leave the company in a difficult position.

Cicchillo: Currency levels have helped, but they do get overstated. For strategic buyers, although it may be less expensive to acquire assets in the US, if they are translating those US revenues back on to their financial statements in euros, there is a negative impact on the earnings side. But the credit crunch has made life difficult for private equity funds and made it a little easier for strategic acquirers to get back into the mix. Access to the growing US market is another important consideration for foreign buyers and the acquisition of US brands and distribution capability is always a draw. Lastly, the US has shifted into a service and technology-based economy and away from traditional manufacturing, so there are attractive R&D-intensive and technology-intensive companies available.

Homa: There are certainly a few financial factors that help to increase foreign buyer interest, such as favourable foreign exchange rates and relatively attractive valuations across many asset classes. However, we have seen the overwhelming majority of foreign acquirers driven by strategic interests rather than strictly financial ones. These buyers are either looking to establish or dramatically strengthen their footprints in the US through M&A, which is oftentimes a much more cost-effective approach than building a greenfield operation.

Siegel: I continue to believe that a lot of the factors that have always attracted foreign investment to the US remain in effect, namely a large market place, a consumer economy, the availability of technology that encourages and enables global transactions and the fact that a US presence facilitates reaching this market. Another significant factor is the impact of the increase in the cost of oil and the effect it is having on our economy and business conditions generally. As the cost of shipping becomes a more significant percentage of a business transaction, the ability to ship products from local sites in the US, as opposed to importing from overseas, may become significant, accelerating the need for foreign businesses to have a stronger US presence.

Rovani: The US is still widely recognised for its ingenuity and innovativeness among many of its international counterparts. Therefore, international buyers realise that acquiring US companies may, in certain cases, give them increased credibility in their fields. We have seen this with European technology firms that end up transferring their headquarters to the US. Indian companies are also very aggressive in seeking out and acquiring US companies.

International buyers realise that acquiring US companies may, in certain cases, give them increased credibility in their fields.

JOHN S. ROVANI

Many have been undergoing transformations into global powerhouses. They recognise that future growth necessitates them to become global corporate citizens by acquiring intellectual property and local footprints, including talent and client bases.

Hurley: The US market is very lucrative and will continue to be an important market for anyone with global ambitions. Successful executives focus on strengthening the competitive position of their businesses. Intel may look to Asia as the most important market for their next 10 years, but Nokia may see more opportunity in the land of Apple where a wounded Motorola results in an opening not to be missed. The motives are to create more organisational muscle and depth of management talent to be able to profit and build continuity.

Do foreign acquirers seem to be targeting healthy or distressed companies, or is a mixture of both? What factors are influencing their investment decisions in this area?

Cicchillo: M&A involving companies either in bankruptcy or teetering on the edge of bankruptcy is likely to pick up substantially over the next 6-12 months for sophisticated international acquirers that are already established in the US. Companies or investors that are not already here will lag a bit, and may not come to the fore for another 12-18 months. For the moment, foreign acquirers tend to target healthy companies. But the best targets with solid businesses are in many cases taking themselves off the market as valuations come down. They are waiting to see if the economy turns around so they can command higher multiples. So international buyers have to be much more selective about which deals to pursue because the companies that remain up for sale may not be the ‘best-fits’.

Rovani: Periods of economic slowdown traditionally put pressure on public companies to maintain their growth through other means than organic growth. International acquirers seek to minimise risk and spend a great deal of time getting comfortable with and securing contracts with local management. For them, the top requirements appear to be management, financial track record, the strength and reliability of contracts and corresponding future revenue streams, as well as future overall growth prospects for the acquisition target. They are, for the most part, interested in stable, growing platforms, which they do not have to worry about managing from afar.

Bradley: Healthy companies are still much preferred. However, many distressed companies offer excellent opportunities for non-US acquirers to enter or expand in the US market at truly exceptional prices. This is the case where the distress is caused by problems that are short term – such as loss of a large customer that can be replaced over time or a temporary downturn in sales – or reparable – such as excessive leverage or poor management – as opposed to more fundamental problems, such as a market shift affecting sales long term. Of course, purchasing a distressed company can be tricky and buyers must be particularly vigilant and be sure their advisers have experience in the distress arena.

Lux: Regardless of the environment today or two years ago, foreign acquirers are attracted to a company which they believe is a good investment. These are strategic decisions, defined by the pursuit of high quality assets. The only difference now is that buyers can acquire these quality assets at a more reasonable price than they could 18 to 24 months ago.

Homa: Foreign buyers are generally driven by strategic rationale and tend to prefer healthy companies that can more easily and quickly be integrated into existing operations. Our experience has been that while many foreign buyers would like to participate in the distressed market, timing and resources often hurt their ability to be considered a credible player. Foreign buyers tend to move too slowly and have unrealistic expectations about the competitive dynamics of the US distressed M&A arena.

Cuellar: While foreign buyers will look at both healthy and distressed companies, their primary focus in the US is on acquiring healthy companies. Strategic requirements and a continuing favourable exchange rate are the main factors behind this emphasis on healthy US companies. Over the last year or so we have also seen a build up of capital by US-based private equity and mezzanine funds dedicated to investing in distressed companies. Moreover, US acquirers tend to have operational and regulatory expertise that makes them more competitive in acquiring distressed US companies. And US acquirers are actively recruiting the human capital needed to fix the operational issues common in turnaround situations. That said, foreign acquirers may catch up to their US counterparts, given that opportunities to invest in distressed or turnaround situations will likely increase over the next 12 to 18 months.

Hurley: They look for healthy targets, but respond opportunistically. Most buyers of troubled companies are suppliers, customers or competitors, and each has complications compared to an otherwise unencumbered strategic buyer. Asians tend to buy failing parts of the supply chain. Europeans tend to want to fill product line holes. US companies provide access to customers who spend and react to new product offerings. Besides defensive actions, most foreign buyers are interested in being more familiar with the US market to help drive overall goals.

Siegel: Many US based companies with basically sold businesses are feeling the effects of the downturn in the economy, but given their products, market presence and business base they will get through the downturn and will be well positioned to grow as economic conditions stabilise. Clearly these businesses are solid acquisition targets, and may be priced favourably, given the cost of capital and the fact that for a foreign buyer its cost of capital is even less given the current exchange rates.

Are foreign private equity firms active in the US? Are their efforts curtailed by the global credit crunch or is the impact somewhat mitigated by currency exchange rates?

Siegel: We are seeing a greater interest from foreign private equity firms seeking investments in the US. In this environment, we are seeing some private equity firms committing to use more of their equity capital, which they need to put to work, to acquire the company, with a goal of refinancing or putting on additional debt later on or in conjunction with a follow-on transaction. Under these circumstances, a foreign buyer has a significant leg up to the extent that its equity invested, as measured in US dollars, costs it less than it would have previously. Because of the economic downturn the multiples of earnings paid for the companies is also less, so that even though less debt is available, the overall cost of the deal is still attractive to the buyer.

While foreign buyers will look at both healthy and distressed companies, their primary focus in the US is on acquiring healthy companies.

HECTOR J. CUELLAR

Cicchillo: We have certainly seen foreign private equity firms active in the US. The global credit crunch has made it harder to access debt, and when they do it is pricier and often a lower percentage of the overall deal structure. That said, leverage pieces are out there for equity funds chasing good, solid deals in the middle market, particularly when there is a strong bolt-on story to explain to the lenders. A premium is placed on the due diligence aspects and lenders are asking a lot more questions about the underlying business than they did in the heady days when debt was very freely available. Also, because of the higher equity levels, funds have to pay a lot more attention to their business case analysis and to the fit of the target, and rely much less on prospective synergies.

Lux: Foreign private equity groups are just as active in the US as US firms are abroad. The days of companies being limited to their own country are over.

Hurley: We see foreign private equity firms acting through their portfolio companies rather than directly for new platforms. There are pockets of technology in places like Nordic countries where niche businesses like dental imaging equipment manufacturers are owned by European private equity firms and their natural target in a growth plan is the US because of the discretionary income which drives spending on cosmetic dentistry.

Rovani: There is a lot of interest in the US market on the part of overseas private equity funds. However, many of these are being cautious in light of the current economic downturn and trying to focus their acquisitions through their overseas portfolio companies wishing to expand into the US. On the other hand, we have seen significant interest and aggressiveness on the part of US private equity players seeking to diversify their risk through overseas acquisitions in Europe and Asia, in particular.

Cuellar: We are seeing activity by private equity firms from throughout Europe and Asia, but the credit crisis is global, not limited to the US. The international private equity firms are essentially facing the same challenges as their US counterparts. The so-called 'mega-deals', which almost always have significant debt requirements, are struggling to get completed. But there is still a lot of activity in the middle market and lower middle market, where the multiples are not as high, buyers are willing to put in more equity, and mezzanine debt remains readily available. We are also seeing the emergence of unitranche lenders that will do a blended strip of debt.

Homa: Although there have been some successful examples, we have not encountered many foreign private equity firms entering the US middle market. While the global credit crunch and exchange rates may change the equation, we feel the primary reason may be due to the overwhelming level of competition among US private equity firms. There are thousands of private equity firms already established in the US, so foreign private equity firms may feel somewhat challenged to differentiate themselves and, as a result, tend to focus on their own or other international markets.

Do you expect sovereign wealth funds to ramp up their efforts to acquire US assets? What opportunities and challenges exist for these giants of the investment community?

Rovani: So far, we have seen sovereign wealth funds take minority positions in a number of US companies. However, it is too early to tell how aggressive they intend to be. Certainly, they will need to be aware of FINSA and how much they can own of certain assets (usually no more than 10 percent) and the limited influence they can have on their investment targets.

Hurley: They will muscle their way in for bigger deals, but not for the $50m or $100m deal in the near term. Those guys need to put big chunks of capital to work and see the exit within three to four years. Smaller deals just are not worth it to them. We view them as a big positive for overall deal activity, but more as whale-type players rather than as everyday middle market players.

Cuellar: There already has been quite a bit of SWF investment in the US, primarily in the financial sector. However, most of those investments have been pretty disappointing, at least thus far. I think sovereign wealth funds will continue to be active, but their investments will be concentrated in certain non-financial sectors such as energy, infrastructure, and food and beverage. I also think they will limit their focus to really substantial companies – those with valuations of a least $1bn. We don't expect to see much SWF activity in the middle market.

Bradley: It may currently be difficult to imagine sovereign wealth funds 'ramping up' current levels of activity, since they have, after all, been extraordinarily active given the maelstrom in the credit markets and the resulting capital infusion needs of banks the world over, including Citibank, Merrill Lynch, Barclays, Fortis. But it's clear that sovereign wealth funds are here to stay and will continue to be active globally as well as in the US. From an opportunity perspective, the current credit crisis has inured to their benefit. For example, with credit so constrained and the US dollar suffering, but with the price of oil hitting historic highs and, as a result, sovereign wealth funds being flush with cash, the environment continues to be fertile for these funds to step in and acquire, as demonstrated by Barneys New York and the Chrysler Building, or invest, as demonstrated by their equity stakes in financial institutions and in private equity players Blackstone, Carlyle and Apollo. As ever, cash is king, and these funds will continue to seek opportunities to deploy it. On the challenge side, clearly political considerations stand out. Concerns about national security and the potential political motivations of these funds, together with further calls for more transparency, will continue to colour the landscape and likely only intensify. While these types of challenges may influence the types of deals being made, such as encouraging non-controlling interests, and the sectors in which they are made, such as steering clear of anything remotely defence related, and while they may also yield a bit more in the way of transparency, they will not materially impede the deployment of capital by these funds anytime soon.

Siegel: Obviously, given the vast amount of US dollars held by sovereign wealth funds, it makes sense for them to target the US as a place to put their funds to work and also to continue to support the US economy, which provides a significant amount of foreign exchange to their countries.

Lux: We expect sovereign wealth groups to ramp up their efforts because they have money to spend and the US is an attractive market. There is an opportunity to get quality assets at a more reasonable price, and they have the funds to do it. Global credit will not affect them, but they do face geopolitical challenges.

Homa: Sovereign wealth funds in general have the clear competitive advantage in being able to deploy large amounts of equity capital under a rapid timetable and without the need for debt financing contingencies. They also bring enormous credibility to their portfolio companies, particularly those previously capital constrained, potentially reshaping markets. The key challenge these investors have in the US is managing their perception in the eyes of the American public and those of Congress. The most successful SWFs will be those that are viewed as being fair, long term partners with their US portfolio companies.

Obviously, given the vast amount of US dollars held by sovereign wealth funds, it makes sense for them to target the US as a place to put their funds to work and also to continue to support the US economy.

DONALD H. SIEGEL

Cicchillo: We expect sovereign wealth funds to increase their activities. Many of these funds are in energy-rich environments. For the present at least, oil remains denominated in dollars, so these funds have huge amounts of money ready to deploy. There were significant investments in the financial sector in the fourth quarter of last year. Sovereign wealth fund investments are likely to come out of Asia, and Brazil recently announced it is in the process of forming a sizeable sovereign wealth fund. Whether they will replace private equity funds as a competitive force driving up investment prices remains less clear.

What trends are appearing in competition between strategic and financial buyers, and between US and non-US acquirers, in the battle for M&A assets?

Lux: Strategic buyers are re-entering the marketplace, particularly in the middle market, because valuations are more reasonable and because financial buyers do not have the credit needed to drive up prices. In terms of competition between US and non-US acquirers, there does not seem to be a specific trend, except to note that borders are not what they once were. All competing companies are now on a similar playing field because very little prevents companies from crossing borders on the acquisition trail.

Siegel: In recent sale transactions, companies seem to be targeting strategic buyers as the likely deal partners rather than financial buyers. The driving factors seem to be that the strategic buyers have business reasons for acquiring a company that may enable them to pay more, and the buyers can finance the transaction through their normal bank credit lines. Contrast this with a standalone investment by a private equity firm where the debt portion of the financing must be supported by the cash flow of the business alone. Where we are seeing financial buyers more active, however, is where they have targeted an industry or business segment as a good growth opportunity and are viewing the acquisition transaction as a first of a series of transactions. In this market climate, they and others like them may be willing to put more of their equity capital to work to keep staff busy. The expectation is that, as the new companies grow, they will be able to refinance the debt or potentially sell the company or even a portion of their equity to other funds. In effect they are using additional equity as a placeholder until they can recapitalise at a more favourable rate and in a more favourable capital markets environment.

Cicchillo: As leverage pieces become harder to obtain, the multiples that financial buyers are willing to pay have dropped, opening up some space for strategic buyers to get back into the mix. Competition between US and non-US buyers really depends. Foreign companies are impacted by currency not only in terms of pricing the deal on the front end, but also in terms of the revenue they will add to their P&L on the back end. So the weak dollar is not an unmitigated positive situation driving new investments into the US, and it could in fact cause non-US buyers to slow down.

Hurley: It is mostly the all-in sale versus the recap and 'second bite at the apple' deal issue that causes sellers to scratch their head and evaluate the option to go halfway. Strategic buyers are offering certainty of closing protection and financial sponsors offer autonomy and equity up-side. Strategics say that the principals will play an important role going forward. Strategics are winning more often than not.

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>
> MIKE LUX

Rovani: Recent lower middle market sell-side transactions have shown unusually high levels of interest and offers from financial buyers. In fact, one recently closed 2008 transaction involved 11 interested buyers. Eight were financial and three were strategic. Also interesting is the fact that the two highest offers, in terms of total consideration, were from financial players. We attribute the interest to the significant capital that is still available to be invested and the fact that private equity groups are seemingly moving down market to offset the need for debt financing.

Homa: For quality deals, private equity firms are being aggressive – sometimes more so than strategic acquirers. In order to provide a higher likelihood of deal closure, PE firms are writing equity checks for the entire value. They are accepting the risk of refinancing post closing or once the credit markets stabilise. While earn-outs have historically been used by strategic acquirers, private equity firms are now moving towards the trend of using earn-outs to make the deal sweeter. There are often three components to a middle market deal with a private equity firm – cash at close, rolled or retained equity, and an earn-out.

Bradley: One trend that continues to develop is private equity investors' willingness to use favourable deal terms to make up for some of the lost ground caused by their difficulties in obtaining as much credit as before. We have seen several recent examples where financial buyers prevailed in private company auctions despite a somewhat lower bid, based on significantly more favourable deal terms in the areas of indemnities, survival periods, caps and baskets. Of course, in order to be so bold, diligence must be exceptionally thorough and therefore perhaps more costly.

What insights can we gain into the US market by evaluating deals that sparked patriotic reactions and raised sensitive political issues, such as InBev's recent pursuit of Anheuser-Busch?

Cuellar: Many, many US companies have been acquired by foreign buyers without any reaction from the American public. Miller Beer, GE Plastics, Paine Webber, 7-Eleven and an array of other well-known American brands are now owned by companies based in Europe and elsewhere. No one seemed to be concerned when IBM sold its personal computer business to the Chinese. People get really agitated when they think jobs will be lost – and that can happen regardless of where the buyer is based. Admittedly, there was some emotional resistance when the Anheuser-Busch deal was announced, but the company is unusual in several ways. It has a huge share of the US beer market, literally 50 percent; it is an old company with a very rich heritage and has been run by the same family since the nineteenth century; and its flagship product is an iconic brand that is closely associated with Americana – baseball, American football and the like. Moreover, much of the concern was centred in St. Louis, the Midwestern city where the company is based, so local pride was a contributing factor. Still, while there was an initial flurry of resistance to the deal, there has been little, if any, opposition once the board gave its approval. In the end, a premium offer trumps emotion and national heritage. Otherwise, the only time US citizens and their representatives get concerned is when the deal involves national security interests.

Lux: Anheuser-Busch shareholders were frustrated with poor returns and a foreign buyer had the funds to purchase an asset at a reasonable price while satisfying its own investors' demands for return, even though the price was significantly higher than what the stock had been trading at. In this case, the group providing the best return for the shareholders happened to be a foreign buyer.

Siegel: There is clearly a heightened sensitivity in the US to foreign buyers, especially in areas where US national interests are at stake. Witness the tighter controls and strengthened review process where national security or related issues could be involved. A US seller needs to be sensitive as to who its buyer is and the impact the acquisition will have on its employees, its customers and potentially any regulatory bodies whose approvals may be required for the transaction.

Cicchillo: There has clearly been an uptake of protectionist sentiment in the US. We have seen that in the presidential campaign. Campaigning against NAFTA, at least on the Democratic side, seems to be the order of the day, and the Republicans are decidedly quiet. We have a combination of post-9/11 anti-terrorism concerns and the downturn of the US economy unsurprisingly causing an increase in protectionist sentiment.

Homa: The InBev and other similar transactions highlight the need for foreign buyers to actively manage the perception of such transactions by all stakeholders of the target, not just shareholders. InBev's primary political opposition stemmed from concern over the loss of jobs and by undercurrents of an opportunistic, currency-driven deal. InBev addressed these issues early and directly through an open letter to the St. Louis Post Dispatch. This sort of 'open book' approach may also serve foreign buyers well in smaller middle market deals.

Bradley: Having excellent political and public relations advisers in such situations has always been important, but it is now more essential than ever. Once a bid such as InBev's is made, there is no turning back, so a bidder must have all its bases covered in advance.

Rovani: A lesson learned is the need to retain professional, in-country advisers with deep experience and expertise in promoting low profile mergers and acquisitions advisory work. For larger and potentially more controversial transactions, it is particularly important to retain a team composed of investment bankers, transaction lawyers, transaction accountants, tax experts, public relations firms and government relations firms. We believe that a proactive strategy, plan and process are as critical as the transaction itself.

A key issue for many foreign investors will be whether their proposed deals trigger national security concerns. Can you explain the implications of the Foreign Investment and National Security Act (FINSA)?

Bradley: In the wake of the public debate over the Dubai Ports transaction, Congress passed FINSA in 2007 which was an attempt to tighten oversight of foreign investments by replacing the largely discretionary CFIUS process with a more defined process and creating specific factors that must be considered in evaluating transactions. The proposed April 2008 regulations make it clear the US government is still trying to create the right balance between retaining the flexibility to protect national security interests while giving some more definitive guidance to companies entering or determining whether they should enter the process of having an investment approved. Although the proposed regulations provide more clarity, they do not provide for more explicit 'safe harbour' provisions called for by some to provide definitive guidance to international investors who may still view the process as being overly political and uncertain.

The US government is still trying to create the right balance between retaining the flexibility to protect national security interests while giving some more definitive guidance to companies entering or determining whether they should enter the process of having an investment approved.

WAYNE BRADLEY

Siegel: FINSA is potentially an issue in any foreign investment in a US company, particularly when the target company's business relates in some way to national security, such as defence contracting, or homeland security, such as administration of US ports or other important strategic assets. While the notification process under FINSA is entirely voluntary, in that the parties to a proposed transaction may decide whether or not to notify CFIUS, we suggest that if the target's business potentially implicates national security, we recommend that the parties voluntarily notify CFIUS as early in the acquisition process as feasible and engage directly with CFIUS throughout their review process. By acting in this way, the parties trigger an examination period that cannot last more than 90 days. If the parties choose not to make a voluntary notification, CFIUS retains authority to review the transaction, even after the parties have closed, and the President may seek to undo or restructure the transaction. Moreover, by acting proactively and staying involved throughout the review process, the parties have an opportunity to manage what can become a political struggle.

Cicchillo: Most commentators involved in M&A think the statute probably takes us in the wrong direction by further politicising the review process. Under the original Exon-Florio amendments, the term 'national security' was consciously left undefined. FINSA now requires certain types of transactions to be subject to investigation. If the investors are government-owned for example, there may be an automatic investigation. The definition has been modified to cover energy-related capacity, in both physical assets and also cyber-based energy capacity. It also requires CFIUS to consider unusual factors, such as the foreign jurisdiction's cooperation with the US counter-terrorism effort. Perhaps most significantly, Congress now is going to get notice of certified conclusions to any reviews that CFIUS undertakes. The committee has also made it clear that they think significant minority stakes in US companies might warrant review.

Cuellar: Supporters claim the new law will promote international investment in the US while protecting national security. The reality is that certain transactions – namely, those in which the buyer is a foreign government controlled entity – will receive more scrutiny. Still, we anticipate an increased amount of foreign purchases for the foreseeable future – additional regulatory hurdles and extended due diligence periods notwithstanding.

Homa: To some extent the implications of FINSA are still being played out as the Act was only made effective last October, and the market has been slow. In theory, the greater congressional oversight afforded by FINSA will make foreign control deals much more prone to interference and unnecessary delays, not to mention a potential blocking device for domestic buyers looking to eliminate foreign bidders. These risks are not just limited to larger, higher profile deals, but to middle market deals as well.

Rovani: FINSA provides the CFIUS with more authority to review mergers and acquisitions by or with any 'foreign person' which could result in foreign control of any person engaged in commerce in the US. While encouraging interstate commerce, it enables expanded oversight by the US government of such proposed transactions. Appropriate notifications must take place for CFIUS and US governmental review and this usually happens at the Letter of Intent stage, when the terms of acquisitions are known. It is still too early to tell what the impact of FINSA will be. However, there have been quite a number of companies that have sailed through the review process since FINSA came about. Again, working with a combination of specialised advisers involved in defence related transactions is critical in order for cross-border transactions to be successful in this area.

How would you describe the expanding role and importance of the Committee on Foreign Investment in the United States (CFIUS), and its affect on foreign deals? In your opinion, does CFIUS have the resources to administer FINSA effectively and efficiently?

FINSA may put foreign acquirers at a disadvantage when they compete against US acquirers in an auction where certainty of closure is a key goal. They may be forced to bid higher or include higher reverse break-up fee provisions.

RICHARD CICCHILLO, JR

Siegel: We see the enactment of FINSA as the end result of Congress' unhappiness with CFIUS and its handling of the proposed acquisition of P&O Ports by Dubai Ports World in 2006. While FINSA did not radically alter existing law, it does signal Congress' view of the importance of the CFIUS process in protecting national security and a likely increase in the scrutiny of proposed transactions by CFIUS. It also signals a likely increase in politicisation of the CFIUS process, particularly in light of CFIUS' Congressional reporting obligations. With respect to resources, the reality is that all US government agencies operate under increasingly tight budgets and broadening mandates. However, while FINSA increased the responsibilities of the agencies that comprise FINSA, it did not increase their budgets or resources. Nevertheless, in our experience each of the CFIUS agencies treat their obligations under FINSA a priority. That is not likely to change. Moreover, the strict time frame within which CFIUS and the President must take positive or negative action regarding a proposed transaction was not altered by FINSA.

Cicchillo: Expanding the committee's scope and mandating that Congress is involved in every one of its decisions allows for local concerns, let alone national concerns, to enter the process, as a member of Congress who is concerned about the impact of a foreign acquisition on their particular district now has way of more directly influencing the process. FINSA may also put foreign acquirers at a disadvantage when they compete against US acquirers in an auction where certainty of closure is a key goal. They may be forced to bid higher or include higher reverse break-up fee provisions. The key here is for an international acquirer to undergo a frank assessment of the political implications, locally and nationally, of the transactions they are considering, and to have a plan for discussing and addressing concerns with the key constituencies both at a political level and a community level. It is worth noting that even CFIUS' own material encourages companies not to file cold, but to approach the regulators first to have open discussions with them about the transaction, so that the regulator is educated about what the parties see as the issues, but at the same time the parties have an opportunity to see what concerns the committee may have, and to address those up front.

Rovani: CFIUS, so far, has rarely intervened unless prodded by an aggressive party opposed to the transaction. Usually, the process takes approximately 30 days as long as the new owners (company and individual) are clearly identified and as long as there is no overseas government ownership or controversial person associated with ownership. When it comes to transactions in defence or government contracting, the local Defense Security Service (DSS) must also have signed off on how the acquirer will be handling classified or proscribed information prior to getting approval.

Homa: CFIUS is increasingly important as it has, in certain circumstances, looked past the statutory standards of control and has reviewed transactions where a foreigner seeks to acquire just a minority position. For example, Bain and others ultimately abandoned their proposed acquisition of 3Com when it became apparent that CFIUS intended to prohibit the deal due to concerns that a Chinese telecom company would own 16 percent of the entity. As for the committee's expected performance, the results will largely depend on the level of increased caseload and the committee's ability to focus on key issues and get the right resources from the appropriate federal agencies.

Cuellar: With the addition of FINSA, CFIUS's role has become more critical in cross-border deals, and navigating this review process has become more vital than ever for a buyer. The CFIUS review process was historically limited to sensitive defence assets. However, as a result of a major influx of capital for US assets, the government has become more concerned about infrastructure assets as well as technologies. CFIUS has potentially become more rigorous with the addition of FINSA, but we expect government controlled buyers to feel the additional level of review and scrutiny more than foreign private equity groups or large foreign public acquirers. The US has been open to foreign purchasers and activity has been very strong over the past few years. We expect this trend to continue. Heavy demand will be placed on CFIUS, but it will be able to handle the additional reviews. The due diligence process will be longer. The US is such as valued place of business that foreign buyers will go through the additional effort to secure businesses here.

CFIUS is increasingly important as it has, in certain circumstances, looked past the statutory standards of control and has reviewed transactions where a foreigner seeks to acquire just a minority position.

CHERIE SMITH HOMA

Do foreign buyers need to be aware of certain unique elements of dealmaking in the US, with respect to issues such as tax, labour laws, product liability, and the responsibilities of a US company director?

Cicchillo: The impact depends on where the foreign acquirer is based. Investors from Western Europe and the industrialised nations, which still account for 75 percent of inbound M&A activity in the US, often face more stringent labour law and privacy regimes in their home countries, such as TUPE in the UK and similar provisions throughout Europe, such as the EU Privacy Directive. So in many cases acquirers from those countries, who are first-time buyers in the US, are somewhat pleasantly surprised to discover they have more flexibility when it comes to handling such issues. The two common concerns about the US are product liability and environmental law. But these have been discussed for years now and it is really nothing new or shocking to investors. So it is hard to see US regulation being a disincentive to US investment. Tax planning is obviously a key element of a cross-border transaction and one that needs to be addressed early in the acquisition process, probably before the bid or the letter of intent is signed and certainly before the acquisition takes final form.

Bradley: As is also the case with US buyers doing deals abroad, foreign buyers looking to do deals in the US must always be mindful of the nuances of local laws – and not just different interpretations of similar concepts, but also concepts that have no easy analogue in the foreign buyer's home country. Foreign buyers would be well advised to retain experienced US counsel to help them identify and work through these issues.

Homa: Specific target country considerations always need to be evaluated in dealmaking and what represents 'market' in one country may not represent 'market' in another. For example, reps and warranties and indemnity provisions vary from country to country. Further, in the middle market, there are often post closing operating concerns for the selling shareholders and management team members that need to be properly vetted and conveyed.

Hurley: In general, it is easier to do business in the US than outside because of workforce and permitting and intellectual property issues, but we do have a litigious society and much more of a contractual orientation. The US is more transactional than interlinked relationship based. As a result, we expect to move more quickly and professional are generally aware of what is 'market' for deal terms.

Siegel: Deal making in the US is complex. It requires compliance with a myriad of detailed and sometimes overlapping federal, state and, in some cases, local laws and regulations. For public and private companies, especially ones organised under Delaware corporate law, there is a substantial body of case law on the duties and responsibilities of the directors of the selling company and the process that must be undertaken to approve a sale transaction. These address, among other requirements, customary deal protection provisions, such as board fiduciary outs, no-shop and go-shop provisions, voting agreements and the like. Understanding and complying with these requirements is critical to making certain that the transaction will close as negotiated and to avoiding a costly and time consuming court case.

Lux: The biggest issue foreign buyer needs to be aware of is the overly litigious environment in the US. Tax is another unique element because in the US it is not just federal tax that has to be applied, but also state and local taxes, depending where the company's offices are located. Foreign acquirers also need to be aware that if you are a company director in the US, you can be sued. Lawsuits often go after the directors personally as well as companies.

What fundamental advice would you give to foreign acquirers scouring the US market for M&A targets in the months ahead?

Hurley: This is a great time to make approaches and to focus initial discussions on how they as a foreign partner can help to make the business even more successful and would like to explore ways to work together. Business owners are generally not thinking about selling now, so unless they are already in a formal process, just approach them as a potential strategic partner and let the discussion evolve to a potential acquisition at full value with certainty of completing the deal.

Siegel: The US economy is still in a state of flux as we try to deal with housing and credit issues and the economic changes brought about by the increased cost of oil and its impact on consumer confidence and costs of products generally. While many businesses are struggling, others are surviving or even flourishing in this environment. Buyers who are willing to target and identify companies that have solid fundamentals will acquire business platforms on which to grow and realise significant returns. So the first word is patience and the second word is perseverance, as the willingness to see beyond the current short term issues may help a buyer identify the real diamonds in the rough. Buyers, and especially overseas buyers, who are willing to share synergies and can provide assurances of closing with the selling companies are more likely to be successful purchasers.

Rovani: Timing is everything. Small to mid-sized private business owners recognise that the capital gains tax treatment will change under a new political administration, with change likely coming in 2010. This is good new for buyers in that private company sellers will likely be more motivated to sell (assuming a liquidity event is on the back of their minds) before 2010 than they have been in quite some time. Regardless of whether Obama or McCain win in November 2008, current capital gains tax rates expire in 2010 and all experts are predicting them to go up. The question is by how much.

Homa: Foreign acquirers should enlist solid advice and counsel from local M&A advisers who have the right combination of industry experience and other resources to help get deals completed. They should stay focused on evaluating acquisitions from a strategic perspective. Just because a target is 'available' or appears attractive from a valuation perspective, it may not necessarily fit within an acquirer's strategic plan and therefore not be worth the time and effort to consummate a deal. In addition, foreign buyers should establish a clear plan early on for any outside financing required in order to address any closing concerns. Finally, there is a tendency for sellers and their advisers to consider foreign buyers as being slower and less responsive than local buyers. Having an efficient decision making and approval process and maintaining deal momentum will go a long way towards correcting that perception.

This is a great time to make approaches and to focus initial discussions on how they as a foreign partner can help to make the business even more successful.

T. PATRICK HURLEY, JR

Lux: Foreign buyers need to focus on the quality of assets and not simply get excited because they can take advantage of some currency arbitrage or because they are getting something at a reduced price. If the quality is not there, they should not force a deal to happen. They also need to work with strong local advisers on accounting, legal and tax issues.

Cicchillo: The identification of advisers with significant cross-border experience early on in the process is key. Coordination and articulation of the roles between the various advisers – investment bankers, accountants, lawyers, both in the US and the acquirer's home country – has a large bearing on the success of a transaction. Most of the academic literature on M&A says that one out of two transactions ultimately fail to achieve the buyer's goals. The figure is probably higher in cross-border transactions. According to the literature, the number one reason is failure to have appropriate integration plans in place and to appreciate the importance of identifying, understanding and dealing with cultural differences between the home country and the foreign jurisdiction where an investment is being made. That is certainly true for investment in the US. The business culture, while in many ways is more flexible than that in a lot of other countries, still remains unique and distinctive and it is important for international acquirers to do the integration planning on the front end and carry through on their plan.

Cuellar: Foreign buyers should assemble a strong team of investment banking, legal and financial advisers. Next, they need to remember that speed is of the essence, so have financing in place in today's challenged credit market. Finally, they should remember that the dollar's value has made it attractive for foreigners to acquire US assets. Although there is some conflicting economic data on the US, productivity increases and a weak dollar are bringing manufacturing activity back to the US, so the window for the soft currency could be slowly closing. ■