# Merger & Acquisition Focus

**Year End 2010**

The promise and potential pitfalls of cross-border deals

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Obstacles remain, but deals are possible

Ask the Advisor

# The promise and potential pitfalls of cross-border deals

Once a rarity, international M&As are becoming more common every day. Asian and European companies, in particular, are shelling out large sums of money for strategic acquisitions of U.S. companies. If your company plans a sale in the near future, it may encounter some surprising international suitors.

Even domestic deals are risky and fragile, and cross-border M&As have even more ways to fall apart. Sellers interested in attracting a foreign buyer and actually completing a deal must address their buyer's needs and help them overcome any cultural hurdles they encounter.

## Adjusting your mindset

If you've had trouble finding a U.S. buyer and would like to make your company more attractive to foreign dealmakers, you may need to adjust your selling strategy. Cross-border deals are becoming more common (see "International boom" on page 3), but when you enter this market the world may become your competition, and your company needs to stand out.

One way to do that is by simplifying your offering and tailoring it to a specific buyer. Research potential international acquirers to learn more about their home markets and long-term objectives. This will enable you to highlight products or divisions that could have the greatest appeal in nondomestic markets.

## Lend a hand

It's not enough to find an interested foreign buyer. Perhaps your most important role in a cross-border deal is making due diligence as easy as possible. Foreign buyers must comply with legal and regulatory requirements both in their home countries and in the United States, and they may be unfamiliar with U.S. accounting practices that make it possible to accurately assess your company's financial statements.

These issues take time to work through, so you should help a buyer by simplifying other matters. For example:

**Establish your IP's status.** Learn whether your intellectual property holdings (such as trademarks, copyrights and patents) are protected in your prospective buyer's home market, or whether anything will have to be resubmitted for protection.

**Identify employee issues.** Note which employees could be a problem for an international acquirer — for example, foreign citizens holding U.S. work visas.

**Research transferability.** Identify any potential legal or regulatory issues surrounding employee health plans, retirement savings accounts and noncompete agreements and determine how (or if) they would transfer to a non-U.S. owner.

## Cultural understanding is critical

Even if everything else is going well, cultural conflicts can kill a cross-border deal. From the beginning, parties need to work together to reduce tensions and ensure that conflicts between employees don't become a situation that threatens the transaction or its long-term profitability.

Make your own employees a priority. Respond quickly and honestly to their questions regarding everything from layoffs to the portability of health care and retirement plans. Some foreign buyers, for example, will need to terminate employees and then rehire them as part of the acquisition process. It's best to explain the process and get it underway as soon as possible to prevent rumors or panic.

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With the help of your HR department and, possibly, consultants who specialize in cultural integration, teach employees about unfamiliar aspects of your international buyer's culture and business practices. That way, they won't face a rude awakening once the deal closes.

At the same time, be sure to correct any misperceptions your buyer may have about U.S. workers — for example, that Americans don't respect authority.

## International boom

After several years of sluggish activity, cross-border deals returned with vigor in 2010. According to Dealogic, global M&A volume was up 24% for the year in late August, compared with the same period in 2009. In contrast, M&A volume among U.S. companies was up only 1% over 2009.

The pool of international M&A players is also becoming more diverse, as Chinese and Indian buyers join the Europeans and Japanese. China's Geely Holding Group, for example, recently made a $1.5 billion acquisition of Ford Motor Co.'s Volvo unit. In September, the *Financial Times* estimated that the total volume of outbound cross-border deals from Asian-Pacific acquirers was more than 2½ times greater this year over last year — about $186 billion in 2010 compared with $70 billion over the same period in 2009.

And help them find ways to work with your employees that reduce the chance of conflict. Defusing tensions may, in fact, be the best legacy that a selling owner leaves behind.

Also act as a voice of reason if your foreign buyer has overly ambitious integration goals. For example, the buyer might expect to move your company's entire operations to a new location halfway across the country in less than six months. You might provide case studies and advice based on your own experience with labor and logistics to help the buyer build a more realistic timeline.

## Complex, but worth it

No matter how much you do to simplify the M&A process for a foreign buyer, expect a few hiccups. It's likely worth the trouble, however — especially when you consider the weak state of the domestic M&A market. ■

# How to keep your business in the family

As business owners approach retirement they must make some important decisions about their company's future: Sell, dissolve or transfer it to family members. If you'd like to keep the business in the family and one or more of your children or other relatives are eager and qualified to assume the mantle, you'll need to start preparing as soon as possible. This kind of business transfer involves several complicated issues — succession and estate and tax planning, not to mention family politics.

## In the eye of the beholder

You've spent a lifetime building your business, so the last thing you want to do when transferring it is to cut corners. Hire experienced financial advisors to review your company's financials and determine its market position, beginning with a business valuation.

*Determine if only those children who are active in the business should retain current, or receive future, ownership of it.*

Whether you transfer the business during your lifetime, upon your death or upon your spouse's death also has value implications. Let's say you decide to will the company to your spouse. No estate tax will be due on your death because of the marital deduction (as long as your spouse is a U.S. citizen), but it may be due on your spouse's death, depending on the business's value and current estate tax laws. So consider minimizing your company's value to reduce the future estate tax payment on your spouse's death.

Keep in mind, however, that the IRS looks for businesses that may have been undervalued in an effort to minimize taxes. This is particularly true for businesses whose fair market value is aggressively understated.

Your heirs also may have different views of the business's proper value. This is particularly true of "inactive heirs," or those who won't inherit the business and whose share must, therefore, be "equalized" with other assets such as insurance proceeds or real estate. So make sure your valuation expert clearly understands the valuation's purpose and your estate plans.

## Who me, retire?

When (or if) you plan to retire is another major issue to be resolved. First, can you afford to do so? If you want your children to take over but you need to free up cash for retirement, you may be able to sell shares to your successors. There are several methods (such as using trusts) that provide tax advantages as well as help your children fund a business purchase.

Next decide how long you want to stay active and whether all family members that are currently active in the business should stay involved. That means assessing each person's aptitude, ability and temperament. Then you must determine if only those children who are active in the business should retain current, or receive future, ownership of it. Finally, decide what any inactive heirs should receive.

### Heir apparent

Most important to the company's future success is the decision about who will take the helm when you leave. If you've not done so already, start transferring some leadership responsibilities to your heir apparent. And consider whether the decision-makers should report to a formal or informal board of directors, or an institutional executor or trustee.

With your advisors, examine whether your company can meet its capital and borrowing needs and how it can maximize its intellectual capital. If a solid management team already exists, put in place incentives for your key employees to stay on when the next generation of your family assumes ownership and control.

### Plan as an insurance policy

You may be reluctant to plot your business's future because you don't feel ready to give it up. If you plan to work for the foreseeable future, that's fine, but consider what would happen if you died or became incapacitated and you'd failed to make a succession or estate plan. What was intended to fuel your family's future could instead become its burden. ■

# Courting private equity

## OBSTACLES REMAIN, BUT DEALS ARE POSSIBLE

The private equity (PE) sector represents possibly the largest prospective pool of business buyers today. PE investors have largely sat out the economic downturn and are estimated to be holding more than $500 billion in uninvested cash. Unfortunately, these buyers can be hard to reach. Sellers need to know what PE firms are looking for and carefully craft deal proposals to their special needs.

### Holding out

Unlike international buyers, which are actively making acquisitions again (see "The promise and potential pitfalls of cross-border deals" on page 2), many PE investors remain wary of the M&A market. As of late August 2010, PE firms had only led $114 billion, or 6%, of global M&A volume for the year. Compare that with 2006 and 2007, when PE

firms led 17% of global deals, about $1.3 trillion worth, according to Dealogic.

Any recovery in the domestic M&A market this year has, in fact, been driven by strategic players: corporate buyers paying with cash to execute long-term expansion plans. Some of these acquisitions would

have been made regardless. But many buyers have sought — and received — better value for buying in 2010. By contrast, financial deals, which are PE firms' primary strategies, remain difficult to finance through traditional channels.

## Showcase your resilience

Many PE investors have remained on the sidelines over concern that, given the fragile nature of the economy, deals have a high likelihood of failure. A company could look attractive on initial inspection, but suddenly diminish in value if the economy stumbles and falls into a "double-dip" recession. Sellers in cyclical industries such as manufacturing and housing are particularly vulnerable.

To attract PE buyers sellers must, therefore, showcase their stability. This means emphasizing:

**Recession-proof qualities.** If possible, sellers should highlight their record of reliable revenues in various market environments. Positive returns during the depths of the current recession, for example, tell a buyer that your company can handle almost any crisis.

**Efficiency.** Show how you reduced expenses during the recent downturn. The ability to trim inventories and cut debt will appeal to PE firms looking for healthy balance sheets and less risky acquisitions.

**Steady cash flows.** Even cash-rich PE investors will find a seller with robust cash reserves appealing. Such targets can provide buyers with financing to make additional deals in the future.

**Collateral.** Your company's liquidation value — cash flows, physical assets and intellectual property — reduces risk for PE investors. Such collateral will help determine the deal terms that are offered.

## Niche players

Being in the right industry or sector also plays a role in attracting PE money. Recently, these investors have favored fragmented industries (those that lack one dominant player), where performance has remained relatively high through the recession.

For example, seven PE firms currently are bidding for McKechnie Aerospace, which competes in the fairly fragmented aerospace parts sector. Several PE firms also are vying to acquire RBS Plc's Priory Group, which operates health care services. If you're in one of these sectors, you probably have a better chance of selling to a PE firm. But you can also raise your profile by approaching PE groups directly or agreeing to participate in a special deal auction made up of PE buyers.

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## Climate change

Many of the factors that drive PE firms to make acquisitions — financing, stock market performance, industry health — are out of a seller's hands. What sellers can do, however, is work with knowledgeable advisors to prepare for sale, learn what PE buyers are looking for and then promote the most compelling compatibilities. ■

# Ask the Advisor

## *Q. What's a minority stake deal and why should I consider one?*

**A.** Given the uncertain nature of the economy, some companies are still having trouble finding appropriate buyers. One alternative that prospective sellers — or businesses that simply need to raise substantial cash — might want to consider is allowing an individual investor to take a minority stake in the company.

### Who, when, why

In such deals, minority stakeholders typically buy a significant position — ranging from 20% to 40% of a company. Private-equity funds are the most likely candidates, but potential partners include companies you might originally have considered as prospective buyers.

Minority-stake deals typically are short-term strategies. Most of these investors either buy the company after a few years, or they sell their shares when an appropriate buyer is found.

### Minority-stake route

If they have the financing, most buyers prefer to acquire a company outright, rather than take a minority interest in it. However, there are other scenarios in which buyers might seriously consider this route — for example, to:

**Tiptoe into a new market.** A buyer might want to enter a new geographic market or introduce a new product line, possibly with an acquisition. To test the waters before fully immersing itself in a risky venture, the company could buy a minority interest in a business that's already successful in the market or sector. If all goes well, it might later buy that business.

**Enhance value before reselling.** A buyer might take a minority stake in a business, make improvements that increase its market value, and then sell it to another buyer. Private equity firm Revelry Brands, for example, took a minority ownership stake in yogurt maker "siggi's" this past June. Revelry intends to introduce siggi's to a larger number of markets and enhance its brand identity.

**Take advantage of its only option.** In some cases, a minority stake deal is the only decent option for a potential buyer. For example, private — particularly family-run — businesses with no intention of selling or going public are otherwise closed to outside investors. A minority stake deal enables an investor to get its foot in the door and eventually possibly buy.

### Sellers see upsides, too

Minority stake deals can be a boon for sellers, too, enabling them to raise cash without relinquishing control. However, with any substantial capitalization, owners should be ready to give up or share some control with their investors until certain benchmarks have been met. ■

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