



VIEWPOINT

ISSUE 27

A Publication of
Mirus Capital Advisors, Inc.

SOLD! VERKAUFT! VENDUTO!

INCREASED GLOBAL M&A ACTIVITY CREATES NEW OPPORTUNITIES FOR GROWING COMPANIES

By Donald Richards & Enrique Shadah

WHY THIS MATTERS:

- Globalization trends are making US companies very attractive to international buyers.
- Sovereign Wealth Funds (SWFs), investment funds managed and backed by sovereign nations, are wielding in excess of \$2 trillion of capital and have emerged as a significant and growing international buying force.
- Government regulation has stymied high profile M&A deals in the European Union, and is an ongoing challenge in many parts of the developing world, leading buyers to seek out opportunities in the US market (although there are regulatory challenges in the US as well.)

Globalization is a key factor in nearly all business conversations these days, including those related to mergers and acquisitions. Although US firms continue to outpace all other countries in the pursuit of cross-border acquisitions, the US regained its position as the leading host country of foreign direct investment (FDI) in 2006, and is projected to have maintained a similar position in 2007.¹ In this Viewpoint, we review the recent surge in cross-border M&A – and how US-based companies can benefit from the interest of international buyers.

According to Bloomberg.com, international buyers accounted for 26% of all M&A dollar volume activity in the US during the first eight months of 2007. This was the highest percentage of international activity in more than four years...and international investors announced \$282 billion in US-based acquisitions in 2007 compared to \$218 billion in all of 2006. Non-US buyers are taking advantage of a relatively accommodating regulatory environment, the need for geographic expansion, globalization of financial markets, a weak US dollar, and the potential effects of tightening credit, which could impact the ability of US private equity to compete as effectively in the M&A marketplace.

¹ United Nations Conference on Trade and Development

"There is perhaps an assumption that deal flow involving companies from emerging economies would by and large be one-way traffic, as companies in developed markets seek to gain a foothold in those fast-developing territories. However, the hunted are fast becoming the hunters, with increasing numbers of companies in developing nations, casting their eyes far beyond their own borders, putting their stamp on the international acquisition trail." — Ian Gomes, chairman of KPMG's New and Emerging Markets Group

This is good news for US business owners, who are positioned to benefit from growing cross-border M&A interest and activity, despite current economic uncertainties and a slow down in overall M&A activity. More than ever, businesses that are seeking liquidity and that offer leading market positions may be highly attractive to international buyers.

THE GLOBALIZATION OF BUSINESS

In a 2006 Accenture/Economist Intelligence Unit Global M&A survey of senior executives in North America, Europe and Asia on their M&A activity, it became clear that M&A is becoming more important as a growth strategy. When asked to estimate the percentage of their company's total global revenue growth that came from M&A deals in the last three years, 25% of respondents said it was 20% or more. When asked about the next three years, 57% of respondents answered that M&A would drive more than 20% of future revenue growth.

M&A activity has become more global because business has become more global. Companies must seek new markets, new customers, new products and new operational capabilities outside their home base — or risk being left behind by more global peers. It is worth noting that one study — The Columbia Program on International Investment's 2007 report — found that companies with 25% of revenue or employees outside their home markets had higher than average financial results.²

Companies can, of course, compete globally in many different ways, from exporting goods and services, to forming strategic partnerships, to purchasing foreign subsidiaries. In 2004, US-based multinationals exported goods worth \$400 billion according to the US Bureau of Economic Analysis. During the same year, these corporations sold goods worth \$2.62 trillion — or nearly seven times as much — through foreign affiliates.³ Accordingly, economists have long looked at cross-border acquisitions as a substitute for exporting: rather

than shipping products abroad to new markets, companies can simply buy local firms to gain access and market share. The willingness to buy a foreign company depends on many factors: trade and tax law policies, the pricing of a prospective acquisition target, and how readily an acquired company can be integrated into an existing business model.

Moreover, US companies are not the only ones increasing their global presence. Developed country economies from Europe to Asia have become more significant players in the M&A market in recent years. But, perhaps the most surprising trend has been the rise of cross-border interest from developing world economies such as China and India. During the first three quarters of 2007, over \$100 billion in transactions were announced where the target asset was in a developed country and the acquirer was from a developing country.⁴ Citigroup M&A Director Devinjit Singh reported that outbound M&A, or transactions in which Indian investors purchased non-Indian companies, had increased from \$4.4 billion in 2005 to \$24.5 billion in 2006. In China, 14 outbound transactions were completed in the first half of 2007, nearly double over the same period in 2006.⁵ Additionally, other developing economies such as Russia, Brazil and the Gulf States have begun to get in the mix. According to the same [KPMG New and Emerging Markets survey](#), the first six months of 2007 saw 67 transactions in which investors based in 10 developing countries bought firms in the developed world, compared to 126 transactions in which investments flowed from developed market economies to developing market targets; targets; essentially a 1:2 ratio as compared to a 1:4 ratio for comparable transactions in 2003.

Cross border merger and acquisition activity has been climbing steadily in the past decade. In 2002, Capital IQ reported that 11.9% of all US companies acquired were purchased by non-US acquirers. By 2007, that percentage had risen to 15.2%; and conversely, US buyers purchased 15.4% of all foreign targets in 2002, and 18.4% of them in 2007.

Despite the slow down in worldwide M&A activity in the last half of 2007, cross-border activity is still significant. Thomson Financial reports that cross-border activity accounted for 47.5% of worldwide activity in the first six months of 2007, surpassing the previous year's total by 67%. Deal activity is heavily concentrated between the US and Europe, representing over 70% of cross-border deals done in 2005. However, Asian companies have also been active in cross-border transactions, with deal volume nearly quadrupling from 2003 to 2006. Two recent high-profile examples include Taiwan's Acer purchase of Gateway Inc. in October 2007 and the \$4.9 billion acquisition of the Bobcat division of Ingersoll

² World Investment Prospects to 2011: Foreign Direct Investment and the Challenge of Political Risk, a report by the Columbia Program for International Investment, September 7, 2007

³ "Foreign Investors Face New Hurdles Across the Globe" by Deborah Solomon, Wall Street Journal, July 6, 2007

⁴ "M&A: Still a Big Deal", UBS Wealth Management, November 2007

⁵ "Emerging Markets Closing the Gap on Developed Countries in the Race for International Acquisitions," KPMG New and Emerging Markets, September 7, 2007

Rand by South Korea's Doosan Infracore Co., the largest cross-border acquisition in Korean history.

Another high-profile and significant development is the emergence of Sovereign Wealth Funds (SWFs) on the cross-border transaction scene. SWFs, operating on behalf of sovereign states, deploy the accumulated wealth of their sovereign state in increasingly higher-risk assets, such as real estate and equities, rather than in traditional investments in government bonds or money-market instruments. Sovereign Wealth Funds, managing in excess of \$2 trillion of capital, have emerged as buyers in a wide variety of scenarios; including the Abu Dhabi Investment Authority's (ADIA's) \$7.5 billion investment in Citigroup, China State Investment Corp.'s \$3 billion investment in the Blackstone Group, and Dubai World's recent investments in MGM Mirage and Barneys New York.

Although SWFs have been around for years, their aggressive move into the cross border M&A realm is relatively new. The massive reserves built up in recent years from Middle East petrodollars or huge Asian trade surpluses have led to a significant increase in the number and size of such funds. These funds could increase from current levels of \$2-3 trillion, to more than \$12 trillion by 2015.⁶ This massive amount of investment capital will have a significant impact on asset classes and the cross-border M&A market as a whole.

WEAKENING OF THE DOLLAR

It seems intuitive that a cheaper dollar would entice more international buyers to look at US targets: consider that in January 2000, a Euro bought 1.016 dollars, near parity. In the fall of 2000, the Euro dipped further, to a low of about \$0.83. Today the Euro is worth more than \$1.48, giving European-based investors an advantage in purchasing US assets. Other currencies have experienced similar appreciation versus the dollar. However, several bodies of research indicate the correlation between exchange rates and M&A activity is weak. In fact, a global Conference Board survey of CEOs and CFOs⁷ determined that less than 10% of respondents were inhibited by exchange-rate volatility when making foreign investment decisions, which include cross-border M&A transactions. Regardless of currency valuation fluctuations, solid strategy and proper fit are still paramount when buyers look to execute cross-border deals.

CHANGES IN THE WEATHER

At the same time that international acquirers are becoming more active and benefiting from stronger currencies, two major trends in the regulatory environment have converged to foster an improved climate for cross-border M&A among US-based companies.

Foreign acquirers are increasingly focusing on US companies, because the US market is relatively open to foreign investment. A recent ACG/Grant Thornton/Eureka Private Equity Global Transaction survey of 200 middle market executives, investment bankers, private equity firms and deal-making service providers found that 36% of respondents thought that the US had the best acquisition candidates, and 41% believed that the US was the easiest place to get a deal done.⁸

All this occurs against the backdrop of a worldwide increase in government protectionism that has blocked or delayed transactions as diverse as US-based Carlyle Group's planned acquisition of a controlling stake in Yangzhou Chengde Steel Tube Co. (restructured as a 49% stake), and Spain's Telefonica SA's purchase of Telecom Italia (significantly restructured due to government concerns.)⁹ Spain and France, followed by India and Germany, have already begun considering laws that would make it more difficult for foreign investors to buy local companies, according to the Wall Street Journal. And the Columbia Program on International Investment's 2007 study reported a marked increase in regulatory changes unfavorable to foreign investors. The previously-noted rise of sovereign wealth funds has the potential to further exacerbate this trend as a lack of transparency; and a perception of these funds as "political" entities that has resulted in numerous articles and comments from political leaders questioning the motives of the funds and their investments in "sensitive" areas and market segments.

The US has maintained a relatively open door to foreign investors. Because of its size and accommodating regulatory environment, the US ranks as the number one recipient of foreign direct investment. **Some \$184 billion was invested in US companies by foreign entities in 2006, and estimates project that the US will continue to lead this category from 2007-2011, drawing an average of \$250 billion per year.**¹⁰

However, even in the US, there has been some movement toward protectionism. A planned purchase of American port operations by a United Arab Emirates-based Dubai Ports World (a division of Dubai World) set off a storm of criticism in 2006. That debacle, as well as an earlier attempt by the China National Offshore Oil Corporation to buy Unocal, motivated Congress to reform the Committee on Foreign Investments in the United States (CFIUS), an organization charged with reviewing cross-border deals that involve national security concerns. As a result, increased regulation and protectionism is a risk even in the United States. Further, the high-profile nature of many of the transactions involving

⁸ ACG/Grant Thornton/Eureka Private Equity Global Transaction Survey, conducted in June 2007

⁹ "Foreign Investors Face New Hurdles Across the Globe," by Deborah Solomon, Wall Street Journal, June 6, 2007.

¹⁰ World Investment Prospects to 2011: Foreign Direct Investment and the Challenge of Political Risk, produced by the Economist Intelligence Unit in co-operation with the Columbia Program on International Investment, 2007

⁶ "Currencies: How Big Could Sovereign Wealth Funds Be by 2015?" by Stephen Jen, Morgan Stanley Research Global, May 3, 2007

⁷ "Do Exchange Rates Matter?," by Gail D. Fosler, Eliza Winger, The Conference Board, May 2004

SWFs have led to increasing concerns and calls for potential regulatory review of the actions of SWFs within the US. Senator Evan Bayh (D., Ind.), Chairman of the Senate Banking Subcommittee on Security and International Trade and Finance, recently called for regulatory oversight measures in an Op-Ed piece in the Wall Street Journal, citing the lack of transparency and government ownership of SWFs as problematic factors.¹¹ In order to head off a potential political conflict, U.S. Treasury officials recently met with representatives of two of the largest, and least transparent SWF funds, ADIA and the Government Investment Corp. of Singapore, to negotiate the drafting and implementation of a voluntary code of conduct for transparency, disclosure, governance and fund organization. The US and the European Commission are also encouraging the International Monetary Fund in its efforts to develop such a code.¹² But despite this focus, CFIUS has only blocked one deal and SWFs are still generally free to invest where they see fit; and the overall climate in the US remains favorable to cross-border investments.

ARE MID-SIZED BUSINESSES LIKELY CROSS-BORDER TARGETS?

International buyers are more active than ever in the small- and mid-sized business segment. Here are some of the factors being considered when they evaluate a US-based company:

- **Complementary products:** products and/or services that extend and complement those of an international buyer. For example, Swedish conglomerate Alfa Laval expanded its range of products centered on heat transfer technologies and solutions when it acquired US-based AGC Engineering, a leader in sanitary plate heat exchanger parts, service and new units to the dairy and food processing industries.
- **Distribution capabilities in markets where they're not active:** sales and distribution infrastructure to market the same sort of products and or services in the US that an international company sells overseas. For instance, Saint-Gobain's building products division had distribution in 24

countries but not the US. That was a key factor in their acquisition of Owens Corning's Norandex subsidiary in June 2007, immediately gaining one of the top 15 US-based building products distributors.

- **Leading-edge technology:** developed systems, processes or products that can be applied to another company's core business. For example, email archiving and litigation support capabilities were the main draw when UK-based enterprise search vendor Autonomy acquired Zantaz, a Pleasanton, California-based firm.¹³ The combined company now offers an integrated capability for archiving, searching, analyzing and managing litigation support data.

SELLING TO A CROSS-BORDER INVESTOR

Cross-border acquisitions are more complex than domestic ones, since they involve at least two sets of legal and regulatory requirements, additional currencies, multiple languages and often, significant cultural differences. Accordingly, companies interested in exploring cross-border transactions need to take these factors into account when developing their transaction strategies. Additionally, utilizing resources that are well-versed in the unique challenges of completing cross-border transactions may be of value.

All of these developments: a growing push towards globalization, an increase in international buyers including SWFs, a receptive regulatory environment and a weakened US dollar mean that international buyers are more likely than ever to be interested in US businesses of all sizes and industries. Accordingly, US business owners contemplating a sales transaction should not limit themselves to local strategic or financial buyers; but also consider whether financial or strategic investors from overseas, who may be interested in gaining footholds in the US marketplace, may be even better-matched suitors.

¹¹ "Time for Sovereign Wealth Rules" by Evan Bayh, Wall Street Journal, February 13, 2008

¹² "U.S. Pushes Sovereign Funds To Open to Outside Scrutiny" by Bob Davis, Wall Street Journal, February 26, 2008

¹³ "Autonomy Acquires Zantaz for \$375 Million," Chris Preimesberger, eWeek, July 3, 2007

Donald Richards is a Partner at Mirus Capital Advisors, with transaction experience in over 20 countries. **Enrique Shadah** is an Analyst at Mirus. Mirus is a mid-market investment bank with significant cross-border experience, specializing in strategic mergers and acquisitions. By combining solid business, industry and transactional expertise, proven process, creative thought, and personalized, partner-led service; Mirus has completed hundreds of successful sell and buy-side transactions for both public and private companies since 1987. Mirus is a registered broker-dealer and FINRA Member.

WE DO
THINGS DIFFERENTLY.



VIEWPOINT articles are archived at www.merger.com. Redistribution via e-mail is encouraged.