



## CEO Insights

*This paper will benefit midmarket business owners who wish to shape their exit strategies based on an understanding of foreign buyers and their motivations in buying US businesses as well as economic and midmarket trends and drivers.*

### ***Cross Border M&A***

Are you ready for

# Foreign Buyers?

By Anand Divekar

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## EXECUTIVE OVERVIEW

*“Global presence is needed because technology has shortened the innovation process, organic growth is now too tedious, costly and halts business challenges. So the merger pathway allows for that global presence to be sped up. It’s now increasingly cross border and in the process, we are merging not just different corporate cultures but different heritage, ethnic and religious bridges that need to be crossed. We are in for exciting times in leveraging mergers and creating value.....”*

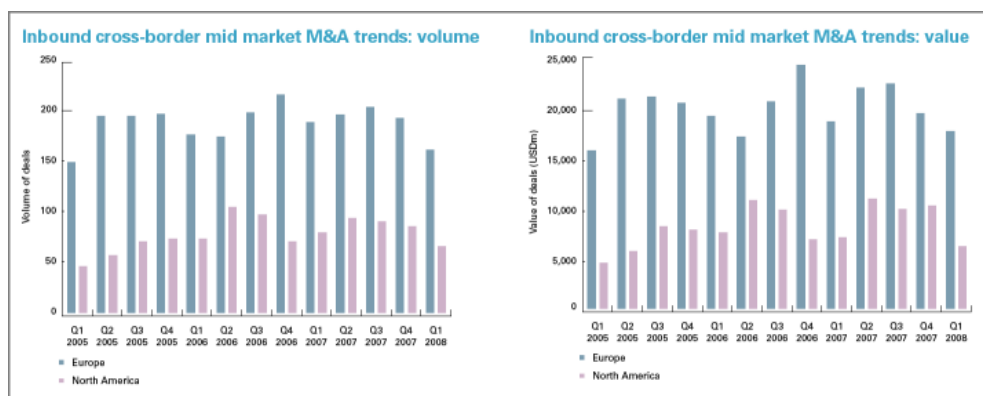
Professor Annie Koh, Dean of Executive Education, Singapore University

With globalization, foreigners have increasingly become significant players in the US mid-market, opportunistically consummating deals even during periods of recession or market volatility. Given the liquidity crunch, foreign and local buyers unable to secure financing for large deals in 2008-2009 are increasingly expected to gravitate toward midmarket deals over the next 6 to 12 months. Industry consolidation is also expected to contribute to midmarket deals in this timeframe.

While deal volume and value has dropped in 2008, deals are still getting done albeit with less leverage due to tighter credit markets. Midmarket deal value for North America fell 22% from \$35 billion in Q1 2007 to \$27 billion in Q1 2008. *Inbound* cross-border midmarket M&A also fell in the same timeframe but not significantly (see Fig 1). Although multiples have softened due to issues in the banking sector, many sectors have remained at relatively high levels on a historic basis. Industry practitioners remain guardedly optimistic and expect cross-border deal volume to increase during 2008-2009 (Cross-Border M&A Reporter, May 2008).

**FIGURE 1: INBOUND, CROSS-BORDER, MIDMARKET M&A HISTORICAL DATA**

Source: Cross Border M&A Reporter, May 2008



The drop in deal value follows a record year in 2007 when global M&A reached \$4.3 trillion, a 21% increase over 2006. Cross border M&A went from 26% of global M&A in Q1 2006 to 57% in Q4 2007. Also in 2007, the US was a net M&A target, due to a weaker dollar - inbound M&A was \$354 billion versus outbound M&A at \$248 billion. M&A deals inside the US (public & private) in 2007 reached \$1.4 trillion, of which cross border M&A accounted for \$602 billion. (Bain & Co., 2007)

The relevance to midmarket sellers is clear – given the increasing desire of cash-rich foreign buyers to establish a global presence, a seller desiring the optimal sale price must engage with foreign as well as local buyers when possible. This paper provides an overview of foreign buyers, their motivations and country/region information. It can help sellers become more effective negotiators during the M&A process.

## GLOBALIZATION AND WEALTH GENERATION

Over the last several years, substantial cash hoards have been built up overseas by foreign companies and governments reaping the benefits of globalization. Some of these benefits arose from increasing world demand for natural resources such as oil and gas, while others arose from value generated by manufacturing and services sectors in foreign countries. Value generation was especially enhanced in cases where foreign governments embraced policy changes to enhance entrepreneurship and the business climate. Figure 2 shows recent foreign exchange reserves in key countries.

Top Holders of Foreign Exchange Reserves			
Country	Reserves in Billions of USD	Country	Reserves in Billions of USD
China	\$1,905	Brazil	\$201
Japan	977	Singapore	168
Eurozone	530	Hong Kong	160
Russia	475	Algeria	150
Taiwan	278	Libya	79
India	253	Norway	44
South Korea	212	Kuwait	175

Figure 2: Foreign Exchange Reserves by Country (Sep 2008)

Source: Eco-Bridge Research

### OIL & GAS

Many Middle Eastern countries as well as Russia and Norway built huge foreign exchange reserves after 2004, as prices for oil and natural gas spiked along with global consumption. Soaring demand for oil from both developed and emerging countries caused oil prices to spike starting from around \$30 per barrel (in 2004) to over \$120 (in June 2008) before falling below \$50 in December 2008 when this paper was published. The governments of these countries, flush with historic levels of foreign exchange reserves, created sovereign wealth funds as vehicles to manage the investment of these funds globally and optimize returns.

### MANUFACTURING AND INFORMATION TECHNOLOGY

In "The World is Flat", Thomas Friedman described the role of globalization in leveling the playing field to the advantage of companies in India, China, Eastern Europe, Latin America and elsewhere. In China and India, the primary drivers took root in the eighties and nineties respectively, due to government liberalization which put the entrepreneurial spirit in these countries into overdrive.

By leveraging technology and the internet to transcend conventional barriers such as international boundaries and time differences to provide cheap but high quality goods and services to US businesses and consumers, For example, Indian and Chinese companies have made themselves indispensable to businesses and consumers. As a result of these efficiencies, business models in every US industry have been impacted (see Sidebar 1 for an example). Entire industries are restructuring, from manufacturing (auto and aircraft) to

#### Side Bar 1: An Example - R&D industry in India

The offshore R&D industry in India has mushroomed into a \$9.35 billion industry growing at 23% annually and expected to reach \$21.4 billion per year by 2012. US based customers include companies (such as Cisco, HP, GE and Motorola) as well as smaller businesses that depend on these centers for engineering, strategic direction and even the profits and losses of an entire product line marketed and sold globally. Products include software, computer chips, telecom devices and other products.

Offshore R&D centers have increased from 180 in 2000 to 594 in 2008 in spite of the rise in Indian wages, spiraling at 16.2% annually for the last 3 years. Indian engineers are still substantially cheaper than US equivalents. Additionally, the workforce is now more experienced and innovative. Indian engineers and managers now have about 7 to 15 years experience working for large US corporations and are well qualified to lead R&D in various technical fields.

Source: Business Week, Aug 11, 2008, "India – R&D Stronghold"

services (call centers, software development) and even research & development, metamorphosing into more sustainable forms. These changes have facilitated wealth generation by foreign businesses willing to adapt quickly and help build the new world with its dependency on cheap labor. While China became the preferred location for all types of manufacturing facilities, India with its large population of educated, English-speaking workers, became a leader in information technology and related services such as call center operations.

## FOREIGN BUYER TYPES

Foreign buyers can simply be wealthy individuals who wish to live in the US with their families. In such cases, buying a business of a specified minimum size is the simplest way to get a green card. In general though, foreign buyers are wealthy companies and government owned funds. For many foreign companies, success with exports of products and services was the first step to globalization, facilitating hyper growth and big profits. This created a new problem, albeit a desirable one – a need to put this cash to work. Some companies decided to use professional investment firms (financial buyers) to manage a portion of their funds while others chose to grow through strategic acquisitions. These buyer types are summarized below:

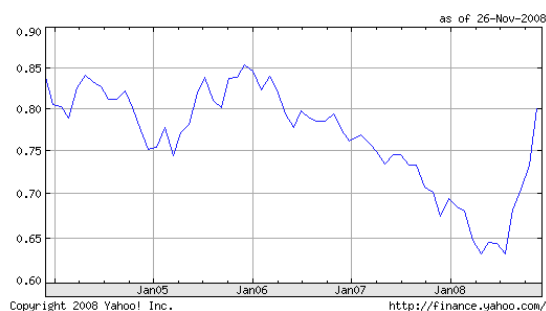
1. **Financial Buyers** utilize vehicles such as venture capital and private equity (managed by professional money managers). They are financed by rich companies, pension plans and other wealthy benefactors. In recent years, several foreign governments have created sovereign wealth funds as vehicles to invest foreign exchange reserves in international portfolios of profitable companies.
2. **Strategic Buyers** are generally corporations which acquire companies which strategically complement their existing business models and have the potential to accelerate horizontal or vertical growth through access to new markets with new and improved products and services. The acquirer may gain several benefits through the acquisition, including raw materials, technology, experienced management and staff, customers, brand names, etc. (see Table 1 for a more comprehensive list).
3. **Hybrid Buyers** are generally serial acquirers who are growing their existing portfolio of investments in an industry through roll ups and consolidations. Consolidation of smaller companies in a market can improve efficiencies due to economies of scale, as well as reducing competition in smaller, riskier markets. Hybrid buyers look for market share as well as cash flows from new acquisitions.

## ECONOMIC TRENDS AND DRIVERS

Economic trends play an important role in facilitating foreign buyers and the business cycles which occur in cross border M&A. Major trends which have driven recent M&A activity are described below.

- **Exchange Rate Trends**

From early 2006 to mid-2008, the US dollar fell steadily against major currencies (Fig. 3). From April 2006 to April 2008, the dollar fell 13% against the Chinese Yuan and 27% against the Euro, making US assets cheaper for foreigners and causing inbound M&A deals to accelerate (Fig 4). From mid-2008 however, the dollar has risen steadily against major currencies as world financial markets crumbled. This rise has coincided with a drop in liquidity across the globe, causing a drop in the global pace of M&A deals.



**FIGURE 3: US DOLLAR TO EURO EXCHANGE RATE**  
SOURCE: YAHOO FINANCE

In 2007, the US was a net M&A target - inbound M&A was \$354 billion versus outbound M&A at \$248 billion, due to a weaker dollar (Bain & Co., 2007). During the first half of 2008, there were an estimated 190 cross border deals with a total value of \$200 billion (Twaronite, 2008). If this pace had continued, it would have exceeded the record set in 2007. However, the rapid deterioration of the world financial system in the second half of 2008 caused a significant slowdown in M&A transactions.

There are of course, cross currency risks attached to every cross border deal, but risk management techniques are available to sophisticated buyers to mitigate these risks. Side Bar 2 below describes one such technique.

	Pct. of total U.S. deal volume	Value in billions
2007 <sup>10</sup>	20%	\$300.15
2006	14	216.98
2005	12	139.07
2004	11	96.16
2003	11	64.92
2002	16	72.95
2001	14	110.14
2000	22	330.70

<sup>10</sup>Year to date Source: Dealogic

**FIGURE 4: INBOUND M&A**  
(SOURCE: DEALOGIC)

#### Side Bar 2: Cross Currency Risk Management

Sophisticated buyers do have some options to reduce their exposure to cross currency risk. Although the equity portion of the purchase price usually originates in the buyer's home country, transactions are usually financed locally in the seller's country (the US) and the debt serviced out of cash flow of the purchased company. Therefore, the foreign exchange risks of buying in a country with a weakening currency is mitigated somewhat if the buyer also borrows in that currency. On the other hand, if something interferes with the cash flow of the purchased company and the buyer is forced to exchange funds to meet the debt obligation, a weaker home currency can increase its debt burden.

Source: A. Sutton, "[Truth of the US Dollar Devaluation Behind Bernanke's Words](#)", MarketOracle.com, June 14, 2008

- **Liquidity**

Buyers depend to varying degrees on the availability of cheap capital to facilitate deals. Increased liquidity facilitates a healthy M&A environment, by encouraging more buyers, which also leads to higher multiples. Borrowing a portion of the purchase price from a lender (or an underwriting syndicate) allows buyers to execute more transactions and share the risk with the underwriters (lenders). Corporate buyers also borrow, but many have the ability to finance transactions themselves using a combination of stock, cash and earnouts.

When lending dries up, borrowers can no longer execute as many transactions as they normally would, unless they execute cash transactions. Starting in 2007, many US-based private equity groups, corporate buyers and private investors found themselves in a tight liquidity environment. Additionally, as major global financial institutions found themselves near collapse, fear drove multiples down in banking and associated industries. During the first half of 2008, cash-rich buyers from the Middle East and Asian countries were not impacted as much by the liquidity crisis, and picked up the slack, buying businesses around the world, when possible, at reduced multiples. However, even these buyers slowed down in the second half of 2008 as the financial crisis worsened and impacted stock markets, bank deposits and valuations of existing investments and other sources of cash.

## WHY FOREIGN BUYERS ACQUIRE US BUSINESSES

Table 1 below itemizes typical motivations for foreign buyers. Please keep in mind that motivations can vary widely based on buyer type, industry and geography.

**Table 1: Why Foreign Buyers Acquire US Businesses**

CATEGORY	FOREIGN BUYER MOTIVATIONS
Market Size and Presence	<ul style="list-style-type: none"> <li>The US is the largest market in the world, an attractive place to do business for foreign companies in expansion mode, looking to globalize their business.</li> <li>Business presence in the US provides credibility with international customers, bankers, lenders, supply chain participants and markets.</li> <li>Owning a US based business is a matter of prestige in many countries.</li> </ul>
Efficiencies of the 'Factory' Concept	<ul style="list-style-type: none"> <li>Buyers implementing the Factory Concept enhance their competitiveness by consolidating selected processes and resources in a central location. This facilitates standardization of business processes, staff training and cost cutting and helps achieve quality goals while minimizing costs.</li> <li>Asian buyers can leverage cheap labor in their home countries to drive production/development costs down</li> <li>Not all processes can be consolidated using the Factory concept. Activities likely to remain in the US include marketing/sales, distribution, finance, HR etc.).</li> </ul>
Portfolio management and diversification	<ul style="list-style-type: none"> <li>Sophisticated foreign buyers often wish to build a portfolio of companies based on functional capabilities, geographic presence (US, Europe), customer base, etc.</li> <li>Diversification often becomes a priority to mitigate risks such as country risk, sector risk, financial risk, etc. Diversification requires a global perspective on economies, markets, product and service offerings, employee skill sets, as well as trends in currency exchange rates, interest rates, etc.</li> <li>For example, from 2007 to 2008, Europe was the preferred target for Indian buyers due to the rapid appreciation of the euro over the dollar.</li> </ul>
Management team, Skilled employees	<ul style="list-style-type: none"> <li>An experienced management team and skilled employees can be vital to the successful operations of a buyer who does not have a replacement team.</li> <li>For example, China has a shortage of managers capable of running an operating company in the US. This is due to a lack of interest among qualified local employees as well as issues with language skills and international management skills.</li> </ul>
Market positioning	<ul style="list-style-type: none"> <li>The competitive positioning of a target acquisition is an important factor in the buyer's decision to purchase. Brand name, market share, product quality, reputation and pricing all impact the buyer's decision.</li> </ul>
Sales & revenue growth	<ul style="list-style-type: none"> <li>Upward trending revenues and profitability are key drivers of buyer interest. Sellers are advised to make company operations more efficient and improve financials if possible prior to being marketed.</li> </ul>
Customers and relationships	<ul style="list-style-type: none"> <li>Buyers generally prefer diversification across a stable and growing customer base. Too much revenue concentration in a small customer base is perceived as risky.</li> <li>Examples of parameters which help evaluate the customer base include trends in accounts receivable, write offs, customer loyalty (repeat business),</li> </ul>
Access to Raw materials	<ul style="list-style-type: none"> <li>Buyers may buy a company if doing so facilitates economic and timely access to raw materials, including natural resources as well as supply chain manufactured parts. For example, China's bid for oil company Unocal (2005) was fueled by a desire to better control their oil supply.</li> </ul>
Access to Trained Manpower	<ul style="list-style-type: none"> <li>Skilled human capital usually commands premium prices. Experienced workers, proximity to reputed colleges and community colleges, the absence of worker unions are some of the factors which make a company more attractive to a buyer.</li> </ul>

CATEGORY	FOREIGN BUYER MOTIVATIONS
Technologies	<ul style="list-style-type: none"> <li>• Companies may be acquired for their intellectual property (patented technologies).</li> <li>• Buyers may also be interested in technologies and licenses already purchased by the seller - these can help the buyer automate their own processes at reduced cost.</li> <li>• The occurrence of similar (pre-merger) technologies at buyer and seller makes post merger integration easier. Differing technology bases can incur significant cost and delay in integration.</li> </ul>
Size of Target Company	<ul style="list-style-type: none"> <li>• Post-merger integration of large companies can take several years before they benefit the buyer's bottom line, so large acquisitions are less likely to occur during a recession. In challenging economic times, smaller companies are more likely to be acquired for the quick benefits they can contribute to the buyer's bottom line.</li> </ul>
Intellectual property	<ul style="list-style-type: none"> <li>• Patents, trademarks and brand names purchased in the US can be monetized around the world. They are internationally recognized in many countries and are protected by international laws which are accepted by most countries.</li> <li>• The US is one of the safest havens in the world to monetize intellectual property.</li> <li>• Caution: The Federal Govt. may block a sale to a foreign buyer if the Seller's intellectual property (or operations) is (are) critical to national security.</li> </ul>
Immigration and Work Visas	<ul style="list-style-type: none"> <li>• Acquisition of a US business allows an owner (and his family) to receive green cards, if the investment and the number of US employees meet certain criteria.</li> <li>• A US business presence may also mitigate risks related to the scarcity in H1 visas, allowing the foreign buyer's employees to visit the US and serve US clients.</li> </ul>
Business processes	<ul style="list-style-type: none"> <li>• Many US businesses own mature business processes due to technology and trained workers. This is desirable to foreign buyers to improve their own processes at home through knowledge transfer and sharing of best practices.</li> <li>• Post merger integration of business processes can pose serious risks to a buyer. The due diligence process may therefore include a focus on discovery to estimate the level of effort required to integrate processes at the buyer and the seller, including changes which facilitate the Factory concept described above. This effort may reflect on the negotiations which determine the final sale price.</li> </ul>
Improved access to capital (post merger)	<ul style="list-style-type: none"> <li>• Under normal circumstances, a US presence would result in improved access to capital since US lenders perceive US-based assets as a sound basis for loans. The subprime mortgage mess has however, significantly altered this picture, at least for the moment.</li> </ul>
Freedom from legal issues	<ul style="list-style-type: none"> <li>• Buyers are typically less interested in companies with legal issues, and for good reason. Legal issues can spiral out of control and consume management resources for long periods of time and at great cost to the company. Sellers should resolve all legal issues if possible, before marketing the business to potential buyers.</li> <li>• A buyer acquiring a seller with significant legal issues will likely insist on an asset deal. This allows the buyer to cherry pick only those parts of the company which they really want and which are free of legal issues.</li> <li>• Although legal issues can be a deal killer, they can (in some cases) be mitigated by the presence of experienced legal counsel on both sides who have similar definitions of "reasonable and customary" allocation of risk.</li> </ul>

*Note: Motivations can vary widely based on buyer type, industry and geography. The above descriptions include a sample of the more common motivators.*

## FOREIGN BUYER CHARACTERISTICS

### GENERAL

- It is widely expected that in 2009 and beyond, M&A will be dominated by Chinese, Indian, Russian and Middle Eastern buyers. Sovereign wealth funds representing UAE, China, Dubai, Singapore, Saudi Arabia and Kuwait are likely to be the most interested in investing in the US.
- Corporations and sovereign wealth funds are at the top of the list of investors most likely to account for the bulk of US investments in 2008-09 (Merrill Datasite survey conducted by The Deal, Sept. 2008). Sovereign wealth funds are now among the richest foreign buyers in the market. They are government owned, based in China, the Middle East, Russia, Norway etc. and have war chests totaling over \$3 trillion in cash (with an additional \$5 trillion in foreign exchange reserves), generated largely from the sale of oil and manufactured goods (Wikipedia). While their focus is generally on larger transactions, they also invest in the US midmarket.
- Industries most likely to be of interest to foreign buyers include banking, financial services, energy, real estate, healthcare and information technology, industrial products and pharmaceuticals (Merrill Datasite survey conducted by The Deal, Sept. 2008).
- In addition to cultural issues, foreign buyers will face increasing US regulatory requirements which include differences in accounting standards and a review of their political intentions. Consequently, some Asian and Middle Eastern buyers may face a more uphill task than European buyers. Overall though, the US is still remarkably open to foreign investment.
- While Sarbanes Oxley compliance is not a requirement for private US firms, it is a concern for foreign acquirers whose stock trades in the US stock market. Integration of an acquired (private) company's operations is usually a top priority due to the downside risks associated with non-compliance.
- Foreign buyers are apt to do smaller deals (than most US buyers) and negotiate more, especially in tough economic times, such as a recession. They are also more interested in majority positions in foreign investments to help manage risks related to management decisions and company strategy.
- During a lending crisis such as the one in late 2008, some buyers prefer to use stock rather than cash to finance a transaction. However, if the buyer's stock price has fallen recently, using stock to finance an acquisition is an expensive proposition, leaving cash (or a combination) as the only other viable option.
- Some buyers tend to view periods of financial stress as a bottom fishing opportunity, especially for acquisitions in distressed sectors such as banking and finance. Sellers should expect more due diligence and buyer conservatism. This can cause significant delays in the acquisition process due to prolonged due diligence and ensuing negotiations. In some cases, the end result could also be deal failure if the seller's future prospects have dimmed in light of structural changes within the industry and the company.

## OUTBOUND MIDMARKET M&A BY REGION/COUNTRY

In this section, we focus on outbound M&A data by country, as a matter of relevance to US sellers.

Cautionary Notes:

- Data on the midmarket is typically more difficult to find, since it is inconsistently tracked as a separate category by country, but we have tried to provide high level indicative data where possible.
- The financial crisis which gripped the world in 2008 has impacted deal volume across the globe. Numbers reported below do not reflect the impact which accelerated in the second half of 2008 since this data is not yet widely available.

### ASIAN TRENDS

Outbound midmarket M&A for Asian countries is shown in Figure 5 (Deloitte - MergerMarket study, Oct 2007).

Midmarket in this context is defined as deals ranging from \$50M to \$250M in size (including minority stakes).

#### SINGAPORE

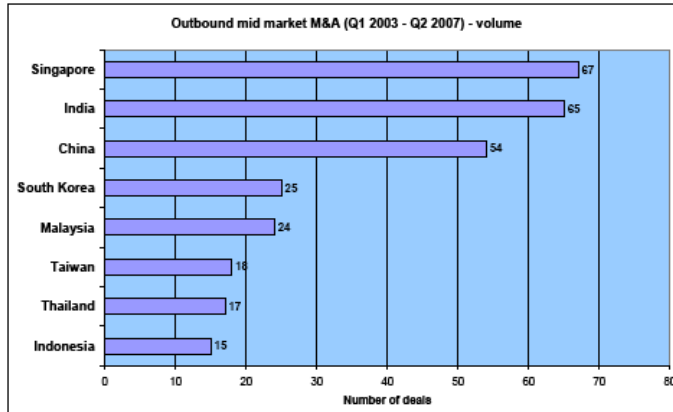
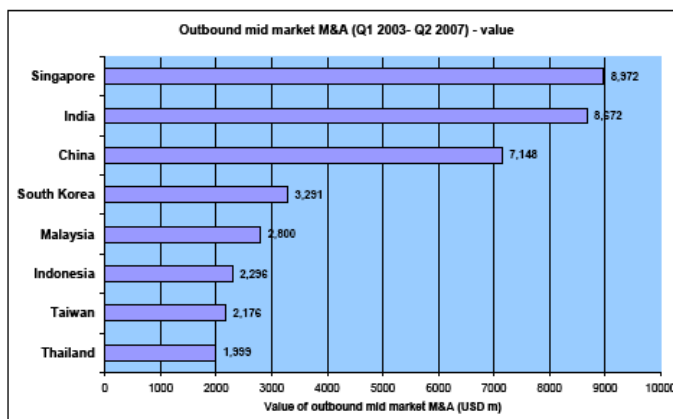
M&A activity is driven largely by Sovereign Wealth Funds, including Temasek (the private equity arm of Singapore's government) which returns 18% annually on its investments. In 2006 alone, Temasek conducted 14 deals (across all markets), worth nearly \$20 billion. From 2001 to 2007, Temasek has conducted 18 deals in the midmarket worth \$1 billion.

The current sector focus is in TMT (telecom, media and technology), tourism, pharmaceuticals, biomedical and financial services. Strengthening long term exchange rates and increasing costs for domestic acquisitions are expected to drive increasing outbound activity in coming years. Temasek and other Singapore buyers are expected to diversify and invest heavily in US and European companies in future (Deloitte - MergerMarket study, Oct 2007).

#### INDIA

In 2007 the Indian economy grew at a rate of 9.6% and is expected to be around 7.5% in 2009. Outbound midmarket M&A activity from India has steadily increased since 2003. It also exceeds inbound M&A activity, making India a net acquirer. The majority of outbound deals typically target companies in the US and UK.

Indian deals tend to be highly leveraged and are therefore susceptible to the decline in lending across the globe in 2007-2008. Deal volume and average size have dropped from 2007 to 2008. Through Oct 2008, Indian buyers executed 182 outbound cross-border deals with a total value of \$14.6 billion, and an average deal size of \$80 million (Grant Thornton India, Nov 2008). Private equity deals contributed another \$9.7 billion. In the



**FIGURE 5: OUTBOUND M&A FROM ASIA**  
**(FIGURE 5A: VALUE, FIGURE 5B: VOLUME)**

corresponding period in 2007, the total value of outbound deals was US\$32.8 billion and average deal size was \$75.6 million (Grant Thornton India, 2007). Major sectors of interest have included TMT (telecommunications, media and technology), pharmaceuticals, healthcare, biotech, consumer goods, financial services, industrials and chemicals.

*Note: Since this data includes all transactions (not just midmarket deals), the actual count and average size of midmarket deals will be smaller than reported above.*

## CHINA

The Chinese economy has been growing at a rate of 10% a year since 1978, but dropped below this threshold during 2008 and is expected to be around 7.5% in 2009. China's foreign exchange surplus (Figure 2) represents massive potential spending power and the government is increasingly fueled by a desire to invest in assets with higher yields than low yielding US Treasury bonds.

Through Oct 2008 (per Dealogic estimates), Chinese companies have announced \$114 billion of outbound M&A deals, compared to \$74 billion last year. That is way ahead of India and Russia, at \$21 billion and \$14 billion respectively. In Q3 2008, Chinese companies completed 20 cross-border deals, 14 of which disclosed a value of \$9 billion, an increase of 403% over Q3 2007 (Zero2IPO.com website).

*(Note: Midmarket data not separately available.)*

China's economic model which consists of several SOE's (state owned enterprises) organized by market segment, is viewed with some suspicion by several countries who fear a strategic and political motive by the Chinese government in cornering companies which deal with energy and other commodity raw materials. As a result, regulators in both countries are usually involved in an M&A decision. (Slater, 2008)

China-based investment entities occur in 4 discrete forms. A) In the commodities sector, SOE's such as CNOOC, PetroChina and Sinopec are active dealmakers who buy companies to guarantee supply of raw materials which fuel its energy hungry economy. B) SOE's in other sectors leverage existing large domestic competencies (such as the steel, auto, power and finance industries). Compared to the commodities companies, these latter firms tend to be more commercially-oriented, with more focus on improving shareholder value through their deals. C) China's growing, privately-owned corporate sector is also looking for opportunities abroad. Their deals tend to be small and rare in their pure form. D) Lastly, the government has the fifth-largest sovereign wealth fund (SWF) in the world, China Investment Corp, with hundreds of billions of dollars in foreign exchange reserves.

Although globalization is a strategic priority for many Chinese executives, establishing a foreign presence through M&A has taken second place to exports. The primary hurdle is a shortage of global talent in every department, especially managers with soft skills who can delegate, negotiate with partners and have a profound understanding of European and American markets. Many Chinese managers are also reluctant to accept foreign assignments (Orr, 2008). Chinese companies do have the option to hire foreign managers. Managing them however, requires an understanding of their expectations, and building clarity around career paths, corporate governance and management expectations. These are not traditional business strengths in China, but forward looking businesses are beginning to invest to overcome these barriers by sending their managers abroad for education and training.

The outlook for outbound M&A in coming quarters is positive, especially in industrials, chemicals, financial services and consumer sectors, which comprise 60% of current M&A deals in China (Orr, 2008).

## **MIDDLE EAST**

Oil rich countries in the Middle East are expected to be among the biggest buyers in coming years as they continue to grow large piles of cash through profits on sale of oil and gas to the world. Per KPMG estimates, a breakeven price of \$30 per barrel would provide sufficient funding to meet the national budget requirements of most Middle Eastern countries. Even a conservative price estimate of \$50 per barrel in the coming years would generate enough profits to create a cash hoard of \$20 trillion by 2025 (KPMG International, 2007).

Oil price increases starting in 2004-2005 generated a budget surplus of \$28 billion for Saudi Arabia alone by the end of 2005. In 2007, sovereign wealth funds in Kuwait, Saudi Arabia, Dubai, Abu Dhabi and Qatar combined held an estimated \$1.5 trillion and were increasingly looking to diversify their holdings and boost their returns (Grocer, The Middle East: Quenching Its M&A Thirst, 2007). Outbound cross border M&A initiatives from the Middle East have not looked back since they spiked in 2004. In September 2007, outbound M&A from Middle Eastern countries for the year totaled \$64 billion (Dealogic), with the US and UK being the most popular destinations.

Sovereign wealth backed transactions out of the Middle East are typically less leveraged than deals out of countries like India and are therefore less likely to be impacted by the 2007-2008 declines in financial markets. All-cash transactions are not an issue for these investors. They are also less likely to make a panicked exit during times of financial stress. A cultural aspect of Middle Eastern investments to keep in mind is the Islamic Shari'ah law which bars investment vehicles from investing in financial firms that offer credit, charge interest, or companies associated with pornography, gambling, pork or alcohol.

## **RUSSIA**

Russia has the world's largest natural gas reserves, the second largest coal reserves and the eighth largest oil reserves. It is the world's leading natural gas exporter and the second leading oil exporter. The Russian economy has been growing at 7-8% a year since 1999. Russia has been following a strategy of expanding abroad in locally developed industries like oil & gas, metals and mining, and telecom. Such acquisitions have helped leading Russian companies access new markets, customer and resource bases and know how, and improve production quality.

Comparing the first half of 2007 to the first half of 2008, outbound midmarket deals increased from \$1.1 billion to \$1.4 billion of which 40% went into US acquisitions, followed by Europe. Average deal size also increased by about 40% to \$120 million. The most active sectors were the consumer goods, industrial, telecoms, financial services, and the media and technology sectors (PriceWaterhouseCoopers, Mergermarket Joint study, July 2008).

## **EUROPE**

European buyers have fewer hurdles than buyers from other countries as regards meeting US regulatory requirements, which include differences in accounting standards and a review of political intentions. The UK, Germany and France are the most active M&A participants in the European Union. Alternative energy companies are in great demand and European buyers have dominated the bidding for such midmarket assets. Industries seeing buyer demand include industrials, TMT, financial services, energy, mining and utilities, consumer, business services, pharmaceuticals, medical & biotech. The majority of deals (62%) involve companies with enterprise value in the range of \$30 million to \$100 million.

European midmarket deal value fell from \$37.6 billion in Q1 2007 to \$32.1 billion in Q1 2008, a drop of nearly 15%. The tightening in the liquidity markets has impacted M&A deal values, but industry watchers expect the pace to pick up again in the next six months. (Cross-Border M&A Reporter, May 2008)

## CONCLUSION

### CURRENT STATUS OF MIDMARKET M&A IN THE US

Foreign buyers are highly motivated to acquire businesses in the US and as a result, deal making is continuing in the midmarket in spite of the tough financial times in 2008. Aggressive buyers continue to search for buying opportunities which allow them to outdistance the competition. The lower levels of financing needed for midmarket deals also makes them less likely to be impacted by the liquidity crunch. Additionally, post merger integration is simpler with midmarket companies, allowing earlier and more certain realization of ROI. A note of caution - buyer risks include overpaying for assets which may have a reduced ability to generate profits during the global recession which now looks increasingly likely.

### FUTURE OUTLOOK

As central governments around the world take actions to stabilize financial markets and boost business activity, many changes are occurring simultaneously – they include interest rates, currency exchange rates, liquidity, oil and gas prices, and shrinking demand for various products and services as the recession deepens. Business revenues and profitability at companies everywhere are likely to come under stress during the next year or longer. Due to the uncertainty from these rapid changes, some buyers are now waiting on the sidelines, resulting in a drop in M&A activity in the midmarket. While cash-rich investors in Asian and Middle Eastern countries are not as severely handicapped by the liquidity crisis in the US and Europe, some are wary of a global recession and could wait for the financial markets to stabilize before resuming acquisitions, especially in light of poor financial performance with their recent investments.

Midmarket sellers looking to exit in 2009 and beyond must engage with both local and international buyers to facilitate a competitive bidding scenario aimed at finding the buyer with the most synergies, to help negotiate the optimal sale price. It is important for the seller to understand the needs of foreign buyers so as to emphasize the synergies during price negotiations. While regulatory requirements and compliance can be issues for larger cross-border M&A transactions, these can be overcome more easily in the midmarket, especially in industries which are not politically sensitive. Sectors which are likely to command high levels of buyer interest include alternative energy, TMT (telecom, media and technology), banking and financial services, commodities and industrials.

We expect a high percentage of overall transactions to originate from Sovereign Wealth Funds and companies in Asia and the Middle East over the next 6 to 12 months, once the immediate financial turmoil subsides. European buyers will also likely continue to buy in the US, to position them for future growth. Industry consolidation (local and international) will also contribute to deal volume, as companies weakened by the recession divest a division or the entire business.

Although times are uncertain, there are likely to be many opportunities in the future for buyers and sellers. In the meantime, sellers should continue to focus on flawless execution of their business plans to gain market share from their competitors. Buyers should be on the lookout for opportunities with the synergies needed to meet their goals. They may also need to be patient and provide sufficient time for the realization of value from their investments.

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Eco-Bridge is a privately held M&A Advisory firm with partner networks extending across USA, India and Europe. We provide advisory services on a variety of topics and work with buyers and sellers to provide mid-market M&A transaction support across several industries.

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