Transactions

Eastern Approaches…

Maximising success with Emerging Market acquirers

crossboarder

Business owners in Western Europe are increasingly recognising companies and institutions from Emerging Markets (EM) as serious contenders when searching for a strategic partner or when attempting to sell their business outright.

But do Western European vendors understand EM purchasers and their respective cultures well enough to successfully negotiate the best deal for their business?

What can you do to maximise the success of these cross border transactions?

Destination 'Western Europe'

Mergers and Acquisition (M&A) activity by Emerging Market[1] (EM) entities in Western Europe has increased dramatically over the last six years. During this period, EM entities made some 844 acquisitions or investments in the region with a combined value of nearly €120bn.

As result of the 'credit crunch' and the global economic slowdown, 2008 has been a very weak year for global M&A activity. Despite this, 2008 was a record year for M&A transactions conducted by EM acquirers or minority investors, with an unprecedented 256 completed deals.

Whilst we expect the overall slowdown in the global M&A market to continue in 2009, there will be an abundance of attractive transaction opportunities in the mid-market segment for EM buyers, driven by strategic investment rationale. There are fundamentally strong, under-geared EM entities that are looking to acquire sound Western European targets. Having established themselves domestically as successful enterprises, they will continue making acquisitions abroad.

This could represent an opportunity to get a strategic EM investor on board (through selling a minority or controlling stake) that could not only provide you with additional funding, but also access to high-growth markets. If your company is facing a possible distressed situation, this could also be a viable strategic option to consider, which could allow your company to thrive in the future.

However, many Western European vendors can still be reluctant to deal with EM buyers as they have concerns over their ability to deliver on the transaction. Similarly, some EM buyers can feel that they are included in the sale process only as an option of last resort, after the vendors have tried and failed to sell their company to Western European trade and financial counterparties.

So what can you do to improve your chances of a successful sale? What do you need to know and how can you ensure your business is positioned appropriately so that it attracts interest from EM buyers?

Whereas the transaction lifecycle will be broadly similar to dealing with other Western European bidders, there are numerous issues that will need to be addressed in order to make the deal work for both parties, especially around bridging cultural differences.

This paper offers some insights on the steps that you as a vendor might consider taking in order to bridge these differences and make your business more accessible and attractive to a prospective EM buyer.

Our comments focus on the initial phases of the deal and are by no means exhaustive. Through our experience of advising on cross-border transactions, we know very well that every deal is unique and the corresponding challenges are almost always different.

We hope that this document will provide some food for thought and we look forward to continuing to work with you.

Chris Hemmings

PricewaterhouseCoopers Global Corporate Finance Leader

February 2009

Mergers and Acquisition (M&A) activity by EM entities in Western Europe has increased dramatically over the last six years. Some 844 acquisitions or investments were made in the region with a combined value of nearly €120bn.

Whilst we expect an overall slowdown in the global M&A market in 2009, there will be an abundance of attractive transaction opportunities in the mid-market segment for EM buyers, driven by strategic investment rationale.

1 Emerging Markets are countries or regions with high growth economies, including India, China, Russia, CIS, Latin America and Central and Eastern Europe.

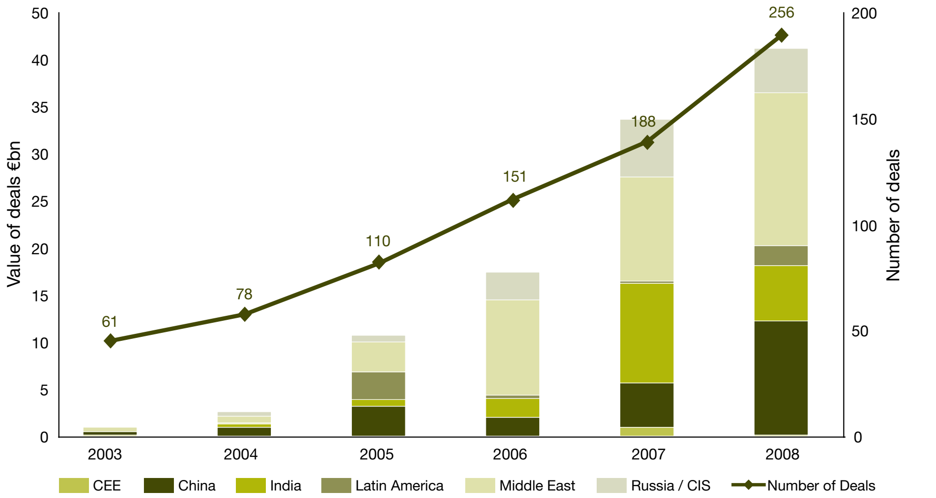
M&A trends and deal drivers

2008 witnessed an unprecedented 256 deals where EM buyers acquired Western European businesses with an overall value in excess of €45bn.

Mergers and Acquisition (M&A) activity by EM entities in Western Europe has increased in each of the last six years, with 2008 encompassing an unprecedented 256 deals with an overall value in excess of €45bn.

M&A Activity 2003-2008
Emerging Market Acquirers / Western European Targets

Equity value (€bn) and number of deals by year

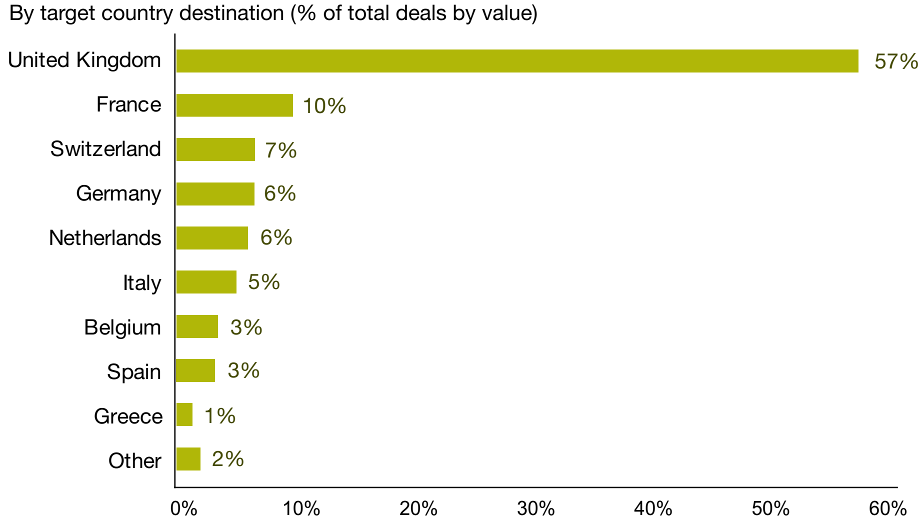


Source: Dealogic January 2009

Middle Eastern entities and sovereign wealth funds (SWFs) have set the pace, accounting for nearly 40% of cumulative transactions by value and 19% by volume between 2003 and 2008. Chinese private or state-owned enterprises (SOEs) account for one-fifth of the deals. Indian multinationals looking for technology, brands and routes to markets have been the most active by volume, performing one-third of the overall transactions, which account for 18% of the value. Russia's energy companies and high net worth entrepreneurs have completed about 15% of the transactions.

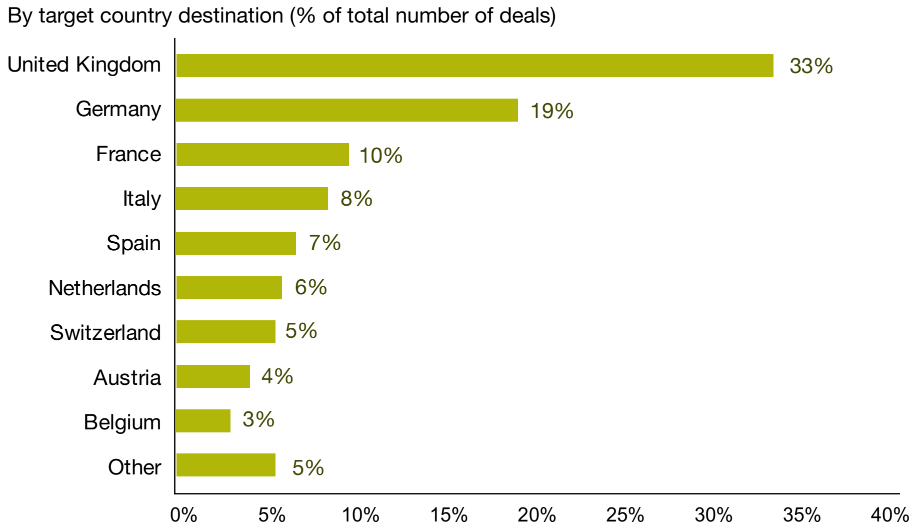
M&A Activity 2003-2008
Emerging Market Acquirers / Western European Targets

By target country destination (% of total deals by value)



Source: Dealogic January 2009

M&A Activity 2003-2008
Emerging Market Acquirers / Western European Targets



Source: Dealogic January 2009

The United Kingdom has been the largest recipient of inbound M&A activity by EM acquirers in the last six years, accounting for 57% of overall transactions by value and 33% by number. The country's financial services industry and its openness to and appetite for dealing with EM investors have been significant deal drivers.

Deal drivers for 2009 and beyond

There will be an overall slowdown in global M&A activity in 2009, as a result of the reduction in available credit and weak state of the global economy.

It is expected that these conditions will not leave EM entities unaffected, and some will direct their efforts towards their domestic operations and delay their overseas investment plans. Some larger Chinese enterprises, for example, are concentrating on streamlining their domestic operations and will be looking at foreign acquisitions on a more reactive, rather than proactive, basis. However, some Indian companies, for example, have continued to make outbound acquisitions in the second half of 2008, in some cases, competing for assets with other Indian bidders, as in the case of Axon, where both HCL Technologies and Infosys were keen contenders.

The falling valuations of some Western European companies and the distressed position of others, will entice some more opportunistic EM enterprises to look for overseas investments. At the same time they will be notably more selective in their investments, and will look beyond the valuations in order to identify fundamentally sound companies.

Transactions that do take place in 2009 and beyond, will be mostly driven by fundamentally strong EM buyers looking for Western European acquisitions, motivated by market expansion, backward / forward integration, knowledge and technology acquisition, economies of scale, access to and association with international brands and risk diversification rationale.

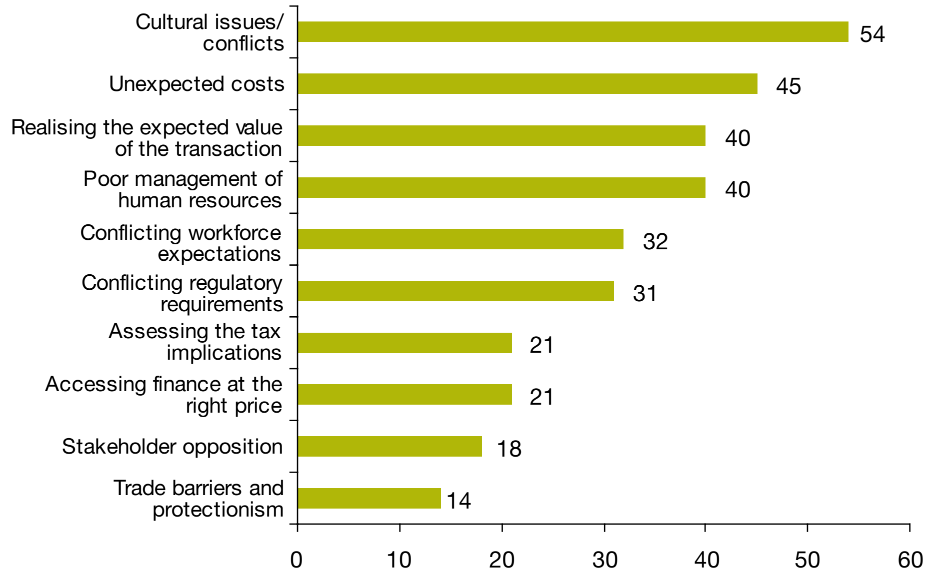
We predict that transactions in 2009 and beyond will be driven by fundamentally strong EM buyers looking for Western European acquisitions. This activity will be motivated by a number of factors including market expansion, backward / forward integration, knowledge and technology acquisition, economies of scale, access to and association with international brands and risk diversification rationale.

Challenges in cross-border transactions

In a survey conducted by PwC, global CEOs identified cultural issues / conflicts as representing the most substantial obstacle to success in cross-border M&A.

There are numerous challenges that must be addressed in order to make a cross border transaction work. In a survey conducted by PwC, global CEOs identified cultural issues / conflicts as representing the most substantial obstacle to success in cross-border M&A.

Key obstacles for cross-border M&A



Source: PwC Global CEO Survey 2009

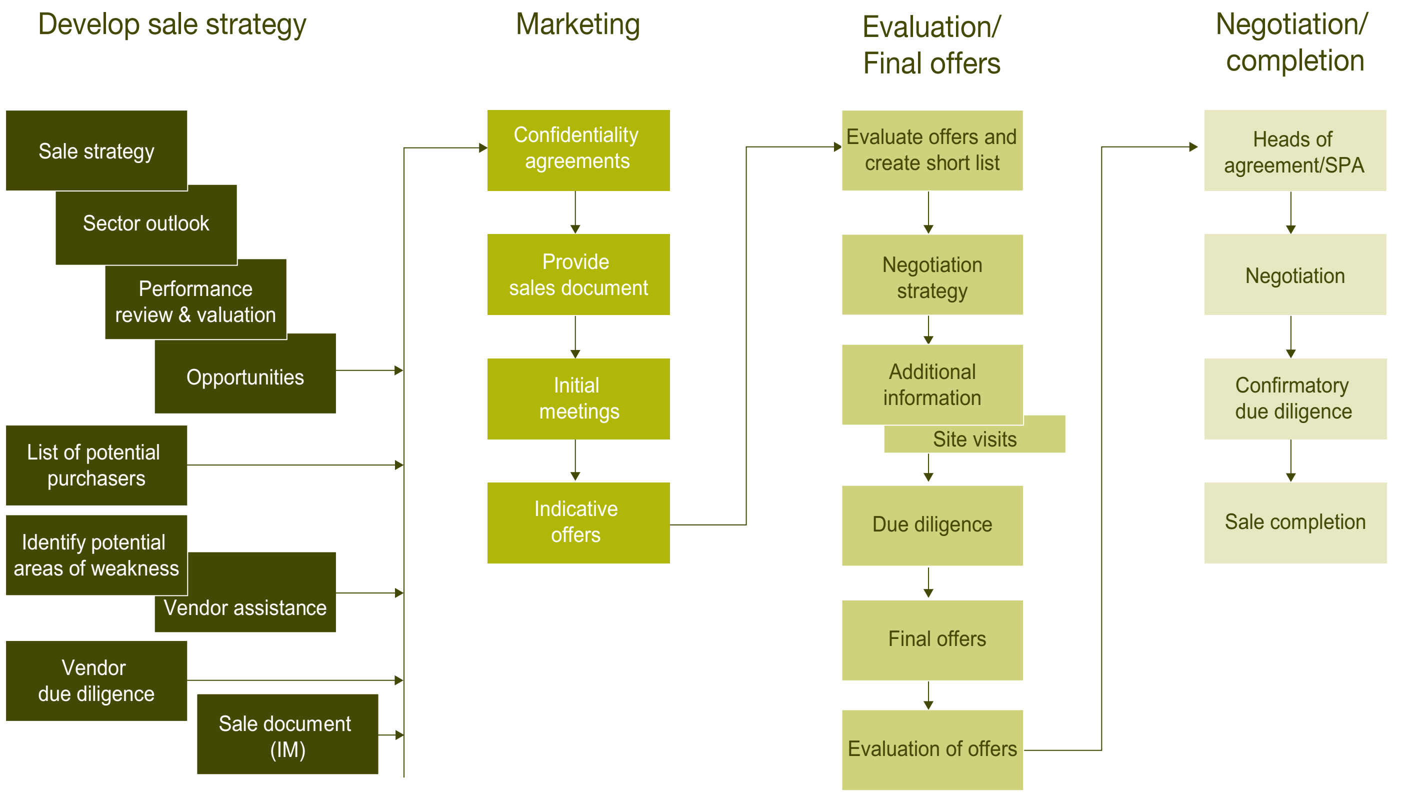
It is important to note that these issues are not unique to EM acquirers, and these types of challenges are prevalent in all cross-border transactions.

Although Western European vendors can have concerns about the ability of EM buyers to deliver on their side of the deal, the volume of deals done by EM acquirers over the last six years is a clear indication that EM buyers are able to close deals. Bid processes are becoming quite common in domestic EM transactions and this is helping EM acquirers in their appreciation of overseas M&A practices. However, some EM buyers, especially those in the mid-tier segment attempting an outbound acquisition for the first time, still need to develop a better understanding of Western European sales processes and find ways to gain better visibility of businesses for sale in Western European economies.

So what are the steps that you need to take to make sure that you understand your potential EM suitor, to make your company more accessible to an EM buyer, and to maximise your chances of successfully completing the transaction? The remainder of this document provides some insight on the steps you might want to consider when marketing your business to a potential EM acquirer.

Tailoring your disposal strategy towards EM buyers

Typical Western European Disposal Process



Identify potential EM investors from the outset

Getting an EM purchaser or investor on board should not be viewed as a tactic of last resort; in the current climate it could be a vital strategic option to consider, as a means of allowing your company to thrive, or simply survive, as a going concern.

Researching the key potential candidates within each EM country, and focusing on entities that have done cross-border transactions in the past could be a good starting point when searching for potential bidders. This will be a more difficult task when trying to identify rising mid-market players as, unlike in Western Europe, there is often limited information about these entities in the public domain. Appointing financial advisors with a local presence, who have relationships with these companies, could help you identify and shortlist credible bidders.

Tailor the sales documents

The documentation needed for a transaction with a prospective EM acquirer will be manifestly similar to a ‘standard’ deal with a Western European counterpart, but should be tailored to accommodate certain facts and circumstances. It will still be necessary to produce an Information Memorandum and ‘teaser’ document, but there will be differences.

These differences, as articulated overleaf, are sufficiently material that we would recommend the use of tailored ‘teasers’ appropriate to each market that will be involved in the bidding process. This can mean producing several different versions of the documents, taking into consideration the different strategic priorities of EM acquirers, as well as their customary business and cultural norms.

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Understand the strategic rationale of EM purchasers

It is vital to understand the strategic priorities driving a potential EM acquirer to make a cross-border acquisition and tailor the sales documents accordingly: why are they interested in making an acquisition and what will they value in the target entity?

These strategic motivations can vary from country to country, and from buyer to buyer, but examples of what these priorities might be are set out below:

China – technology transfer

The internationalisation of Chinese firms is driven largely by their desire to gain greater advantage within the Chinese market, for example by seeking new technologies, expertise or brands, or to further China's established 'national agenda' in sectors such as aerospace, energy and natural resources. In positioning a business for sale to Chinese buyers, it is therefore important to consider carefully how your business will help the investor to increase its market share in China.

India – distribution networks

There have been numerous deal drivers for Indian acquirers executing outbound transactions – these include backward / forward integration, access to markets, knowledge and technology, economies of scale, and access to and association with international brands.

Indian companies also have a significant domestic market to develop and it is therefore important to illustrate how your business can help to build or enhance a market position in India. At the same time, Indian companies are also interested in developing global businesses. As such, they will be interested in brand positioning and in understanding how your business can fill their gaps in product and service offerings and achieve greater geographic coverage.

Middle East – prestige is important

The prestige factor has often been important for Middle Eastern buyers in Western Europe with a considerable number of deals executed so far by SWFs into high-end property development, financial services and luxury brands. Middle Eastern SWFs are also seeking to build industries in strategically important sectors such as aerospace, or to develop industries such as leisure and tourism which can attract people to the Middle East region and encourage them to lengthen their stop-overs.

Latin America – growth through globalisation

South American companies are increasingly trying to expand overseas to grow and diversify their risks in terms of markets, raw materials and exchange rates. They are seeking to enter Western European markets by establishing a bridgehead in one country and using it as a platform for further acquisitions and expansion.

Russia/CIS – cash rich investors

Aside from the expansive ambitions of state-controlled energy companies, the majority of Russian transaction activity in Western Europe so far has been focussed on capital raising, luxury goods and property, often by wealthy, brand conscious individuals.

Emphasise how the transaction could help the bidder's position

With EM buyers being geographically distant to Western Europe for the most part, deals are less likely to be driven by cost synergies and more likely to focus on market entry, technology, brands, customer relationships, distribution networks and economies of scale.

You should tailor your sales documents emphasising how your company can help potential acquirers achieve their strategic goals, not only in new Western European markets but, just as importantly, in their domestic space.

Do you have technologies that can be used in EMs?

Promoting technologies and / or brands which may be employed to improve the EM company's operations at home, and emphasising your company's management skills, will serve to highlight how your deal could represent a significant gain for the EM business.

Have you successfully sold products in EMs?

If so, state this in the tailored teaser and Information Memorandum. Articulate the reasons why your products have been successful abroad and how you think they can add value to the purchaser's business.

Tailor the presentation of financial information

Potential EM acquirers will want to be provided with the types and format of financial figures with which they are familiar. Some EM buyers, especially those from the Far East, place greater emphasis on net assets than on cash flow and EBITDA multiples.

Other EM acquirers, that are not as interested in the value that can be attached to intangible assets, such as a strong brand, may exclude assets such as intellectual property and goodwill from their valuations. Therefore a comprehensive explanation of the value attached to such assets may be required by the vendor.

Strategic investments

A number of Western European companies are currently struggling to meet the terms of loan covenants or pay the coupon or interest on issued debt, as a result of the credit crunch and stagnating economic prospects. Consequently, they are facing administration or receivership procedures and are branded as distressed assets.

EM buyers have demonstrated that they can be prepared to look beyond short-term financial issues and high levels of gearing. The acquisition of a Western European company may have significant strategic value to an EM buyer, and could still achieve a good valuation. Indeed, a declining market in Western Europe may well translate to a growth market in an emerging economy, if the brands, products or technologies could be successfully transferred.

Marketing your company to EM buyers

The decision-making processes in EM companies are often consensus-based, making the acquisition process significantly slower compared to Western European counterparties.

Once you have identified potential EM acquirers and have produced the tailored sales documents, you should make your approach. However, difficult questions remain to be answered: whom do you approach and when is the best time to do that in order to maximise the chances of success?

Identify who is in charge

It is vital to understand who is pulling the levers of power in an EM acquirer. For mid-size companies, it is not as simple as looking at the organisational chart and selecting the finance director or corporate development director, typical steps that you would undertake for a Western European counterparty. For most larger EM entities, however, the process need not be very different.

Western European companies hoping to attract EM buying interest should fully research the EM entity's ownership structure and background. EM corporate structures can be very complex, and not transparent, sometimes with more informal decision-making arrangements in place, with owners or patriarchal figures wielding the real influence.

Timing is everything

Many EM acquirers, in particular those from India and China, are used to prolonged acquisition processes with long periods of exclusivity, allowing them significant time to make their indicative offers. Their decision making processes are often consensus-based, making the process significantly slower compared to Western European counterparties. It is not unusual, for example, for non-disclosure agreements to take four weeks to be signed.

Western European vendors should be aware of this and should allow sufficient time for decisions to be made. This is particularly important in an auction process, where EM buyers would normally be disadvantaged relative to Western trade or financial buyers, due to the slower speed of their decision making, but also their relative inexperience in making cross-border acquisitions. In some cases, specifically for SOEs, every definitive offer has to go through a series of approvals, including those from the relevant Government Ministry and this may also slow down the process. Therefore in order to allow for a considered response from the potential buyer, EM acquirers should be approached early in the disposal process, even in advance of the main Western European bidders.

Meetings and communication flows

As in all deals, it will be necessary to build good personal relationships with the key decision makers in the prospective acquiring entity, to supplement the discussions between advisors. EM acquirers can prefer to build close personal relationships with the key executives of the target business, specifically with the heads of the various business functions.

Although advisors can play an important and valuable bridging role between the chief protagonists, many EM entities, particularly those from India and China, prefer to deal directly with the principals. For Middle Eastern buyers, status and rank are important and they will want to know exactly who they are dealing with. You should therefore allow sufficient time to build relationships with the buyer. It will give both parties greater understanding of each other and will significantly improve the chances of completing the deal.

This will always be easier and in the end more successful if it is possible to involve advisors sensitive to the local cultural differences of the relevant markets. Representatives of the buyer will often be more open when dealing with someone in their own language and who they believe understands their culture.

When using translators to communicate with the bidders, it is important to ensure that they have a clear grasp of business and technical language. Working through translators will also increase the time required to progress the deal.

Customised vendor due diligence

Vendor due diligence (VDD) is now an accepted practice in most Western European markets as it can provide assurance to the purchaser, expediting and potentially shortening the decision-making process. However, this exercise would only assist the EM buyer if its scope is specifically tailored to meet their demands. Contacting local advisors early in the process to ensure that the bidders' requirements are accommodated within the scope of the VDD report is a logical step. You could arrange the engagement with your VDD providers so that you have the flexibility to expand the scope of the project at a later stage of the process, providing top-up due diligence in the areas that might interest the EM bidder.

You should also be prepared for some amount of "direct" due diligence by the EM bidders through their own advisors, as complete reliance on VDD reports is unusual for them, in particular if they view the VDD as an extension of the Information Memorandum.

Explain the 'rules of the game'

It is important to ensure that your prospective acquirer or partner fully recognises the extent to which Western Europe is a transparent and regulated environment, as well as what are the accepted norms of doing business. For example, some EM purchasers are not used to signing confidentiality / non-disclosure agreements that are common in Western European transactions.

Be ready to provide them with explanations of the nature of the industry and its regulatory and political context, as well as the need to comply with local rules such as the UK's Takeover Code, in addition to the laws and regulations (e.g. on health and safety, environmental liabilities, employment law and corporate governance) applicable when running the business. Whereas this is often assumed knowledge when dealing with Western European counterparties, you have to be prepared to spend some time focussing on these points (both in your marketing documents and verbally) to make sure that they obtain a full understanding of the legal and regulatory environment.

Making the transaction work for both parties

Some Western European vendors might feel that they are 'losing face' within their local community by selling to an EM buyer. This can be a particular concern for family-owned businesses where local stakeholders may perceive such a sale as the 'last resort' and the business to have been in financial distress.

Address these concerns upfront with the potential EM purchaser and ask them to provide a clear indication of their investment strategy in the short and the long term. When doing so, also help them develop a localisation plan so that the transition in ownership can take place smoothly. Many EM companies find it difficult to take management control of a Western European company post-acquisition. Spending time with a buyer to help them develop such a plan will generate significant trust and confidence between the seller and the buyer.

In order to gain more comfort over the credibility of a mid-tier EM acquirer, you could ask the bidder for access to their records, so that you could commission reverse due diligence to understand better the quality of their financial statements, internal controls and corporate governance standards. The EM bidder may not be accustomed to this approach, unless there is going to be combination of businesses, but your advisor could assist you in conveying this message in the most effective and diplomatic way.

Pre-emptive transaction processes

The focus of this paper is on auction deal processes, which include the prospect of a number of possible bidders. As many EM acquirers are used to prolonged sales processes involving extended periods of exclusivity, auctions, which take place in a short and frenzied period of time, have not generally been attractive to EM buyers.

However, there are a number of EM bidders actively considering acquisition opportunities in Western Europe. This could represent a transaction opportunity, especially for:

- private equity vendors looking to exit from some of their portfolio investments;
- companies looking to delist from a stock exchange and find a strategic or financial backer; and
- companies facing industry consolidation trends and looking for a partner in high growth markets.

We believe that it is likely that there will be more direct or pre-emptive transactions in 2009, initiated both by bidders and vendors.

Be prepared to negotiate hard on the valuation element of the offer, and think outside the scope of the intrinsic value of the business, considering how much the company is worth from the point of view of the EM acquirer.

Receiving indicative offers

The indicative offer given by some prospective EM acquirers might not be in the same format as other Western European bidders, and will depend on the past cross-border M&A experience of the EM buyer and the financial advisors assisting them.

Be prepared to negotiate hard on the valuation element of the offer, and think outside of the scope of the intrinsic value of the business, considering how much the company is worth from the point of view of the EM acquirer.

Also be aware of the different negotiating styles of EM buyers. The modest and deferential negotiating style of some Indian buyers can mean that it is sometimes difficult to identify what their position is and where their priorities lie, whereas some EM negotiators can continually try to reopen discussions, demanding discounts on the price or last minute government subsidies and tax exemptions.

Concluding thoughts

The impact of the credit crunch is curtailing all forms of M&A activity. Despite this, the seemingly irresistible movement of global economic gravity towards Emerging Markets means that transactions with EM partners will be more common. With each new deal announced, EM buyers will win greater acceptance as sound, commercial M&A partners.

By tailoring your sales documents to take into consideration the agenda of the EM purchaser, involving them in the process at the right time, communicating with them appropriately, and addressing cultural differences and potential expectation gaps, you will make your business more accessible to them, increasing the chances of taking the opportunity to the next phase of the deal and ultimately to a profitable close.

Appointing experienced deal advisors on both sides of the transaction will help you to manage the transaction and assist you with the financial and operational elements. They should also provide you with a means of bridging any cultural gaps.

PwC has been successfully advising on cross-border deals for many years. We know that each deal has unique requirements with corresponding opportunities and challenges, and our experience and our people can help guide you through each stage of the transaction cycle to a fruitful conclusion.

PwC experience in cross-border transactions

- Over the last 10 years, PwC advised on more than 3,200 deals globally, of which 39% were cross-border
- During the last five years, we advised on 100 Emerging Market transactions, with a combined deal value of $12.2bn
- In 2008 alone, PwC advised on 82 European cross-border deals with a combined deal value of $8.1bn

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