Fourth Edition | Chapter 3

THE GLOBAL COURTSHIP

STEERING A CROSS-BORDER DEAL TO THE LOI

BEST PRACTICES OF THE BEST DEALMAKERS
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Introduction by
David Fergusson | Editor

"Everybody's money is the same color and there's plenty of capital out there. It boils down to – one – the chemistry of the teams and the culture of working together and – two – what are you going to do for me? Besides the economics, is it going to help us grow, [and] get broader expertise, broader distribution channels?"
– Paul Aversano, Managing Director, Alvarez & Marsal

BEST PRACTICES OF THE BEST DEALMAKERS

Drawing on the experience and expertise of the "best in class" dealmakers, The M&A Advisor (http://www.maadvisor.com), together with the leading provider of virtual deal management services, Merrill DataSite® (http://www.datasite.com), publishes the quintessential dealmakers guide series – Best Practices of the Best Dealmakers. Profiling the proven strategies and unique experiences of the leading M&A practitioners, this series is distributed in regular instalments for M&A industry professionals in both print and interactive electronic media. Previously published features and chapters are also available in the online libraries of Merrill DataSite and The M&A Advisor. We are pleased to present **The Global Courtship: Steering a Cross-Border Deal to the LOI**. This installment examines the post-strategy development processes and best practice methods associated with cross-border deal origination and resolution, culminating with the formulation and signing of the Letter of Intent (LOI).

On the following pages, you'll find helpful observations provided by candid interviews with leading dealmakers, including buyers, sellers and advisors, as well as timely insights into the most current trends.

INTRODUCTION

A 4th quarter surge has pushed mergers and acquisitions activity to a record-high of 4.6 trillion dollars compared to the previous record of 4.3 trillion 7 years ago. In no small measure it is significant that nearly half of 2015 deal values were cross-border and that foreign direct investment growth year over year has eclipsed that of domestic M&A for the first time also.

As we have seen in the previous chapters of this 4th edition of *Best Practices of the Best Dealmakers*, the expertise in cross-border M&A – from advisory to legal, accounting to investment banking, private equity to corporate – has matured to a point that deals can now be made virtually anywhere, anytime and very quickly.

Still, the process involves a huge amount of thought, as exemplified in the previous chapter's focus on M&A strategy. In the next phase – deal sourcing, identifying a target and negotiating a letter of intent (LOI) – we have sourced our esteemed M&A Advisory Faculty from locales across the globe to share their knowledge and advice on how to get to what many liken to a marriage proposal – the LOI.

We include views from practitioners with experience in several regions around the world – from KPMG lawyer Silvia Sorribas in Barcelona, Spain, to Brazilian M&A attorney Luciana Tornovsky of Demarest Advogados in Sao Paulo, Brazil. From London, we have insightful views from private equity expert Giles Derry of Dunedin and Torben Luth of investment firm JZ International. EMC's corporate development Vice President Jennifer St. Pierre is based in Hopkinton, Massachusetts, but sources deals globally with a concentration in Israel and shares her methodology in this chapter. We are also indebted to Charles Otton, investment banker from UBS, Julian Brown, Head of the East Coast M&A practice at PwC, and Paul Aversano, a Managing Director at global professional services firm Alvarez & Marsal, for their keen insights.

In the next chapters of Best Practices of the Best Dealmakers, we will be adding new perspectives from more global dealmakers on various aspects of the art and process of ushering deals through due diligence, the closing, and the honeymoon period after the close. As always, we invite our readers to share their thoughts and observations on these topics with us for future editions.

David A. Fergusson
Editor
Best Practices of the Best Dealmakers

The Global Courtship: Steering a Cross-Border Deal to the LOI

Part I: Sourcing a Target in the Global Market

"It comes down to how technology is shifting, how we are intending to participate in the shift, and what strategic relevance start-up companies can bring to the company. From the technology perspective, Israel has a lot of great experience and innovation." – Jennifer St. Pierre, Vice President, Corporate Development, EMC

In October 2015, the global consulting firm McKinsey published results of a global survey on M&A practices and capabilities. Most respondents reported that their companies regularly examined their portfolio for new opportunities—and many do so at least once a year. But McKinsey suggested that an annual review may not be enough in today's fast-moving, increasingly cross-border M&A market. "The level of activity raises the stakes for companies reexamining their own business portfolios, as the shifting competitive landscape creates new opportunities—and threats," McKinsey said. "Whether companies are successful because they look for opportunities more often or the other way around, we can't say. But the correlation, combined with the fast pace of M&A activity in general, does suggest that more frequent portfolio reviews may be better."

As we saw in the previous chapter, successful mergers and acquisitions begin with a well-formed strategy and today – as opposed to even 10-15 years ago – that includes a global M&A component. The pace of cross-border M&A has now reached par with purely domestic M&A and is expected to continue as part of long-term globalization trends. In this chapter of *Best Practices of the Best Dealmakers*, 4th Edition, we will be sharing insights from top M&A practitioners on deal sourcing and negotiations leading up to letters of intent, which are often compared to proposals of marriage.

One of the more active participants in deal sourcing is Torben Luth, a Partner at JZ International, based in London with an office in Madrid. He is responsible for deal sourcing as well as pre- and post-deal completion relationships with targets and brokers. JZ International is an industrial holding investment group that specializes in investing in and growing small to medium-sized businesses in partnership with founders and entrepreneurs. It has a network of more than 2,000 contact points all over Europe, and Luth says the firm builds

relationships with not only small boutique firms but also wealth management firms. The network feeds deal leads to JZI, but Luth and his partners also are voracious readers of trade publications and go to trade shows throughout Europe and North America looking for more leads. "We want to see who's growing and who's not growing," Luth adds. "If we find a target we'll go to one of those contacts and if it came from the network we'll feed business back to them." In an average recent year, Luth estimates some 300 potential deals have come across JZI's desks and about 100 of these lead to visits to the potential target. Luth personally visits 60-80 sites per year. The actual number of deals consummated varies by year because some deals take longer (more than a year). "This year we've done four deals. One year we did 11 but that included some small add-on acquisitions. We probably average 2-5 deals per year," he says.

One of the more acquisitive companies in today's cross-border M&A landscape is EMC, a leader in data storage and cloud services as well as other tech services. Jennifer St. Pierre is EMC's Vice President of Corporate Development and has been sourcing deals for 10 years, actively closing more than $5.7 billion in software and other technology acquisitions. She says deal sourcing involves identifying a need that can either be filled by growing organically or making an acquisition. "It comes down to how technology is shifting, how we are intending to participate in the shift, and what strategic relevance start-up companies can bring to the company. If it's inorganic, it comes down to examining firms, how they're addressing a technical need and then identifying a candidate." EMC does not focus on region or country, but "which company best meets the strategic requirements." Still, in recent years the company has made several acquisitions of firms in Israel. "From the technology perspective, Israel has a lot of great experience and innovation." As an example, St. Pierre cites Herzliya, Israel-based XtremIO, a flash storage company that EMC acquired in 2012. "We acquired it, brought it into EMC, hardened the technology and brought it to market in a way that could not have been done in a similar timeline organically. It was the fastest zero to $1 billion (in aggregate bookings) acquisition in company history."

Charles Otton is a Managing Director and Co-Head of the Global Industrials Group, Americas at UBS. He has 21 years within UBS and the investment banking industry, serving for 10 years in London and the past 11 years in New York. He has extensive experience in M&A, equity and debt transactions

"Some companies base their growth strategy in multiple acquisitions. In those cases, it is absolutely necessary to have in-house a strong corporate finance department led by an expert, transaction driven, CFO." – Silvia Sorribas, Partner, KPMG

in the aviation, transportation/travel, capital goods and infrastructure sectors. He has advised on transactions in North America, Latin America, Europe and the Middle East. When it comes to working with corporations in sourcing deals, says Otton, UBS's large international investment banking practice makes a difference. "It gives us a window into what our clients are most interested in and allows us to work with corporates who will look across borders for deals. Often international M&A is best done by people who have better understanding than others about how to buy something in a different jurisdiction," Otton notes. "We're very joined up globally. It helps that the team has worked and functioned in lots of different areas and jurisdictions while at UBS, which allows us to leverage our integrated, global footprint in order to meet the needs of our clients." Otton adds that the larger US corporations have business development functions in-house. "Sometimes they are quite separate functions and sometimes they are integrated – it depends on the nature of the organization." He recommends that all sizeable corporations – mid-market as well – should use an external bank.

From her law firm in Sao Paulo, Brazil, Luciana Cossermelli Tornovsky helps local and international clients source deals. She is a Partner at Demarest Advogados, specializing in M&A and corporate law. Demarest is one of the most reputable law firms in Brazil and one of the largest in Latin America, assisting clients across the Americas, Europe, and Asia. They have offices in the most important cities of Brazil, including São Paulo, Campinas, Rio de Janeiro, and Brasília, and also in New York.

Tornovsky has worked on many important domestic and M&A cross-border transactions. When a client starts to talk about buying or selling, she says: "First I have to understand their strategy. If they are trying to expand their business, we will look at competitors. If they want to acquire or sell a business, I can then help them try to identify candidates. Our law firm has many, many clients. We often introduce them to other clients as long as we are not conflicted." She says it is very common in Brazil for companies to include an internal corporate development specialist in the deal source process. "Clients

always have this kind of business development person who is looking for opportunities in the market," says Tornovsky. "This person will be 100 percent involved in the case. A business development person is more effective and can be present in all meetings and can contribute a lot."

Another legal practitioner, Silvia Sorribas from Barcelona, Spain, agrees. She is an M&A and corporate lawyer with KPMG, who has more than 25 years of legal experience advising companies, both national and international. She began her career at Garrigues Abogados in 1990 (formerly Arthur Andersen), and in 2004 she was promoted to partner. In today's world, she says, most of the investors seek quality providers according to their own criteria and research. "Companies are now more global than ever and investors are very specialized not only in terms of risk taken, size of the target and transaction's category, including private equity versus venture capital, management buyouts, strategic acquisitions, but also in terms of the different business sectors such as energy, pharmaceuticals, tourism, real estate, distressed debt." She adds that the "art of the success of a given deal always depends on the expertise and knowledge of the different specialists involved. It is difficult to talk about deal flow in general terms. Some companies base their growth strategy in multiple acquisitions. In those cases, it is absolutely necessary to have in-house a strong corporate finance department led by an expert, transaction-driven CFO."

Julian Brown heads up the US East Coast operations of PwC Corporate Finance LLC. Prior to his move to the US, Brown gathered more than 20 years' experience in deal origination and execution in Europe, South America and Canada. He has advised clients ranging from large listed multinationals to family-owned businesses on their M&A and financing transactions in a wide range of sectors. "For me, it's very much a question of your M&A strategy," Brown says about deal sourcing. "It's just an extension of your corporate strategy. So the extent that my corporate strategy is that I want to expand into Eastern Europe, that's where I'm going to look for targets." Brown notes that sourcing practices differ by sectors. "If you're a healthcare services provider, you will want to be more domestic because regulation etcetera. There's not a lot of synergy cross-border in health care, whereas a pharmaceuticals is a totally global space." Brown also says an in-house corporate M&A specialist makes sense for companies that to multiple deals in a short timeframe, but adds that, for a corporation whose strategy may be one or two acquisitions over the next five years, "An internal function may not be appropriate…To the extent that you

"What our clients tell us first and foremost it's the relationship with the management team of the target company."
– Paul Aversano, Managing Director, Alvarez & Marsal

do rely on third-party providers, you really need someone with experience and skill. If my search is taking me more regional or global, that's a difficult ground to cover. So a corporate should be trying to speak to intermediaries in those sectors on a regular basis – also just to get their message out." He also advises publicly listed companies to have their CEO's talk about their M&A strategies on analyst calls.

Alvarez & Marsal is a global professional services firm that delivers performance improvement, turnaround management and business advisory services. Paul Aversano is a Managing Director in A&M's Private Equity Services practice and the Global Practice Leader for the firm's Transaction Advisory Group. For 20 years, Aversano has specialized in leading both buy-side and sell-side financial accounting due diligence projects for complex public and private company transactions, as well as transactions in the capital markets. He works to deliver the firm's services to clients in North America, Europe, the Middle East, India, Asia and Latin America.

Aversano says his years in the business have convinced him that there is a strong trend toward industry-specific M&A expertise: "In the past there were more generalists in market expansion. Now the industry is more focused and going deeper into each sector. Corporations are selling assets and businesses if they are not dominant in the market." Even in private equity, he says, "The day of generalist funds doing deals are kind of over. It's a barbell effect in private equity. On the corporate side, they're going deep where they can dominate a market." Aversano adds that, in today's market, most deals are being sourced based primarily on valuation. "Valuations are very high and difficult to transact, so we are seeing deal flow going into places where valuations are lower. In Europe, valuations are lower and we're seeing more deals going there right now than in past 10 years. In Brazil, the currency has devalued 40 percent and we're seeing US-based firms saying the valuations look attractive. They're saying 'rather than competing with everyone in the US, let me look at getting into Latin America.' They're looking at China and we're even seeing people doing deals in Africa for the first time."

Part II: What Makes a Winning Pitch?

"You have to be able to show, especially in Europe, that you're bringing something beneficial not only to the seller but to the company going forward. If you've only been thinking of yourself, you're going to lose your friends and your wife's going to lose her friends." – Torben Luth, Senior Partner, JZ International

In the McKinsey report mentioned in Part I, respondents whose companies considered acquisition targets in the past year reported completing at least one deal in just over two-thirds of the cases. Of those that tried but failed to complete an acquisition, 52 percent indicated that their companies engaged with at least one potential target but ultimately did not close the deal. Respondents expected little change to their companies' rationales for deals in the next five years, and the most frequently cited reasons all related to growth: expanding offerings, entering new geographies, and acquiring new assets.

So if that many deals fail to launch, what are the best practices for putting together a winning pitch? M&A practitioners interviewed for this chapter described this as an art form, in which the most successful dealmakers discover the chemistry that will add value to a combination and promote the growth of the combined entity going forward.

"What our clients tell us first and foremost it's the relationship with the management team of the target company," says Paul Aversano of Alvarez & Marsal. "I travel all over the world. Everyone's money is the same color. It boils down to – one – the chemistry of the teams and the culture of working together and – two – what are you going to do for me? Besides the economics, is it going to help us grow, get broader expertise, broader distribution channels." In his experience, Aversano says, the most successful pitches came from managers who met and got to know the target's management. "We like the management team and we can see ourselves working with them. Relationships are first priority," he said. "The second priority obviously is valuation. Also, the certainty of closure and the timing of closure – how quickly you can do it – those are important." When he started in the M&A business in the 1990s, the typical diligence period was 90 days. "Then the dot-com boom came and it was five days," he notes.

After the dot-com bust in 2000-2001, the market went back to longer exclusivity periods, and then tightened in the years leading up to the 2008 financial crisis. "Now it's shortening again," he says. "The market for deal

"On the sell-side I always advise my clients to put a confidentiality agreement on the table and have any potential buyers to sign it before releasing any information."
– Luciana Tornovsky, Partner, Demarest Advogados

sourcing and deal flow has become very, very efficient. It squeezes the market and insures maximum value. We see people trying to jump the auction process. Sometimes they don't even get to the LOI stage. Sometimes it works and sometimes it doesn't. Some banks won't give you that strategy and demand auction."

From her perspective in Barcelona, KPMG's Silvia Sorribas says the art of putting together a winning pitch stems from the essential element of understanding "the needs of the seller behind the transaction and the key needs or interests to be covered by the offer, as well as who are the real decision makers." She adds that there are essential ingredients that are different in each pitch. "Of course, price and payment conditions, but also the size and quality of different contingencies and presented waivers and warranties from the banks. Of course, for many transactions decisions taken by authorities – antitrust authorities for example – are essential."

Luciana Tornovsky says she advises her clients not to dwell on problems or issues unless they are significant. "Just tell them what you want to buy, how much more or less you will to pay. You should inform the target what you can contribute to the company. Do you have synergies to add? Will you keep their employees? If you raise too many issues in this very preliminary stage it could disqualify you," she states.

At EMC, Jennifer St. Pierre says, acquisition pitches are tailored differently to every deal. "We don't put a winning pitch together until we've gotten together with the CEO and his founders," she notes. "A lot of what we bring into the pitch is past success stories in terms of how we've acquired smaller companies and accelerated their growth." She adds that the EMC acquires are often entrepreneurial, backed by venture capital firms. "From a tech perspective, companies want to see their technology out there in the market, see customers using it. We can provide them that avenue as well as our expertise – how to excel in the enterprise."

Julian Brown at PwC boils down the winning pitch's key ingredient to "whoever pays the highest price and has lowest level of reps and warranties." A PE-owned business is likely to have a number of potential suitors, he says. "If you're targeting a family business or one still owned by an entrepreneur, again varying by geography, their concerns will be much broader than the transactional outcome. They'll be more concerned about what happens to the manufacturing base in town where I live, what's the future of the business when I let go. How will the management team and employees be treated? It's a matter of knowing who your buyer or seller is. It's really knowing all of the factors. There's no such thing as too much information or too many relationships."

Adds UBS's Charles Otton: "You've got to be direct, offer a compelling price and without too much conditionality. Offering a share of the upside is another way to pitch it so people see benefits of the deal."

"You have to be able to show, especially in Europe, that you're bringing something beneficial not only to the seller but to the company going forward," says Torben Luth. "If you've only been thinking of yourself, you're going to lose your friends and your wife's going to lose her friends. I don't think we've ever managed to do a deal where we haven't showed this." Luth adds that the key element of getting the deal done is the "extra beyond the money. Chemistry with your future partner is also key. There are a lot of great buyers in the universe and in Europe and for a majority of sellers money is important, but equally important is what you are going to do to help the company grow."

DEAL NOTES

Debunking 5 Myths About Private Equity

In a recent blog, Giles Derry, Partner in London-based Private Equity firm Dunedin, addressed the "Infamous Five" common myths about private equity. Following are excerpts:

It's in the name: private equity. Many people suspect that, if it's private, there must be something bad about it. So here's five "myths" about private equity that management teams should know the truth about:

Myth 1: PE firms are asset-strippers. To grow a business we need to invest. If we're growing the manufacturing capability of an engineering business that's going

to mean bigger factories, more machinery, more people to operate that machinery, so there is a huge investment that goes into a lot of our businesses. If they are growing – and that is clearly why we're interested – then we invest in them. And let's not forget that more investment means more jobs. The figures speak for themselves; PE-backed businesses employ more than 800,000 people in the UK.

Myth 2: PE firms over-leverage companies. We absolutely use leverage, but we use it conservatively. Across our portfolio average gearing is about two times EBITDA. Some of our businesses have no external leverage. We use a financing structure that is appropriate for the business and the management team. Leverage is not all bad. There are positive aspects. Leverage can improve the returns for everybody. It does improve our returns, but it also improves the management's returns. Leverage allows management teams to buy into a business at a discounted rate.

Myth 3: PE is risky. Our financing structures are appropriate for growth businesses. If you look at businesses that have been private equity backed and have used leverage, the proportion that end up in formal distress is much, much lower than the wider economy. We care about every single business we invest in. We will only make two or three investments a year, so each one is deeply important to us. Consistency of returns across the portfolio is incredibly important to our investors.

Myth 4: PE firms are untrustworthy. Private equity has further to travel in terms of improving its image and its public reputation. US presidential candidate Mitt Romney could not avoid the fallout from one poor investment despite many that grew and created more jobs. When it comes to trust, it comes down to people and individuals who create a culture in their firms and the way they deal with people. That is why we spend so much time on management due diligence and getting to know people. This process builds trust in both directions. You can check our references: we're happy for you to talk to other companies we've invested in and dealt with.

Myth 5: PE executives are not aligned. Every single time Dunedin makes an investment, each of the partners will also personally write a check. We invest on exactly the same terms as our fund. We put our money where our mouth is.

Part III: Partner Identified – Working Out the Deal

"You have to make sure you have good networking time so you don't get any nasty surprises in the due diligence because the chances of renegotiating an LOI in the mid-market are not good. There is a lot of family pride in these companies selling their businesses." – Torben Luth, Senior Partner, JV International

In its survey, McKinsey asked executives about their companies' capabilities across the four areas of M&A – integration, M&A operating model and organization, due diligence and deal execution, and M&A strategy and deal sourcing. Those from the high-performing companies reported proficiency more often in all four areas than their peers at low-performing companies. Their skills were most differentiated in the area of integration. Respondents reported the least proficiencies in "effectively managing cultural differences across organizations and setting synergy targets. McKinsey observed that, because there are often different owners throughout a company's M&A process, "it can be particularly tricky to put proper incentives in place for each one. So, incentives must balance the promotion of post-integration success with the successful execution of an individual's role."

A lot of ingredients go into the special sauce that makes a successful integration. Dealmakers interviewed for this chapter cited the confidentiality agreement, or non-disclosure agreement, as a base in the saucepan before the simmering begins. "In tech that's huge," says EMC's Jennifer St. Pierre. "Everyone has their special sauce that they bring to the table and confidentiality is key. Both sides have to feel comfortable." She adds that with today's cybersecurity risks, confidentiality is an even greater concern than in the past: "It's generally the target company's information that could be exploited. As a buyer you don't put as much confidential information out there."

"Confidentiality is an essential commitment to be maintained by the parties during all the negotiation process," said Spanish M&A attorney Silvia Sorribas. "The level or scope of confidentiality may be diverse depending on the structure of the transaction but it usually covers not only the negotiation itself, but also the information on the target and its business exchanged within the negotiations. All M&A processes usually start with a private Non Disclosure Agreement by means of which the parties undertake to keep the existence of the process and negotiations confidential. A Confidentiality Agreement is

also signed in order to preserve as confidential all confidential information exchanged between the Parties for the purposes of the M&A process."

"It's very important. It should be signed in the very beginning," says Luciana Tornovsky. "On the sell-side, I always advise my clients to put a confidentiality agreement on the table and have any potential buyers sign it before releasing any information. The problem with the CA is that in the case of a breach it will be very hard to enforce because you need to evidence the breach. And you need to prove the damage that the breach caused to you. When you are talking about confidential information, it's very hard to prove a breach." However, Tornovsky says breaches of confidential agreements are "not very common at all." She adds: "If you are on the sell-side, it would be interesting to include a non-solicitation provision in the CA because it could prevent any kind of harassment of the employees. Potential buyers will have direct conversations with personnel of the target. It's especially important if the potential buyer is your competitor and transaction doesn't go through."

As an active buyer or investor, JVI's Torben Luth also sees confidentiality as key. "You have to make sure the seller feels comfortable letting you in, especially in Europe where a lot of information is not readily available. Often it can take quite a few meetings to make sure there's full trust. That's an important first step and after that you have to sign it. We've never done anything without an NDA." Luth adds that these agreements vary by jurisdiction and in some countries, counterparties will require that confidential materials be destroyed or returned if a deal is not completed. "In Germany and Spain you will get that request 90 percent of the time; in Italy it's 50-50; in Eastern Europe it's more common, and in the UK and Scandinavia they generally don't ask for the material back."

The confidentiality agreement's purpose is "to protect the company that is providing information from being splayed into the marketplace," adds Giles Derry of London's Dunedin. "There are high risks of some kind of commercial breach of confidentially in any deal, although I actually think the risks are lower in a private equity deal than for a business being acquired by one of its competitors," he says, echoing Jennifer St. Pierre's concern about cybersecurity.

"You need it, otherwise people can't talk openly," UBS's Charles Otton says about the confidentiality agreement. "Sometimes these agreements can be 10 to 12 pages long. Outside of the US there is potentially less familiarity with

confidentiality agreements – but most people understand the concept. It's the right thing to do."

A&M's Paul Aversano says the confidentiality agreement "becomes paramount where you have one or two competitors in a particular industry" involved in a deal. "We're seeing more and more 'clean rooms' – where the buyer and seller out put everything – data rooms on steroids. Five years ago I didn't know the term. Now it's becoming a trend."

PwC's Julian Brown observes that all deals are about getting access to information. In extreme cases, overly complex confidentiality agreements "can make it difficult to get needed information…Some companies think everything is very sensitive, but it's more likely that only about 10 percent is really dangerous in the hands of a competitor."

Once the confidentiality terms are completed, the best dealmakers engage with management on the other side of the proposed deal – always with integration at top of mind. "We spend a lot of time meeting with the people in the EMC organization that the target company will be working with post-close," says EMC's Jennifer St. Pierre. "Does the business unit feel like it's a good fit technically and culturally? Can the teams be successful together? We do a deep dive from the corporate development side to help inform and build out a detailed business case to rationalize the transaction. Our philosophy from a tech M&A perspective is that the people are the business. Those are the individuals who have developed and come up with the idea you are buying in the first place. You need to make sure there is a connection there." Next comes a go or no-go decision on whether to proceed to the Letter of Intent (LOI) phase. "That really comes down to our business case, with a focus on strategy and numbers," St. Pierre adds. "First and foremost, there has to be a clear fit and need for the technology and an alignment as it relates to overall strategy. Then, how do we justify it from the shareholder perspective? What's the projected return on investment." She notes that in today's seller's market, "there are definitely situations where we may say strategically this makes sense, but financially it doesn't meet the mark."

JVI's Torben Luth deals with investment targets in the mid-market and lower-mid-market throughout Europe. Luth says that there are different ways to approach management meetings and negotiations, but that "pre-LOI meetings are so important. You really have to ask all the right questions so you can put

"It's like a round of golf, there are eighteen key issues, six that the buyer won't give on, six that [the] management team won't give on and the other six will be the major battlegrounds. You'll end up compromising somewhere in the middle. The only problem with the analogy is that it is not always the same eighteen issues!" – Giles Derry, Partner, Dunedin

an LOI together. You have to make sure you have good networking time so you don't get any nasty surprises in the due diligence because the chances of renegotiating an LOI in the mid-market are not good. There is a lot of family pride in these companies selling their businesses." He adds that he makes sure the target and he are "on the right page for valuation and future structure – again it's about developing chemistry. "There's no hard fact for meeting this or that number. We have parameters – if we can't get within that range then that's a definite no-go. If we see that we fall inside the parameters and chemistry is there we'll have a go." He adds that scores of LOI negotiations over the past 15 years, he has only seen two or three deals terminated pre-LOI – all in Poland. "The sellers wanted 100 percent – we wouldn't do that because we want a partner who is going to manage the business going forward."

Dunedin's Giles Derry says management meetings in private equity deals "are very instructive not least because it gives you the opportunity to see the management teams in action. We are making decisions to back management teams. We wouldn't even consider doing a deal without meeting management." The meetings also provide opportunities to build rapport, trust and confidence, he adds: "It's a carefully balanced effort as a private equity house between probing with questions and selling and trying to win the deal."

Likewise, UBS's Charles Otten calls management meetings essential: "You can't buy a business without meeting the management team. You have to understand what makes them tick."

PwC's Julian Brown advises: "the more time that you can get, take it as the buyer. There are lot of processes where you won't be given time to meet management until the LOI. So to the extent that you can get access pre-LOI, that's all good." He says for buyers, the best strategy in these meetings is to "show your vision. Use it at an opportunity to evaluate management and sell yourself as a good buyer."

"If a client of mine really likes the target they will want to spend as much time with management pre-LOI as possible," said A&M's Paul Aversano. "The more information you can get before the LOI, the more certain you can be that the deal will work. Sometimes it works against you – somebody may bid higher." Is there ever enough information from these meetings? Aversano says yes, but that it must be confirmed with due diligence. "Cross-border – outside of the US and Europe – it is very difficult to spend more time with management. Part of it is geographic, but also it's cultural." He said some Asian countries will not allow foreigners to gain majority control. "In India, you have to deal with 'promoters' [agents who represent the management teams] you may not even get in to meet with the actual management." So from a cross-border perspective, Aversano says, gaining enough information is challenging. But as noted in previous chapters of this series, the global M&A market is maturing; advisors, lawyers and accountants are gaining experience in cross-border deals. "Yes the emerging markets are maturing, but people ran in to these high-growth markets 10 even 5 years ago and got burned and that's still fresh in their minds."

Part IV: The Letter of Intent: Good Faith but Intense Diligence Ahead

"*Where it's dangerous to compare the LOI to a marriage proposal is if it gets emotional or you get caught up in 'what are other people going to think about it?' Don't get wrapped up in deal fever. You've got to be level-headed.*" – Julian Brown, Managing Director, PwC

The pace of global dealmaking in late 2015 was rivaling the previous year's level of about $3.4 trillion, levels not seen since before the financial crisis in 2008. Most executives surveyed for the McKinsey report expected 2016 next year to bring as many or more deals as 2015. Those who anticipate a larger number of deals also expect their value to increase – and those who expect to do fewer deals expect their values to decline, McKinsey said. Looking at the longer time frame, respondents expect little change to their companies' rationales for deals in the next five years and the most frequently cited reasons all relate to growth: expanding offerings, entering new geographies, and acquiring new assets.

In the private equity world, Dunedin's Giles Derry says the target businesses he seeks "are scalable, have great management teams, have the capability

of growing internationally, and have some degree of protected intellectual property and/or contracted revenue. As the number of these criteria increase, it's more likely we'll wish to proceed. If none, we won't proceed." Once a go decision is made to proceed to the LOI, Derry says, the buyer will be looking to protect their position and the business they think they've bought. "Does it come with warranties that represent what I actually am buying and at the right price?" Meanwhile, he notes, the seller in private equity deals is usually tasked with giving warranties on what they know is true and seeking to minimize their risk in selling the business. "To a certain extent, those positions are in conflict," says Derry. "It's like a round of golf; there are eighteen key issues, six that the buyer won't give on, six that [the] management team won't give on, and the other six will be the major battlegrounds. You'll end up compromising somewhere in the middle. The only problem with the analogy is that it is not always the same eighteen issues!"

PwC's Julian Brown says both sides should step back at this deal stage and assess whether they've learned enough about each other. "Are there any red flags? Do I have any serious doubts on any issues? Are there any real accounting issues? If your belief is that this company fits in with your strategy and it's more appropriate to acquire than to build, you proceed to the LOI." Sometimes it might be better to step away, he adds. "Where I've seen things get awkward is when the LOI has encouraged a buyer to make it look as attractive as possible," says PWC's Julian Brown. "Things can go wrong after that." In cross-border M&A, "LOIs mean different things in different countries," Brown observes. "Things are totally different in China and in the US It's absolutely essential to have local counsel who know their way around the local legal considerations – what you're actually committing to and what you are not. On the cultural side, it's really important to understand how important the LOI is or isn't. A law firm or investment banking advisor in the country can help you through that."

A&M's Paul Aversano agrees that cultural issues are a big thing. In deciding to proceed to the LOI, Aversano asks "how certain are we going to get to the finish line with these folks. Anything can throw off a deal. There's so much geopolitical risk these days – an Ebola virus in Africa affects the US stock market. There's volatility in China, turmoil in the Ukraine and the Middle East."

The usual points of contention in getting to the LOI are the valuation and exclusivity period, "how long are you going to lock me up so I can't pursue other options," said EMC's Jennifer St. Pierre. "In terms of resolving issues, it comes down to understanding the motives of each side and figuring out what truly motivates the other side. Work through it that way. At the end of the day you can get there – it just takes a lot of conversation and back and forth to understand."

Luciana Tornovsky said there is no rule of thumb to resolving pre-LOI issues. "It must be on case-by-case basis depending on negotiation process." Typical areas of contention are – exclusivity, valuation and access to information in preliminary stages of due diligence. "Some LOIs are more complex than others," Tornovsky said. "I've seen short [ones], only 3 pages, [and] some that only establish the price. Others are much more complicated – more terms and conditions, covering areas like employment agreements after the close."

"The LOI is not a binding document, except for the confidentiality and exclusivity obligations for a limited period of time," says Silvia Sorribas. "The purpose of the LOI is to cover the relevant interests of the parties at this stage regarding all the due diligence process. One important point to this respect is to regulate the right of the parties to terminate the process. The level of liabilities or freedom could be different in each case, depending how the negotiations have been carried out and the level of knowledge of the acquirer on the target company before the signing of the LOI. In case the potential acquirer is a competitor, the due diligence process should be driven in a particular way to protect the interests of the target company in case the transaction is finally aborted." Sorribas adds that, in cases where the target is privately held or a family-owned enterprise, regardless of size, "There are different vectors that influence in the decision to sell and that should be taken into account and respected for the success of the deal, including the personality of individual shareholders. In the same way, in publicly held corporations it is very important to cooperate closely with the management team in order to correctly explain the strategy and motivations for concluding the transaction before the general shareholders meeting."

"Negotiation styles vary tremendously across Europe", observed JZI's Torben Luth. "If you're in the UK, it's very much like in US. It's very straightforward. In Southern Europe there are a lot of softer points – you really have to have the chemistry in the right place to get a deal done. In Northern Europe you have to

understand the things that have not been said. If you listen very carefully you'll find them underneath – and these are usually things that are more important to the seller. Eastern Europe is becoming very Americanized. Most of the local PE funds there are often managed by people who are American-educated. It seems like the American culture is pretty widespread in Eastern Europe – but that might be a generalization."

This chapter began with a comparison of the LOI to a proposal of marriage, and in the next chapter we detail the steps to the altar. The engagement/marriage analogy is not quite as apt in the world of private equity, where the time horizon for an investment is 3-5 years typically. But even private equity expert Giles Derry says it's close – "Like a marriage, it's built on trust and mutual respect. I never think of the LOI as a proposal, but I do think about the ongoing relationship as something that needs work from both sides as long as they are together."

"It's a condensed proposal to marry," Jennifer St. Pierre says of the LOI. "Yes, you're trying to figure out when I make this commitment that both of us are going to have to put forth a great amount of effort to get to the closing. We're going to be engaging with third-party firms. We'll be pulling people from day jobs to work on this so we can refine the business plan and harden the integration plan. Both of you truly need to be committed. If it's only one-sided, the time from LOI to closing will drag on and it will not be a good partnership."

Observes PwC's Julian Brown: "If you've got someone who's got a bunch of different suitors, it drives out the importance of the relationship between the ultimate buyer and seller. The seller is definitely looking for someone who will make a commitment. Where it's dangerous to compare it to a marriage proposal is if it gets emotional or you get caught up in 'what are other people going to think about it?' Don't get wrapped up in deal fever. You've got to be level-headed. And this is the key – if you're buying 100 percent – you're not getting married – the guy on the other side is gone and you own the company now."

The LOI as a marriage proposal is "an accurate statement," says Charles Otton of UBS. "People can get out of it, but it will cause a lot of difficulty and bad will, and companies that move out of LOIs cause significant tension."

JZI's Torben Luth says he uses the engagement/marriage analogy in his deal discussions. "We tell our partners you better make sure we can sit in a meeting

and we can have a very tough and frank discussion and be honest about what is best for the company going forward. And after we've had a drag-down discussion we can still [go] to the pub, understanding we have the company's best interest at heart."

Brazilian attorney Luciana Tornovsky says the LOI is "kind of, not completely" like a marriage proposal: "The LOI is usually non-binding. Marriage I think of as more concrete. But on the other hand, it could be seen as a proposal since it establishes the term and conditions for the transaction to occur."

Dissenting completely from the majority view that the engagement/marriage analogy holds was Silvia Sorribas of KMPG Barcelona. "Personally, I've never would make such a comparison… at least based on my personal experience in both matters. A LOI is addressed to establish the basic parameters of the deal and sets the beginning of the due diligence process. When my husband popped the question, no parameters were established, and the due diligence was already done earlier – at least my due diligence!"

Conclusion

Today's dealmakers are looking global more often than any time in history. Nearly half of the value of M&A activity in 2015 was cross-border. After establishing a strategy that includes cross-border components, successful dealmakers employ a variety of best practices to source their deals in other regions. Utilizing a combination of outsourced local talent and/or in-house corporate expertise, M&A practitioners investigate, negotiate and hold management meetings at a fast pace. Negotiating styles and tactics vary by region and culture. Management meetings are essential to developing good chemistry between the buyer and seller. The go or no-go decision to proceed to the Letter of Intent is usually based on valuation and the chemistry developed between the management teams. In the end, most M&A practitioners interviewed for this chapter likened the LOI to a marriage proposal.

In the next chapter of the 4th Edition of *Best Practices of the Best Dealmakers*, faculty members of the M&A Advisor will share insights on the next phase of the deal process – the due diligence leading up closings. As always, readers are invited to share their views and experiences on these topics.

CONTRIBUTORS' BIOGRAPHIES

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Julian Brown is a Managing Director at PwC. Julian heads up the East Coast operations of PwC Corporate Finance LLC. Prior to his move to the US, Julian gathered more than 20 years' experience in deal origination and execution in Europe, South America and Canada. He has advised clients ranging from large listed multinationals to family-owned businesses on their M&A and financing transactions in a wide range of sectors. In a trade best learned by experience, Julian has advised families, corporates and PE clients on their successful completion of more than 50 buy-side and 80 sell-side transactions. Julian's career with PwC began in Spain, where he built the Firm's Corporate Finance practice from a zero base to a successful cross-sector team of 25 investment banking professionals focused on deals typically in the $50 million to $500 million range. In 2011, Julian moved to Canada to restructure and lead a team of some 50 investment bankers focused on the same market segment and across all sectors. Julian moved to New York in July 2014 to head up the East Coast operations of PricewaterhouseCoopers Corporate Finance LLC.

Giles Derry is a Partner at Dunedin. Giles joined Dunedin, a leading private equity firm specializing in the UK mid-market, in 2005. He has overall responsibility for origination at Dunedin. He has a particular specialty in the Financial Services and Business Services sectors. He was involved in the buyouts of Blackrock PM, Red, Formaplex and Enrich, and sits on the board of Blackrock PM. He was also Chairman of the ICAEW Corporate Finance Faculty. He has a degree in natural sciences from Durham University and qualified as a chartered accountant with Arthur Andersen in 1996. He worked in the Financial Markets practice and the Corporate Finance department before moving to Sand Aire Private Equity in 2000. When not in the office, Mr. Derry likes to take part in challenging charity events. In previous years he has crossed 200 km of the Arctic Circle on sledges with huskies, completed the Artemis Great Kindrochit Quadrathlon, and this year completed the Raid Pyrenean, a 720 km cycle from the Atlantic to the Mediterranean in under 100 hours! He also enjoys swimming, skiing, cooking and spending time with his wife and three daughters.

Torben Luth is a Partner at JZ International, which is based in London with an office in Madrid. He is responsible for deal sourcing as well as pre and post deal completion relationship with targets and brokers. JZ International has completed over 50 transactions in Europe since 2002, focused primarily on family-owned businesses with an EBITDA between $3 and $20 million. Prior to joining JZ International in 2001, Mr. Luth served as Director of European Development at Jordan Industries Inc, where he helped their US portfolio companies create and execute their European business strategies. He also assisted their European portfolio companies as they developed and implemented strategies involving US expansion. Prior to joining Jordan Industries Inc, Mr. Luth was the Special Advisor to the Danish Ministry of Trade and Industry in the Invest in Denmark department, which is the governmental body that focuses on creating jobs in Denmark through international corporate expansion. Mr. Luth started his career as the founder of a graphic arts equipment manufacturing company. He sold that company after 8 years at which point it had sales in over 50 countries around the world. He holds an MBA from Robert Kennedy College in Zurich, Switzerland.

Charles Otton is a Managing Director and Co-Head of the Global Industrials Group, Americas at UBS. He has 21 years within UBS and the investment banking industry, serving for 10 years in London and the past 11 years in New York. He has extensive experience in M&A, equity and debt transactions in the aviation, transportation/travel, capital goods and infrastructure sectors. He has advised on transactions in North America, Latin America, Europe and the Middle East.

Silvia Sorribas is a Partner at KPMG. Silvia, based in Barcelona, Spain, is an M&A and corporate lawyer who has more than 25 years of legal experience advising companies, both national and international, listed or relatives, with experience in corporate advisory, commercial contracts, corporate restructuring, mergers and acquisitions, shareholder agreements and joint ventures, venture capital, investment services companies and collective investment, corporate governance and capital markets. She began her career at Garrigues Abogados (1,700 professionals) in 1990, and in 2004 she was promoted to partner. She was the first woman of the firm promoted to partner in Barcelona and the third of M&A on the corporate law department in Spain. She joined KPMG as a partner in May 2004. She is a graduate of the Management Program at the international business school IESE (2010).

Jennifer St. Pierre is Vice President, Corporate Development, at EMC. Since joining Corporate Development in 2008, Ms. St. Pierre has led over $5.7 billion in software and other technology acquisitions. She has been responsible for helping accelerate EMC's growth by investigating and executing on market opportunities that align to the strategies and objectives of the company's business unit and board. She works closely with and advises EMC's executive management team and EMC's business units and associated businesses on strategy execution through mergers and acquisitions, strategic investments, creative business structuring, business plan development, transaction execution, integration and tracking. Ms. St. Pierre joined EMC in 2006 through the Finance Training Program, working in the Internal Audit Department before joining Corporate Development. She holds a MBA from Bentley College, and a Bachelor of Science in accounting from the University of Massachusetts at Lowell.

Luciana Cossermelli Tornovsky is a Partner at Demarest Advogados, a law firm in Sao Paulo, Brazil. She specializes in Mergers and Acquisitions and Corporate Law. Luciana Tornovsky worked as a lawyer in the Latin America practice group at the US firm Gibson, Dunn & Crutcher, LLP, in New York, NY, from August 2000 through March 2002. She is a member of the International Trade and Foreign Relations Commission of the Brazilian Bar Association, São Paulo Chapter (OAB/SP), and of the International Bar Association (IBA). She is the author of the chapter "Contracts in International Trade" (Contratos no Comércio International) in International Trade Law (Direito do Comércio Internacional), coordinated by Antonio Carlos Rodrigues do Amaral, published by Aduaneiras, 2004; the chapter "Brazil" in Securities World 2005 – Jurisdictional Comparison, published by European Lawyer, 2005, and the chapter "Limited Liability Companies, Corporations, and Other Legal Entities" in Business Laws of Brazil, published by West, 2009-2010. She has also had some articles published: "Takeover under Brazilian Law", published by IBA Magazine, October 2003; and "Shareholders' Agreement for an Indefinite Term" (Acordo de Acionistas por Prazo Indeterminado) on the BM&F BOVESPA website, June 2010. Ms. Tornovsky has been the vice-president of the Harvard Law School Association of Brazil since 2006. She is currently a member of the Harvard Business School Angels of Brazil and co-chair of Harvard Women Alliance in Brazil.

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