THE M&A ADVISOR

THE M&A ADVISOR SYMPOSIUM REPORT

MAY 2014

Featuring

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Columbia University

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BEST PRACTICES OF THE BEST CROSS BORDER DEALMAKERS

At The M&A Advisor's International Financial Forum in New York this spring, veteran dealmaker Marshall Sonenshine, Chairman at Sonenshine Partners, moderated a revealing examination of the complex environment for global M&A. A panel of dealmakers with an array of expertise, including communications and politics, discussed the need for both a global and localized approach to foundation building for successful cross border M&A transactions. The brisk but incisive session addressed:

- The challenges and opportunities of emerging market M&A
- Localization, a form of protectionism in markets where M&A activity has increased
- Ramifications of an increase in social pressure emanating from the growth of the middle class in emerging markets
- Coping with governance issues in China
- Early inclusion of local political risk calculations into dealmaker due diligence in cross border transactions

With cross border M&A activity expected to increase steadily in the years ahead, understanding local political and business cultures in the world's emerging markets can often spell the difference between a fruitful acquisition and a deal that fails when it ought to have succeeded.

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Table of Contents:

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EXECUTIVE SUMMARY

With cross-border M&A deal flow on the rise worldwide, U.S. companies looking to make overseas acquisitions – and non-U.S. companies seeking acquisitions in the U.S. – often find themselves in political and economic environments to which they are unaccustomed and for which they may be unprepared. The result, too often, is that unanticipated local factors can result in unsuccessful transactions. Increasingly, dealmakers are seeking ways to familiarize themselves with conditions on the ground in the geographies in which they wish to become active.

At the 2014 M&A Advisor International Financial Forum in New York, a panel of experienced cross-border dealmakers examined the need to better prepare U.S. buyers for the rigors and complexities of the political and business environments in emerging markets in order to take maximum advantage of the increase in cross border M&A activity.

The symposium participants included:

Marshall Sonenshine, Chairman, Sonenshine Partners; Professor of Finance and Economics, Columbia University (Moderator)
Michael Henson, Managing Director (London and New York), Sard Verbinnen & Co.
Brenen Hofstadter, President, Supervising Principal, Generational Capital Management
Nicole Y. Lamb-Hale, Senior Vice President, Albright Stonebridge Group
Andrew Rice, Senior Vice President, The Jordan Company

The panelists exchanged observations about the state of cross border M&A in a post-financial crisis environment in which global transactions are increasingly common but also increasingly complex. The session moved briskly as the dealmaker panelists addressed an array of issues, including:

• The challenges and opportunities of emerging market M&A
• Localization, a form of protectionism prevalent in many geographies where M&A activity has increased
• The deal ramifications of an increase in social pressure emanating from the growth of the middle class in emerging markets
• Coping with governance issues in China
• Early inclusion of local political risk calculations into dealmaker due diligence in cross border transactions

Moderator Marshall Sonenshine set the tone for the session by citing his recent M&A experience in order to highlight his theme for the session: the M&A environment overseas is changing fast thanks in part to the presence of new buy and sell side participants. In just the past two years Sonenshine Partners closed on the sale of a piece of Blue Cross Blue Shield to an Italian company and represented a German technology company, RTT, in its sale to a Dissault Systemes, a French tech company. In the same timeframe, Sonenshine Partners, in order to take e-tailer 1-800-CONTACTS private, sold pieces of it to companies in Japan and Korea. In China, the Sonenshine firm represented Alcoa in the sale of redundant manufacturing assets to Yunnan Metallurgical Group Co., Ltd. As a result of the current global M&A scene, Sonenshine said, “We do deals now that would have been considered uncharacteristic a few years ago.”

Sonenshine asked each of the panelists to capsulize their day-to-day emphasis as they seek to adapt to the evolving global M&A paradigm.

“My overall daily objective is to devise ways to help stamp out localization and protectionism worldwide,” declared former Obama Administration Assistant Commerce Secretary Nicole Lamb-Hale, now a Senior Vice President at Albright Stonebridge Group, an international business consultancy headed by former Clinton Administration Secretary of State Madeleine Albright. Lamb-Hale’s firm specializes in “commercial diplomacy,” helping U.S. companies overcome market access challenges, mainly in emerging markets, presented by burgeoning “localization,” a localized form of protectionism which Lamb-Hale calls the 21st century’s major barrier to trade. “We help design transactions so that U.S. companies don’t find themselves, as they approach close, in a situation in which there are government or civil society actors who are trying to kill the deal.” In emerging markets, she explained, “the government always has its finger on the scale, an inescapable factor that has to be incorporated early in every transaction.” She employs stakeholder mapping to account for a transaction’s stakeholders, helping companies sequence their approach to these individuals whose influence and impact can be crucial to a deal’s success – or failure. Stakeholder mapping, she added, is especially effective in China, for example, where there are multiple stakeholders on the national and provincial levels. “If you don’t know who they are they can come up to bite you in a way that you don’t want to be bitten,” she pointed out.

> “We do deals now that would have been considered uncharacteristic a few years ago.”
> – *Marshall Sonenshine*

Andrew Rice is a China veteran, having spent 25 years mastering the subtleties of doing business there. Rice has spent those 25 years at The Jordan Group, a middle market private equity firm where he is Senior Vice President. “Initially, we were helping companies that export overseas to develop sales, marketing and distributor sourcing,” he said. “At first, we were only helping our U.S. portfolio companies to follow their customers overseas. Portfolio companies that were going to Brazil, India, Russia or China wanted their U.S. suppliers to follow them. My team worked with their operating groups to help them think through that." Eventually, The Jordan Group wanted to develop its own greenfield operation – a form of foreign direct investment in which a parent company begins a new venture in a foreign country by constructing new operational facilities. Ultimately, Rice explained, about half of his firm's activities consisted of strategic acquisitions that provided entry to specific Chinese markets. Active in Russia, India and Brazil in the late 1990s, along with Mexico, the Czech Republic and Malaysia, The Jordan Group decided 10 years ago to focus the bulk of its international support on China. "In the 1990s, Russia had the same governance issues as today. Brazil would experience two years of growth followed by currency devaluation. Also, economic woes in neighboring Argentina would flow into Brazil."

A timely and effective communications strategy is an intrinsic part of successful M&A deals, domestic and foreign. For companies that are inexperienced in emerging markets, close monitoring and management of investor and third-party sentiment are especially crucial ingredients. Michael Henson specializes in public communications -- to the investor community and third party influencers such as the financial press -- pertaining to international transactions, including M&A. Henson is a Managing Director in the London and New York offices of public relations/crisis communications firm Sard Verbinnen & Co. In M&A transactions his firm becomes involved early to help the bankers, the lawyers and the company to articulate the strategy and develop a public communications plan. "Is this a deal for growth? Is this a deal aimed at achieving economies of scale? We'll work the communications process until and through the announcement, devising the messaging and bringing it to the public," Henson explained. In hostile scenarios and shareholder activism, he added, "When there is a public negotiation over value, we act as public litigators on behalf of our client." The issues of localization and protectionism to which Nicole Lamb-Hale referred, Henson said, "are what we have been seeing more and more as real deal risk factors as companies try to do large or middle market cross border transactions where there are political and regulatory risks that aren't recognized either by the acquirer or the acquirer's investors. We've seen these risks result in failed deals."

"When there is a public negotiation over value, we act as public litigators on behalf of our client."
– Michael Henson

Moderator Sonenshine asked the panelists, "We're half a decade past the most severe global financial crisis in 75 years, but where are we now in terms of global political and financial risk? Are we facing another Cold War? Are we in a vibrant market for cross border activity or a dangerous market?"

"Certainly the crisis in the Ukraine is the major geopolitical crisis of the moment," Nicole Lamb-Hale acknowledged, "and we are as yet unsure about the impact escalating sanctions could have on dealmakers. What's known is that when the next hammer comes down – and sanctions are imposed on a sectoral basis – it will impact the world's global supply chain and every one of us in this room."

Lamb-Hale cited three current trends she believes will affect cross border dealmaking: the increase of localized protectionism; and the intensifying social pressure emanating from the growth of the middle class in some emerging markets and the fruition of new trade agreements currently in negotiation. Localized protectionism, she re-emphasized, will create more headaches for all participants in emerging market cross border transactions. “The opportunities in those markets can best be realized with the right local partners,” she declared. “Working with advisors to help you identify those partners will be critical because, as much as I fought against these proliferating policies when I was in U.S. government service, the truth is that if you want to do business in these countries you need to play that game.” Enforcement of two trade agreements that are currently in the negotiation stage, she added, will likely be a boon to cross border transactions. If finalized, the Trans-Pacific Partnership will represent 40% of global GDP. The Trans-Atlantic Trade Investment Partnership, she points out, emphasizes regulatory convergence in order to lower multiple regulatory hurdles for dealmakers in Europe.

> “Working with advisors to help you identify those partners will be critical.”
> – *Nicole Lamb-Hale*

Five years after the global financial crisis, Andrew Rice sees a continuing reluctance among his firm’s portfolio companies to revive pre-2007 plans for China expansion. “Many of our companies saw quarterly sales drops of 25% or more when the financial crisis took hold. They went into survival mode and had to make difficult decisions on cuts in order to remain afloat. Most of these companies are still striving to get back to where they were pre-crisis.” For them, Rice added, international expansion has not been a priority.

In China, he continued, non-Chinese acquirers have encountered valuation gaps when they have attempted to buy Chinese companies. “The good news is that more and more owners of Chinese companies are willing to yield control if it’s a strategic deal.” Stand-alone deals, however, remain difficult, Rice cautions.

Moderator Sonenshine pointed out that in a move that has inspired some controversy in the U.S., China has revalued the renminbi upward by 2.5 points. Rice Replied, “China is on track to increase the valuation of the renminbi, which has already appreciated about 35% in the past 7-8 years.” Chinese wages double every five years, he said, “so the costs of products and services in China are increasing.” The Chinese, he emphasized, “are very smart. They know that nearly every economy that has opened its currency up for free trading has collapsed and then over time has been rebuilt. The Chinese are going to let their currency appreciate very slowly and deliberately in order to avoid the collapses that have plagued other economies.” Even though the U.S. runs a trade imbalance with the Chinese, “in most years China’s imports exceed its exports.” Rice pointed out that for every dollar that China exports about 80 cents is dedicated to importing raw materials or components. From the Chinese perspective, he said, Chinese imports and exports have maintained a balance that in the past 10-15 years has been regarded as satisfactory by the Chinese, if out of alignment with the U.S. "But I'm not worried about that," Rice remarked.

According to Sard Verbinnen's Michael Henson, in the post-financial crisis environment, companies with cash-laden balance sheets and investors urging them to deploy that cash should articulate a clear capital allocation strategy to investors when planning an acquisition "because investors often believe that instead of a risky cross border transaction where benefits might not be realized for months or years, a company ought to do a share repurchase and deliver immediate value." For U.S. companies, he added, "that's a hard card to fight in this environment."

"The Chinese are going to let their currency appreciate very slowly and deliberately to avoid the collapses that have plagued other economies." – *Andrew Rice*

Henson urges U.S. companies considering, a cross border acquisition outbound into Europe, the Middle East, Africa or China to determine where risk abides, although the concept of risk-laden growth is often alien to U.S. investors and money managers. "A portfolio manager for Fidelity in Boston might not have the same tolerance for risk in China, Eastern Europe or Russia as a portfolio manager in London who takes a more global perspective and is comfortable with the risk level in those regions." Henson encouraged U.S. corporate buyers looking to buy growth in a foreign market to ask and answer the following question: "Can I convince my investors that this growth is worthwhile and trumps any potential future deal risk caused by regulatory pressure or integration issues?"

Henson cited the failure of what would have been a landmark cross-border transaction as an example of the destructive power of unanticipated risk. Had the deal closed, it would have marked the largest-ever acquisition of a U.S. company – Cooper Tire & Rubber Company – by an Indian company, Apollo Tyres. A dispute with a U.S. labor union, and the reluctance of a Chinese joint venture partner to sell its share of the venue, scotched the transaction, leaving the companies to battle in court over a break-up fee. The aborted Cooper-Apollo deal, plus others, including the pending merger of Swiss cement maker Holcim Ltd. with its French rival, LaFarge SA, represent a consolidation trend among major sector competitors worldwide. Said Henson, "The Holcim-LaFarge transaction appears to be largely about survival in Europe. They are two large champions that are coming under increasing cost pressure in the region. They're looking at that pressure and are saying, 'We are either going to come together and survive, or we give up Europe altogether.' He said that he expects to see a continuation of the consolidation trend among growth-chasing European telecom companies that took shape last year.

The Japanese economy has also been stagnant – for more than 20 years. Cross border M&A transactions rose briefly there last year, thanks to a few large deals. In 2014, Japanese companies are being acquired by U.S. buyers, a startling reverse from the 1980s and early 1990s. Nevertheless, the Japanese economic needle has barely moved.

Until recently, Brenen Hofstadter, President and Supervising Principal at Generational Capital Management, had never ventured into Japan. In a deal that closed in the early spring of 2014, Hofstadter and Generational Capital Management sold a U.S. company, W.B. Johnston Grain of Tulsa, OK, an intermodal transportation solution provider, which builds grain elevators for wheat, milo and frac sand – the latter represents a growth market for the company -- to two Japanese companies. W.B. Johnston moves product via train, truck and a network of ports. The transaction, according to Hofstadter, was anything but a straight-line deal.

"We're agnostic when we take a deal to market," Hofstadter said. "We'll market a company to Canadian, U.S. and global enterprises." He anticipated attracting international buyers, he said, but their initial offers fell short of his client's expectations. At that point the action taken by Hofstadter and his team caused the now-moribund sale to pivot from non-deal to deal. "We did something I've never done in my career: we took a step back to find out why we came up so short. Was it because we were transacting in two different spaces – port operations and grain?"

> "It became clear that certain buyers were valuing the grain asset much higher than the port and vice versa."
> *– Brenen Hofstadter*

During the ensuing month Hofstadter conferred with prospective buyers to better understand their valuation motivations. "It became clear that certain buyers were valuing the grain asset much higher than the port, and vice versa. We ended up splitting the business in half, transacting the port side with a U.S. company at a price that was pleasing to our client." A month and a half later, the grain side was sold to Consolidated Grain and Barge, an enterprise owned by two of the largest Japanese agribusiness entities, Zen-Hoh Grain Corporation and Itochu International Inc. Like U.S. buyers, the two Japanese entities, he explained, focused on the usual M&A metrics: EBITDA, growth and customer diversity. What Hofstadter quickly learned, however, "was that the real motivation behind this transaction, and the reason they paid a premium and closed, was that for Japanese companies, securing food sourcing is on a par in importance with national defense. "Because they have limited agriculture of their own, Japanese agribusiness is pressing hard to acquire companies that possess the relationships like my client has, with the farmers and with the distribution channels, to secure large amounts of food sourcing," Hofstadter noted.

Brenen Hofstadter's account spurred Marshall Sonenshine to recall the strategy his firm employed when it took e-tailer 1-800-CONTACTS private several years ago. "The only way to take the company private was to get rid of the loss-making manufacturing operations," Sonenshine said. Ultimately, the manufacturing operations were sold to two Asian companies, Medicon Pharmaceuticals, Inc. in Japan, a private company, and Miwon, a Korean company. "That strategy unleashed the profit flows so that we could bring in a private equity firm," Sonenshine recalled.

In their closing comments, the panelists offered up the following best practice pearls for the audience of cross border dealmakers:

Andrew Rice urged dealmakers to deploy their advisors early in cross border deals. “Often dealmakers don’t want to get the lawyers and accountants involved until late in the process. I highly recommend that you do that sooner rather than later.” Like Nicole Lamb-Hale, he encouraged dealmakers to become familiar with local practices and stakeholders and to remember that “most of these individuals and companies want to have proper compliance and proper controls. They want to go to the next level and they are looking for U.S. Fortune 1000 and private equity firms to help them become better companies.”

“Often dealmakers don’t want to get the lawyers and accountants involved until later in the process. I highly recommend that you do that sooner rather than later.”
– Andrew Rice

Beyond the implementation political risk assessment at a transaction’s front end, Lamb-Hale recommended that cross border dealmakers become involved in post-close corporate social responsibility activities in overseas locales. “You need to consider in-country CSR opportunities, aligning your activities with the priorities of the governments of those countries.” Inevitably, she added, “you are going to run into a bump in the road and will need individuals who will be your champions in that market. If you’re viewed as someone who is taking and not giving you will have problems.”

Cautioned Michael Henson, “If you are a public company – or even a private company – don’t take your investors or your limited partners for granted. Don’t believe, going in, that they are automatically going to appreciate and support what you are doing. They may, but they may not. Having an ongoing dialogue with your investors, and perhaps your limited partners, about why you’re involved in an M&A deal in a foreign market, convincing them that you understand the political risks, that you understand the deal risk and that you are not just chasing a transaction for the sake it. Make sure that you are communicating with them so that there are no surprises.”

The spirited session reflected general awareness of and concern about the political and financial risks associated with cross border emerging market M&A transactions and about the opportunities that may abound in those markets if the attendant challenges and risks are assessed, understood and dealt skillfully and with dexterity.

To watch candid interviews with industry stalwarts on the "Best Practices of The Best Cross Border Dealmakers" click on the photos below

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To watch the "Best Practices of The Best Cross Border Dealmakers" Symposium Session click on the photo below

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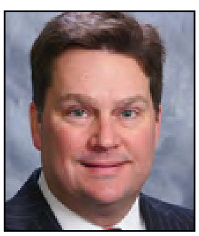
FACULTY PROFILES

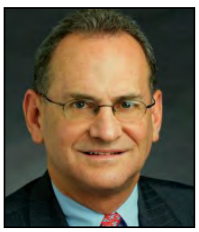
Marshall Sonenshine is currently the Chairman and Managing Partner of Sonenshine Partners. Mr. Sonenshine began his pursuit of the M&A middle market industry at Solomon Brothers where he handled M&A and corporate finance assignments. In 1996, he joined BT Wolfensohn as a partner handling media and transportation M&A. He is known for advising transactions for some of the largest companies in the nation. Sonenshine has lead teams closing deals as large as $20 billion. In addition to Sonenshine Partners, Marshall dedicates his time to educating the future leaders of M&A at Columbia Business School. He is also Vice Chairman of the Board of Arts Connection, and trustee and member of the Executive of the International Center of Photography.

Michael Henson is a Managing Director in London and New York and founding member of SVC's London office. He has extensive experience advising clients on cross-border and domestic M&A transactions, proxy contests / shareholder activism, regulatory investigations / litigation, and other special situations. Michael has particular expertise acting on behalf of clients in the natural resources, energy, healthcare, and financial services sectors. Prior to joining the firm, Michael was a Managing Director at Taylor Rafferty, a cross-border financial communications and investor relations consultancy, where he headed the transaction, special situations and financial media relations practice. While at Taylor Rafferty, Michael advised certain leading British, Russian, and South African companies on M&A, regulatory, and crisis matters. Michael attended McGill University and holds a B.A. with honors in Philosophy.



Brenen Hofstadter is President and Supervising Principal of Generational Capital Management (GCM). He has 20 years experience selling privately held companies across the U.S. and Canada. Prior to joining GCM, he was a partner of a boutique M&A firm specializing in the engineering industry. Prior to that, he was with Citigroup Capital Strategies for 13 years as an Associate Vice President and Managing Director. Mr. Hofstadter led the Generational Capital team that won M&A Advisors' 2012 International M&A Award for its sale of Tarasoft to CoreLogic, as professional services deal of the year, Mr. Hofstadter earned his MBA from the University of South Florida.

Nicole Y. Lamb-Hale is a Senior Vice President of Albright Stonebridge Group, a leading global commercial diplomacy and strategic advisory firm. With more than two decades of professional experience traversing the private and public sectors, Ms. Lamb-Hale provides strategic advice to companies as they develop and implement their global business objectives, including the expansion of their exports to, and presence in, international markets. Ms. Lamb-Hale served in the Obama Administration as the Assistant Secretary for Manufacturing and Services in the Department of Commerce's International Trade Administration (ITA). Ms. Lamb-Hale also served as the Department's lead on the Committee on Foreign Investment in the United States (CFIUS). Prior to serving as Assistant Secretary, Ms. Lamb-Hale was appointed by President Obama to serve as the Deputy General Counsel for the U.S. Department of Commerce. Prior to government service, Ms. Lamb-Hale was a Partner in the law firm of Foley & Lardner LLP. A member of the Council on Foreign Relations, Ms. Lamb-Hale attended the University of Michigan where she studied in the Honors College and earned her A.B. with high honors in political science in 1988. She earned her J.D. from Harvard Law School in 1991.



Andrew Rice is Senior Vice President at The Jordan Company. Mr. Rice joined an affiliate of TJC in 1989. He has held numerous strategy, international business development and investment positions. Mr. Rice has participated in over 45 acquisitions, joint ventures and greenfield start-ups all over the world. Mr. Rice is actively involved with TJC's investments in China and coordinates development activities for TJC's North American portfolio companies in China. He is Immediate Past Chairman of ACG Global and serves on the board of the U.S. China Chamber of Commerce. Mr. Rice holds a B.S. degree in Industrial Engineering and an M.S. degree in Engineering Administration from New Mexico State University. He also completed one year of graduate studies in international economics at the University of Melbourne, Australia, where he studied as a Rotary Foundation Graduate Fellow.