Going West…

Maximising success with Western European vendors

crossboarder

With a burgeoning appetite and increasing competition among companies and institutions from Emerging Markets (EM) for acquisitions and alliances in Western Europe, prospective buyers must ensure that they position and present themselves in the best possible light when approaching Western European vendors, in order to obtain access to transactions and maximise their chances of completing a successful deal.

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 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. There are fundamentally strong, under-geared EM companies that are looking to acquire Western European targets. Having established themselves domestically as successful enterprises, they will continue making acquisitions abroad.

The falling valuations of some Western European companies, and the distressed position of others, could provide imminent acquisition opportunities. While it is important to tailor your decision-making process in order to respond quickly to such accelerated opportunities, it is equally important to be selective in your investments or acquisitions and identify quality companies that will help you meet your long-term strategic goals.

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 may feel that they are included in a sale process only as an option of last resort, after the vendors have tried and failed to offer their company to Western European trade and financial counterparties.

What can EM enterprises do to improve their chances of success? What do you need to know about doing deals in Western Europe and how can you present your investment proposition in the best possible light, in order to ensure you are perceived as a credible and valuable bidder?

Whereas the transaction lifecycle will be broadly similar to dealing with other EM targets, there are notable differences 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 might consider taking in order to bridge these differences and improve your chances of obtaining better access to relevant opportunities.

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

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.

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

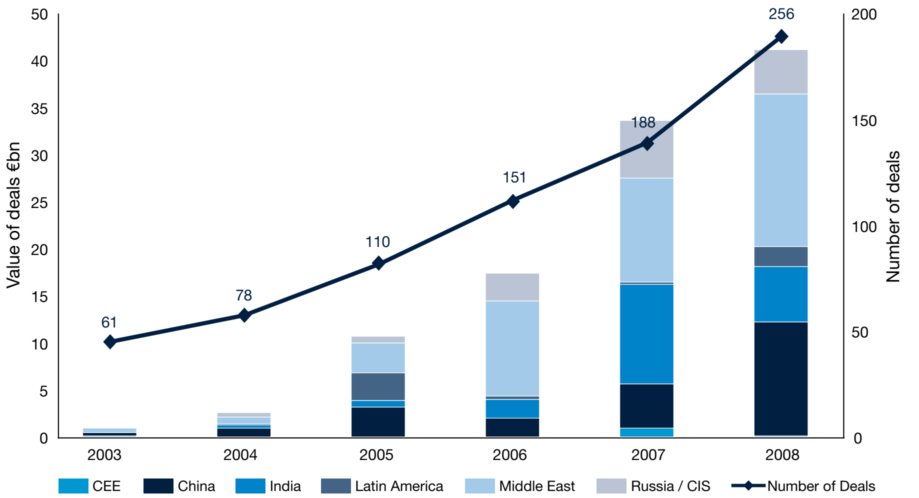
M&A trends and deal drivers

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

M&A activity by EM entities acquiring Western European targets has increased over the last six years, totalling some 844 completed M&A transactions with an overall value of nearly €120bn. 2008 encompassed a record year with 256 completed 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

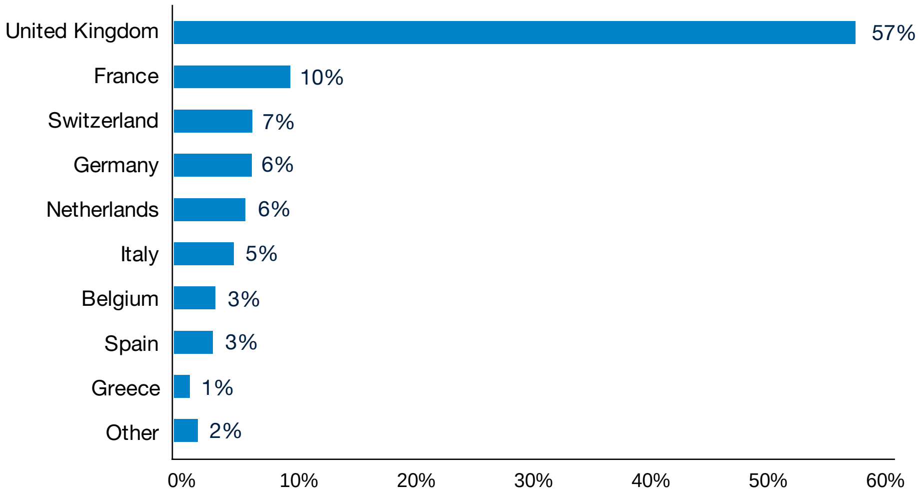


Source: Dealogic January 2009

Middle Eastern corporations 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.

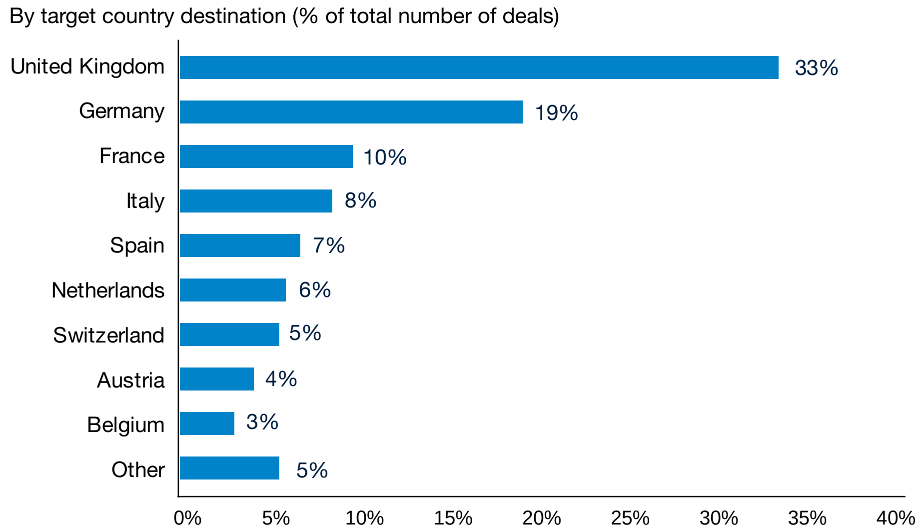
M&A Activity 2003-2008
Emerging Market Acquirers / Western European Targets

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 as a result some are expected to 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 or 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.

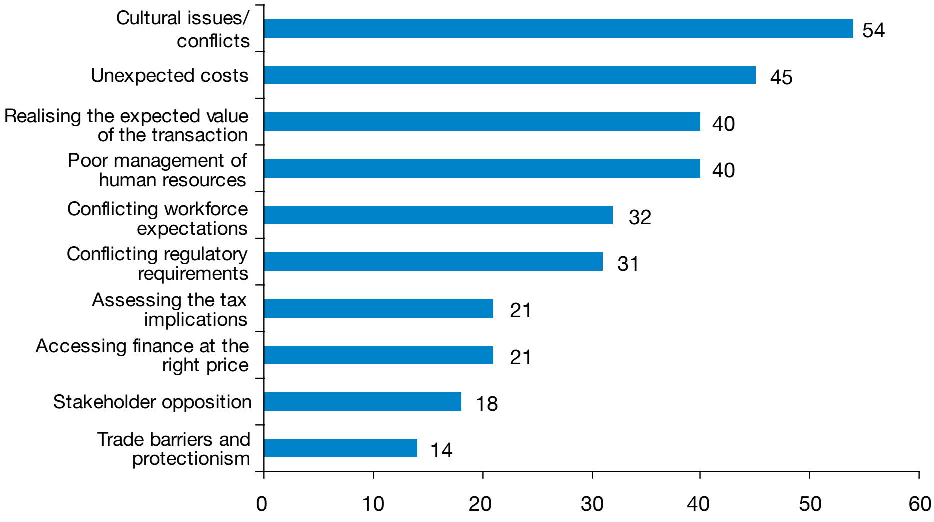
We believe that transactions in 2009 and beyond will be driven by fundamentally strong EM buyers looking for Western European acquisitions. This activity will be motivated by many factors including market expansion, backward / forward integration, knowledge and technology acquisition, economies of scale, 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 in cross-border M&A.

Key obstacles for cross-border M&A



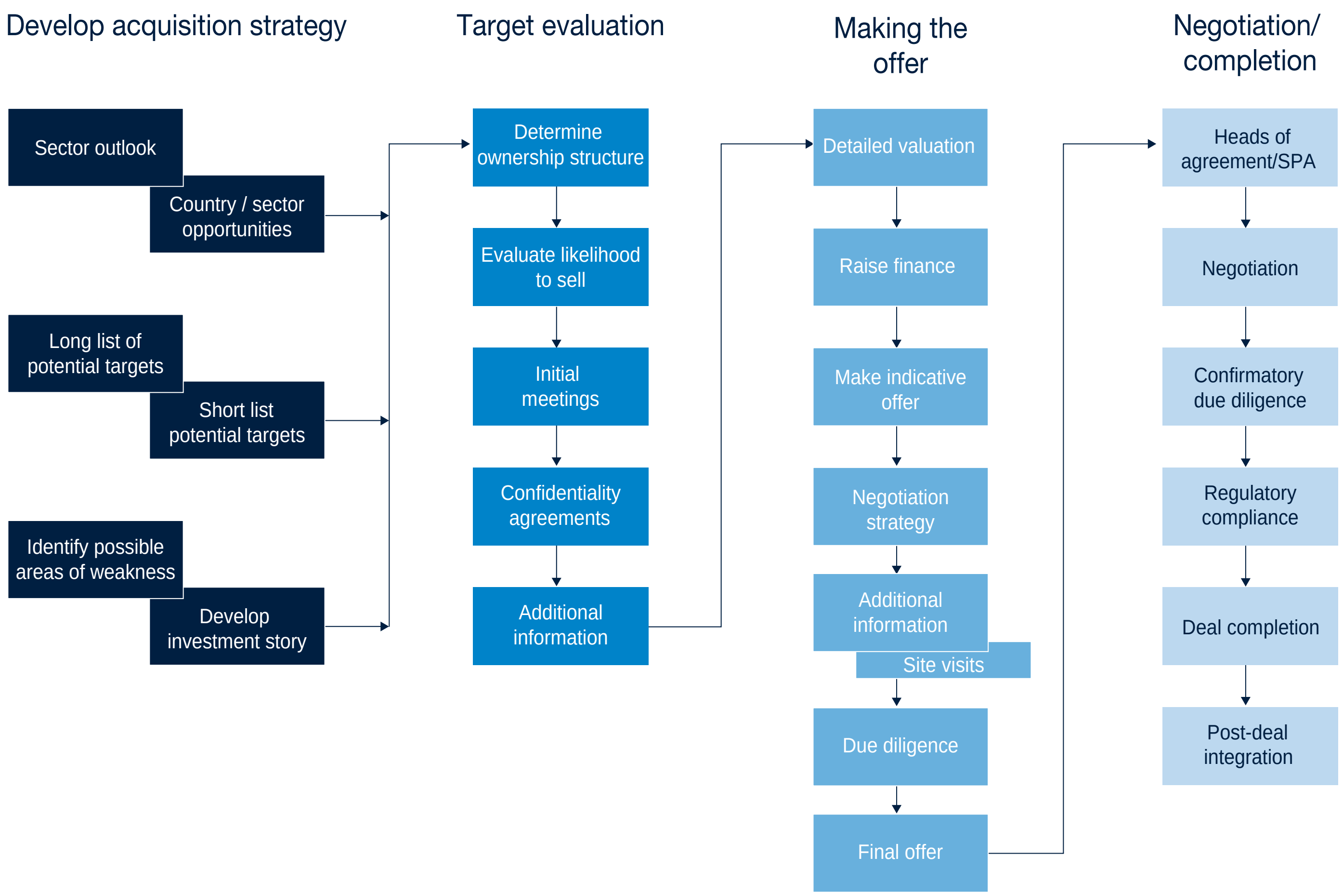
Source: PwC Global CEO Survey 2009

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. However, Western European vendors often have concerns about the ability of EM buyers to deliver on their side of the deal; such concerns must be allayed if a deal is to complete successfully.

The remainder of this document provides some insights on the steps that an EM acquirer should consider in order to be perceived as a credible bidder to obtain access to Western European deals and maximise their chances of completing successful cross-border transactions.

Tailoring your acquisition strategy towards Western European vendors

Typical Western European Acquisition Process



Identify target companies in Western Europe

The process of identifying possible target companies in Western Europe is similar to the one you would normally conduct in your domestic market – you could either perform a 'top-down' analysis and filter the companies yourself, or you could use advisors who would be able to inform you quickly about specific opportunities and potentially attractive targets.

In a 'top-down' approach, one question to bear in mind from the outset is whether the sector is considered to be of 'strategic importance' in that particular target country and hence protected from acquisitions by foreign companies. From a Western European perspective, the concern is that EM investments, particularly by SOEs and SWFs, may be motivated by political (as well as economic) rationale. This will mean that foreign buyers will need to seek government approvals when considering acquisitions in those sectors, which can be time-consuming and difficult to obtain.

Such pre- or mis-conceptions can prevent Western European vendors from approaching relevant EM acquirers and giving them the opportunity to bid for their assets.

You will need to perform a critical analysis of your own organisation.

Identify possible areas of strength and weakness in your company

Reflecting attention back to your own entity, you will need to perform a critical analysis of your organisation, focussing on some key questions:

Do you already have a track record in domestic and international M&A activity?

Have you previously made acquisitions in Western Europe? Previous experience will be an advantage. You will need to be prepared to share information on transactions that you have already completed, including the firms that have provided financial and legal advice. This will help in building credibility, and will demonstrate your serious interest in the sale process. You might also share the names of the CEOs or CFOs of the target companies that you have acquired, so that the vendor can speak to them and obtain references.

Do you have access to acquisition finance?

Do you plan to finance the purchase with cash, debt or equity in your business? Do you have access to acquisition finance and where does this finance come from? You should be prepared to discuss these aspects openly in order to help build trust with the vendor, especially if a third party financier / equity investor is involved and they have a significant role in your decision making process.

Do you understand Western European sell-side processes?

If not, use experienced global advisors to help you understand Western European deal processes. Ensure you appreciate the timeline, what legal documents are required when, which parties should be involved, and what deliverables are needed at each stage of the process.

Do you have 'clean' audited financial statements?

The quality of financial reporting in some EM countries can be inconsistent with Western European standards. To allow the vendor to gain confidence about your financial strength, EM buyers need to be able to show their target a robust set of audited accounts, which are as transparent and as comparable as possible to Western European standards, and ideally prepared under IFRS or the local Western European GAAP.

How robust is your entity's corporate governance structure?

EM acquirers must be aware that corporate governance is an immensely important issue throughout Western Europe. Market regulators and vendors will need to be reassured that an incoming buyer is aware of their responsibilities and liabilities in this regard, and that they have a clear action plan to implement a sound corporate governance structure post-acquisition.

How well do you understand the target's local regulatory and legal requirements?

Demonstrating a clear understanding of the target country's regulatory and legal system will present you as a serious and sophisticated suitor, particularly if you are expected to deal with international stock exchanges or any other overseas market regulators. You will need to develop an understanding of these requirements before embarking on an acquisition in Western Europe.

Other key areas include anti-trust and environmental regulations. In most EMs, these regulations are either not common, or are in their infancy, and accordingly some EM acquirers may not be very familiar with them. Experienced and knowledgeable advisers can assist you in understanding the relevant issues.

Develop a compelling investment 'story'

Having performed detailed analysis of the target entity, and having reflected on your own company, you need to spend some time considering your investment 'story'. Put yourself in the shoes of the Western European vendor to try to understand what is important for them and what their viewpoint might be on a possible foreign purchaser.

Focus on key points relevant to the vendor and leverage your strengths in order to create your investment story, presenting the deal as a positive strategic step for the Western European target, and illustrating that the acquisition will have a transformational and beneficial effect.

Vendor concerns

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 for a business in financial distress. Others may be concerned that the EM acquirers are simply looking to buy a particular technology to take back to their home market, which will lead to discontinued European production and local redundancies.

Your investment story needs to be very clear regarding your future strategy with the target, and why in your view the acquisition makes strategic sense.

Long term investment

As a result of the credit crunch and stagnating economic prospects, many Western European companies may be struggling to meet the terms of loan covenants or to pay the interest on issued debt. Consequently, they may be facing administration or receivership procedures and could be deemed to be 'distressed'. For some EM buyers, the acquisition of a Western European company might have a significant strategic value, and in the recent past EM bidders have demonstrated that they are prepared to look beyond short-term financial issues and high levels of gearing when contemplating acquisitions to develop a compelling long-term investment proposition.

Exposure to high-growth markets

A declining market in Western Europe may well translate to a growth market in an emerging economy. Consider whether the products of the target company can be sold in your domestic market under the same brand via your distribution network – increasing their global reach. If you think that it will be viable for the local name or brand to remain the same post-acquisition, developing your investment story around such a premise could be a successful strategy.

Redundancies

Consider whether there will be many local redundancies as a result of your acquisition. If your rationale is to acquire a launch pad for entry into the Western European market, this might play in your favour relative to other local bidders. If you do not have an existing hub in Western Europe, the prospect of cost synergies through office consolidation and redundancies is lower compared to other potential Western European trade bidders, whose investment case might be based around such synergies and which would be likely to lead to more job losses at the target entity.

Put yourself in the shoes of the Western European vendor to try to understand what is important for them and what their viewpoint might be on a possible foreign purchaser.

Unless you have a previous relationship with the vendor, it is helpful to work with an advisor who has an existing relationship with or access to the vendor, so that they can introduce key management and other relevant decision makers.

Approaching the target

Who are the decision-makers?

When you start short-listing the possible targets and identifying the key decision makers, you will find that in some Western European countries it is not difficult to identify key shareholders and executives from public sources or proprietary databases, given the transparent and rigorous nature of local financial reporting and accounts filing requirements.

In other countries, this can be a more complicated process. Whereas contacting the Head of M&A might be a good start for some larger quoted companies, contacting the owner-manager directly might be more relevant for mid-sized targets, but this can be difficult to achieve without an introduction from a trusted advisor.

Making the first move

Unless you have a previous relationship with the vendor, it is helpful to work with an advisor who has access to the vendor and can provide you with an introduction to their key management, and other relevant decision-makers. Such advisors are likely to have a direct relationship with the target company, understand the local market dynamics, and work for you to facilitate the initial communication. Furthermore, Western European vendors are accustomed to doing deals via intermediary advisors.

At the same time, it is important to involve the real decision-makers in your company at this initial stage (and subsequent key points in the deal), rather than working solely through advisors, in order to build a strong and effective relationship with the target.

The objective of this phase is to establish rapport with the key decision-makers at the vendor, convey that you are a credible counterparty and achieve a positive initial response from them. This response will be influenced by the language in which you make the first contact; if you do it in the local language of the vendor, you are more likely to achieve an encouraging answer.

The vendor management's initial reaction could be guarded, as it takes time to build trust and they will be keen to understand your deal rationale, integration plans and ability to finance the deal. As the relationship evolves, the approach could become more informal. From the outset, you will need to work hard to convey your investment story and describe precisely who you are, what your business does, why you wish to make the acquisition and what you plan to do with it post-acquisition. To this end it will help if you demonstrate a clear understanding of the target country's political and regulatory system and the local corporate governance requirements.

Communicate clearly how the decision-making process works within your organisation and give an indication of the timeline within which you would be able to complete the deal, at the same time expressing a willingness to be flexible and adapt to the seller's timetable.

Continuing the conversation

Once a dialogue has started with a target company it is important to keep the momentum going. This means that your internal decision-making processes need to meet the deadlines agreed with the target. If not, you will quickly find yourself in a competitive auction process.

It is highly likely that you will be required to sign confidentiality letters or non-disclosure agreements before being given access to business-sensitive information. Use this stage to obtain the relevant information that you need to form your views on an indicative offer. At the same time, be aware that some vendors may not wish to disclose details which could be useful to potential competitors if the deal does not complete.

Be prepared for the fact that Western European vendors place more emphasis on cash flow and EBITDA multiples, so the format of the information supplied to you is likely to be focused on these key metrics. While this type of information is acceptable to many EM acquirers, if this is different from your focus areas, such as net assets or intellectual property, be specific about the additional information requirements at an early stage.

At the same time, the vendor will want to know as much as possible about your company. Be open about your ownership and financial backing and set out the expectations and objectives for the acquisition itself. Offering to provide your audited financial statements and speaking about your track record in M&A activity will reflect well upon you. In some instances, particularly in respect of merger share swaps and joint venture activities, the vendor may request reverse desk-top due diligence.

Competitive auction process

The focus of this paper is on pre-emptive deal processes which exclude the prospect of other possible bidders. In reality, expressing your interest in purchasing the target may well trigger an auction process. Alternatively you might have heard about a pre-existing auction process from your financial advisors and wish to join in.

Many EM acquirers, in particular those from India and China, are used to prolonged sales processes involving extended periods of exclusivity driven by their consensus-based decision making. As a consequence, auction sales, which take place in a short and frenzied period of time, have not generally been attractive to EM buyers. Lack of time and limited experience in Western European M&A, have meant that in some cases EM buyers have been unable to make the quick strategic decisions required to meet the tight deadlines in a typical Western deal process.

Thorough preparation on your part is vital, so that if necessary, you are able to increase the speed of your response to the vendor, making them comfortable with your ability to deliver the deal. Dedicating senior resource with a mandate to make prompt decisions will afford you the chance to compete on a par with more experienced Western rivals.

Your internal decision-making processes need to meet the deadlines agreed with the target. If not, you will quickly find yourself in a competitive auction process.

Timing is a critical factor at this stage... the vendor will be sensitive to the speed with which the deal can be closed.

Making the offer

Managing and meeting expectations

The quality of the indicative offer document is extremely important in Western Europe. The standard will convey the professionalism and credibility of the would-be acquirer.

Typical features that are expected to be included in the indicative offer are: a clear description of the consideration for the deal and any price adjustment mechanisms; the proposed financing and debt structure; management and employee incentivisation if appropriate; the future strategy of the combined business; deal timetable; key commercial assumptions; and, should the process allow it, second stage / confirmatory / closing due diligence requests.

Sometimes this indicative letter will be converted into non-binding Heads of Terms which is then used as the basis for preparing the binding legal documents by the lawyers. On other occasions, the deal will move directly to legal documents from the offer letter. We strongly recommend that EM buyers request that a Heads of Terms be agreed, as it will greatly reduce the potential for misunderstandings at a later stage of the deal. It is also critical that any conditions precedent to the deal and essential representations / warranties are specified at an appropriate time.

Timing is vital

The proposed deal timetable could present more of a challenge to an EM acquirer than a Western European trade or financial buyer. Whereas the latter typically asks for a 4-6 week exclusivity period after acceptance of the indicative offer, EM acquirers sometimes expect much longer periods.

Be aware that timing is a critical factor at this stage, as the vendor will be sensitive to the speed with which the deal can be closed, and counter-bidders may well be waiting to approach. It is advisable to reduce the exclusivity period to minimum levels in order to keep the momentum of the deal going.

Regulatory compliance

EM acquirers must acknowledge the importance of compliance with local laws, regulations and expected codes of conduct. Western European economies are highly regulated and the rules are more stringent when the target is a listed business.

When targeting listed businesses in the United Kingdom, for example, EM acquirers will need to comply with the Takeover Code whilst executing the deal, in addition to laws and regulations on health and safety, environmental liabilities, employment law and corporate governance when running the business.

Concluding thoughts

With the combined effects of the credit crunch curtailing other forms of M&A activity and the seemingly irresistible movement of global economic gravity towards Emerging Markets, EM entities are rapidly gaining experience in doing deals in Western Europe.

However, Western European vendors still have concerns as to whether EM acquirers are credible and able to deliver deals on a timely basis, thus sometimes only approaching them as a last resort.

By preparing carefully before you approach the target, analysing and addressing your own strengths and weaknesses, developing and delivering a compelling investment story, being open and transparent about your entity and your future strategy, and getting the communication and timelines right, you stand a much higher chance of being perceived as a credible M&A bidder, and you will be better positioned to close the deal.

Appointing experienced deal advisors will assist you not only to manage the financial and operational elements of the transaction, but will provide you with a mechanism with which to bridge any cultural gaps, maximising your chances of success.

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 deal 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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