

International Issue

*Summer
2008*

Merger & Acquisition Connection

> *Alternative exchanges are growing in appeal*

- > *Preparing your company for foreign scrutiny*
- > *Make your cross-border acquisition work despite cultural differences*
- > *Dealing with the dollar's dwindling value*

New paths for going public

Alternative exchanges are growing in appeal

Going public on an overseas exchange once was considered a novelty. Now, it's a viable and appealing alternative for U.S. companies. If you're considering going public, an overseas exchange could offer benefits ranging from lower costs to fewer regulations.

Scaled to size

An overseas initial public offering (IPO) can be especially alluring for smaller companies still in the early stages of their growth cycle. The Sarbanes-Oxley Act of 2002 (SOX) introduced an array of time-intensive and expensive reporting requirements that have made it impractical for many startup and middle-market companies to go public on a domestic exchange.

At the same time, alternative exchanges have experienced enormous growth spurts. Over the past three years, London's Alternative Investment Market (AIM), which was established in 1995, has become a serious rival to NASDAQ's small-cap market exchange.

AIM once was considered a court of last resort for companies unable to meet the requirements and costs of more established exchanges, such as the NYSE or NASDAQ. Today, however, with 3,000 companies, approximately 250 of them incorporated outside the United Kingdom, it can hardly be considered an "alternative."

In 2006, AIM attracted more listings than all of its global rivals combined, according to the *Independent*. That said, the global credit crunch has hampered AIM's growth somewhat: 2007 saw the lowest number of IPOs listed on the exchange in five years.

Because AIM's regulatory demands are slight, your legal, accounting and administrative costs are typically lower than they would be in the United States.

A submarket of the London Stock Exchange (LSE), AIM targets smaller companies in the \$20 million to \$200 million range, and is particularly appealing to businesses still in their early development stages. The exchange also makes sense for companies offering nontraditional types of IPOs, such as public offerings whose proceeds primarily go to existing investors, including private equity firms.

Greater flexibility

AIM poses several advantages to U.S. companies. For starters, the exchange gives you far more flexibility to determine the terms of your IPO. For example, while NASDAQ mandates a minimum number of shares companies must offer to the public, AIM has no such requirement. And AIM doesn't specify a minimum share price. Therefore, if you need only a small chunk of investment capital, you're free to raise amounts starting at \$3 million.

In addition to avoiding the strictures of SOX, companies listed on AIM enjoy freedom from other regulatory hurdles. The exchange is regulated by the LSE rather than the



First a few requirements

Listing on London's Alternative Investment Market is far less cumbersome than going public on a U.S. exchange like the NYSE or NASDAQ, but there are requirements your company must meet. For example, you must:

- Name a “nominated advisor” (Nomad), registered with the London Stock Exchange — a firm that has practiced corporate finance for at least the past two years that will vouch for your company and perform due diligence,
- Complete an admission document that lists your company's assets, liabilities and other financial information,
- Have sufficient working capital for at least 12 months following the date of exchange admission,
- Have adequate financial policies in place and three years of financial information prepared according to Generally Accepted Accounting Principles (GAAP, which are American accounting standards), and
- Be able to offer shares that are transferable and available to the public.

U.K.'s Financial Services Authority, so neither the British nor the U.S. government reviews or has to approve your prospectus. Companies that list on AIM also avoid the routine regulatory filings required in the U.S.

Because AIM's regulatory demands are slight, your legal, accounting and administrative costs are typically lower than they would be in the United States. Listing fees are also less onerous.

Nomadic guidance

One critical distinction of AIM is its use of “nominated advisors,” known as Nomads, who spearhead IPOs. These advisors from British accounting and financial services companies are responsible for vetting prospective public companies, including sizing up their executive staff, analyzing their business models and tracking their earnings to date. Nomads also work with companies to write their prospectuses, which tend to be less detailed and easier to release than those required for U.S.-based IPOs.

Another benefit of the Nomad system is its continued guidance even after the IPO. Nomads generally help make markets for the newly listed company, which ensures that its shares will remain liquid and its valuation fairly stable. By contrast, some smaller companies listed on exchanges such as NASDAQ may be “orphaned” after their IPO, and their share prices can plummet.

The new contender

AIM isn't the only name in the alternative index game. The Dubai International Financial Exchange (DIFX), which began operations in 2005, is now open to U.S. companies. It was expected to list its first U.S. company earlier this year, but the issuer pulled the deal after its owners became concerned that their filing didn't accord with Dubai laws.

Borse Dubai is the majority owner of DIFX, and the exchange is located in the financial free zone of Dubai International Financial Centre (DIFC), where all financial activities are governed by an independent regulator, the Dubai Financial Services Authority. Its appeal mainly lies in its Middle Eastern location, which is convenient for energy production and distribution companies. Also, less-established companies searching for capital may find investors with a higher tolerance for risk on the DIFX.

But because there's still no precedent of a U.S. IPO on DIFX, companies need to approach it with caution. And because the exchange is so new, it has fewer listings and investors than its competitors, which could limit trading opportunities.

An intriguing option

Foreign exchanges have come a long way from being last-ditch financing attempts. For smaller companies, going public on a growing exchange like AIM is simply a cheaper and less restrictive way to launch an IPO.

What's more, exchange competition shows no signs of decreasing, so opportunities on foreign exchanges should continue to grow over the next few years. ■



Relative value

Preparing your company for foreign scrutiny

When you're positioning your business for sale to a foreign company, conducting an accurate and strategic assessment of your company's value can be a difficult but essential task. For example, you'll need to know what foreign buyers will be looking for during due diligence. You also must prepare for a potential buyer's questions regarding your financial statements.



Your buyer will likely already face a variety of regulatory and legal issues. A clear and well-supported valuation can lower at least one hurdle in the race to the finish line.

Getting started

Before you put out the international “For Sale” sign, seriously consider whether your company's culture can support an acquisition by a non-U.S. company and whether your business is likely to thrive under such ownership. Even if a foreign buyer regards it as an advantageous acquisition, a bad sale could negatively affect your valued employees, and if you maintain a stake in the business after it's sold — you as well.

Understand also that foreign buyers are typically interested in companies with at least a \$20 million annual revenue base. That floor is in part due to increased risks of multinational deals and the expenses related to navigating foreign regulations and currency issues.

Preparing for an international deal can take longer than getting your company ready for a domestic sale, so be patient. If at all possible, begin planning as soon as you think you might eventually sell your business. Identify a few key managers who can be trusted to spearhead the preparation and valuation process.

Self-evaluation

To obtain an accurate valuation of your company, look for an expert with international experience. If you have a specific buyer in mind, you may want to hire a valuator based in the buyer's country, or at the very least someone with knowledge of the country's financial regulations and customs.

Financial statements should be prepared according to Generally Accepted Accounting Principles (GAAP). Be ready to present audited financial statements from the past several years. You don't, however, need to worry about reconciling the differences between domestic GAAP and International Financial Reporting Standards. That's the buyer's responsibility.

Enhancing your profile

Your valuator may use the “rule of 5 and 10” as a starting point. This predicts that a company with an EBITDA (earnings before interest, taxes, depreciation and amortization) margin of 10% will sell for a multiple of five times EBITDA. EBITDA is generally used as shorthand for an approximation of a company's cash flow and is one of a foreign buyer's guideposts to your company's value.

As you prepare for sale, try to eliminate discretionary expenses as much as possible. A prospective buyer doesn't want a target that frequently readjusts its EBITDA for discretionary expenses. And if your company has substantial in-process research and development expenditures (IPR&D), keep supplementary accounts that detail the expenses. IPR&D is treated differently under European Union regulations, so keep that in mind if you're preparing to sell to a European company.

If you've been expensing your fixed assets, you'll likely need to start capitalizing them instead. This will make your earnings from one reporting period to the next

appear less volatile and enhance your reported cash flows relative to capital expenditures.

Easing due diligence

Once you reach the due diligence stage, provide your prospective buyer with a streamlined, easy-to-read summary of your company's assets and expenses. You will also want to give the buyer detailed information about your business processes — including internal controls, information technology, compensation plans and operating manuals for specific products.

You can make it easy for buyers to access your company's data off-site by uploading it to a secure Internet-based document storage site.

All of your properties should be carefully outlined and annotated. This includes intellectual property, such as licenses and trademarks. Foreign buyers often consider

intangible assets the most valuable pieces of any deal, so ensure that you fully own the rights to all of your intellectual property.

You can make it easy for buyers to access and review your company's data off-site by uploading it to a secure Internet-based document storage site. Most international buyers prefer this to shuffling through a ream of paperwork. Plus, it gives them a chance to get to know your company before they conduct a time-consuming in-person review.

Finally, consider performing a due diligence dress rehearsal. Before you release information to a prospective buyer, put yourself in the buyer's shoes and conduct a thorough buy-side review.

Making everyone happy

Remember that your foreign transaction isn't in danger of failing only during the sale process. Most deals founder when the buyer tries to integrate its acquisition. Providing your buyer with a detailed and accurate picture of your company will go a long way toward ensuring the sale is successful for everyone involved. ■

Make your cross-border acquisition work despite cultural differences

American companies are seeking foreign acquisitions in greater numbers than ever before. The declining dollar and migration to Internet-based organizations means cross-border deals are increasingly viable. If an international deal is possibly in your company's future, start thinking now about how you'll handle the complex cultural differences that sometimes sink foreign M&As.

Go with what you know

Domestic M&As are already challenging without having to deal with foreign legal and regulatory systems and a workforce whose makeup and culture can be quite different from what you're used to. Even with a Canadian or British company, there will likely be some elements of friction — such as the persistence of cultural stereotypes and differing perspectives on office culture. But you can take preventive steps to make a cross-border transaction and integration go a little more smoothly.



Most important is to avoid the complications related to buying a business that's radically different from your own. Making your international acquisition in an

unfamiliar industry can, in fact, be dangerous to your bottom line. Instead, target companies:

- That are in the same or a related industry,
- That make or offer similar or complementary products and services,
- Whose workforces resemble your own in terms of size, types of positions and education levels, and
- Whose management structures are roughly parallel to yours.

The more your businesses are in alignment, the less you'll have to discuss during negotiations. Integration, too, is likely to be easier.

Home country advantage

As important as it is for domestic deals, due diligence is even more critical when evaluating a cross-border transaction. To be sure you understand how the company's culture and government regulations affect its financial statements, legal agreements and other vital information, hire legal, accounting and regulatory advisors who work, or have an office, in the country of your acquisition target. Even if you also retain American advisors, seek the input of foreign professionals. They're more likely to spot red flags and give you a heads-up about issues that might alter your deal, such as new legislation or a change in the political climate.



Your local advisors can also guide you through the cultural rules that dictate business interactions — Japan's hierarchical management structure or the importance of clan ties in some developing nations, for example. This kind of knowledge is critical at the negotiation stage, when the wrong form of address or an insufficient show of appreciation can derail proceedings.

If you've made cross-border deals in the past, review them for best practices before pursuing a new international transaction. For example, say that, the last time you made a foreign acquisition, you reorganized the newly merged company's management structure to create parity among nationalities. That wound up being ineffective because considerations of balance overwrote those of experience and skills, creating resentment among employees. You might, therefore, consider a more merit-based management structure for the new target.

Also consider assembling a task force of your employees to serve as cultural ambassadors to the foreign company. This group can provide the target acquisition's employees with insights into your country's traditions and work practices, and it can organize meetings that enable future co-workers to interact and discuss potential stumbling blocks before the two organizations merge.

Retaining your workforce

Essential to a successful international M&A is respecting the national culture of your potential acquisition. Rather than trying to "Americanize" your target, work on creating a merged international culture that draws the best ideas from both sides.

And focus on retaining your key employees and putting the most effective managers in place. In most mergers, some employee turnover is inevitable, but losing executives and managers in an international deal is potentially catastrophic. Not only do these individuals walk out the door with valuable knowledge, but they may also take loyal rank-and-file workers with them.

Long before the deal is complete, interview employees to determine who are likely to be the best management candidates. When choosing managers for the newly merged company, you might be tempted to go with what you know and put only your own staff in key leadership roles. But both companies should be as fairly represented as possible.

Making it work

The more culturally sensitive you are to your new business partner, the more successful your cross-border deal is likely to be. Embracing diversity, respecting the traditions of your acquisition's country and, if necessary, providing greater autonomy may seem like work, but the dividends down the line will be substantial. ■

Dealing with the dollar's dwindling value

Sometimes an M&A deal's attractiveness isn't determined by its participants, but by outside influences. That's been the case as the plummeting value of the dollar has made acquisitions of U.S. companies more appealing to foreign buyers paying with relatively strong currencies.

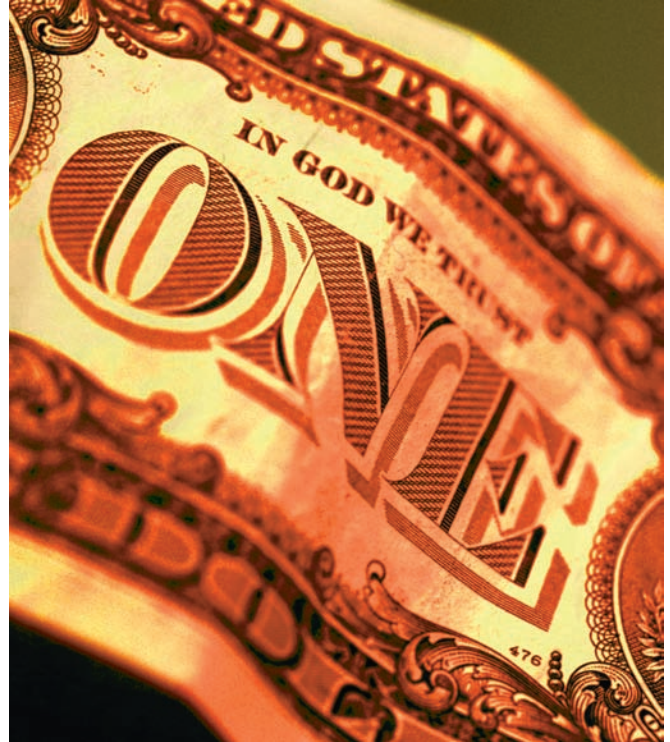
Good news/bad news

The dollar has lost value against virtually all rivals: the euro, British pound sterling, Chinese yuan, Japanese yen and Indian rupee. Even the Canadian dollar has achieved parity with the U.S. dollar — something that hasn't been true since 1976.

But the declining dollar doesn't necessarily mean good — or bad — news if you're trying to sell your company. On the plus side, a cheaper dollar can translate into increased overseas business, as foreign customers take advantage of relatively lower prices for American goods. This, in turn, may result in a higher overall worth of your company. The depressed dollar also makes your company less expensive in the eyes of European and Asian business buyers and may increase the pool of potential bidders.

A cheaper dollar can translate into increased overseas business, as foreign customers take advantage of relatively lower prices for American goods.

On the other hand, dollar depreciation may increase your expenses, especially if your company needs to buy products directly from overseas suppliers or if you rely on foreign labor. What's more, the complexities and costs of a cross-border deal can more than offset the advantages foreign buyers enjoy from a currency imbalance.



Strategy beats currency

Foreign buyers, in fact, are more likely to be interested in acquiring your company for reasons other than currency imbalances. For example, Finland's Nokia purchased the U.S.-based NAVTEQ late last year in what was considered by many to be primarily a strategic, not financial, deal.

Nokia was looking to move out of the low-margin cellular phone business into more profitable products, such as the GPS systems that NAVTEQ makes. To that end, it paid a 129% premium over NAVTEQ's stock price six months before the deal — offsetting any gains from dollar depreciation.

Looking at the larger scheme

So while the dollar's fluctuation may be a big deal for Americans buying French wine or traveling to Japan, it remains a relatively minor factor in the larger scheme of international M&As. If a foreign buyer is considering your company, it's likely that other reasons — strategic and cultural — are spurring their interest. ■