Corporate and private-equity dealmakers increasingly recognize that international transactions will be a crucial part of any company’s growth strategy. But the strategies and practices that are successful domestically don’t always translate overseas — a lesson that middle-market companies need to learn quickly, or risk losses on their new ventures.

To help newcomers navigate this terrain, Mergers & Acquisitions was pleased to partner with Bank of America Merrill Lynch to present a symposium on transformative international transactions. The event featured expert panelists highlighting the issues any company or private-equity group will confront when it expands beyond the U.S.: From crucial details like tax structures and security interests to broader strategic questions like how to ensure a cultural fit between the new unit and the rest of the organization.

In kicking off the event, Jeff McLane, president of Bank of America Business Capital, noted that the reasons for companies to expand internationally vary widely — from acquiring new, lower-cost suppliers to tapping new markets for their finished products — and the resulting financing needs are equally complex.

For those Mergers & Acquisitions readers who could not join us for the discussion in Chicago, we are pleased to present an edited transcript of the event on the pages that follow.

"Bank of America Merrill Lynch" is the marketing name for the global banking and global markets businesses of Bank of America Corporation. Lending, derivatives and other commercial banking activities are performed globally by banking affiliates of Bank of America Corporation, including Bank of America, N.A., member FDIC. Securities, strategic advisory, and other investment banking activities are performed globally by investment banking affiliates of Bank of America Corporation ("Investment Banking Affiliates"), including, in the United States, Merrill Lynch, Pierce, Fenner & Smith Incorporated and Merrill Lynch Professional Clearing Corp., both of which are registered as broker-dealers and members of FINRA and SIPC; and, in other jurisdictions, by locally registered entities. Merrill Lynch, Pierce, Fenner & Smith Incorporated and Merrill Lynch Professional Clearing Corp. are registered as futures commission merchants with the CFTC and are members of the NFA.

Investment products offered by Investment Banking Affiliates: Are Not FDIC Insured * May Lose Value * Are Not Bank Guaranteed.

© 2013 Bank of America Corporation.
Ms. Flynn: Andy, The Jordan Company is known for being one of the first private-equity groups to go do cross-border deals. Can you take us back a little bit to explain why you began doing this as a firm?

Mr. Rice: We’re a middle-market private equity firm, and back in the early ’90s most of our companies had between $50 and $100 million in sales and were leaders in their niche in the U.S. We thought many of our companies had a lot of potential internationally, so we built a dedicated operations management support group to focus on helping our companies internationally. The thinking was that if we could help one company get into Russia and learn how to do business there, then when a second company wants to go to Russia, you are halfway up the learning curve.

As we grew, we would help not only operationally, but to help do a lot of acquisitions and joint ventures. As you know, after you do a deal, then the real work begins. You have to work on integration and putting in proper controls. For the first ten years, all of our deals were to help our existing U.S. portfolio companies that were following their U.S. customers overseas, which reduces the risk. If we supply a key part to G.E. and they are going to China and they want us to follow them, it’s easier.

Eventually we built teams locally on the ground and we started doing stand-alone deals. We built the largest cable operation in Russia. We did a big Telecom deal with Bharti Telecom India. We did six deals in Brazil in the late ’90s. But about in 2002, we decided to focus solely on China as far as having dedicated resources helping our companies. We felt China was the most stable, fastest growing country in the world, and we found them to be supportive of foreign investment. In Brazil, every couple of years the currency would devalue significantly. Russia wasn’t very friendly towards foreign investment. The infrastructure in India really hasn’t improved a lot in the last 15 years.

Ms. Flynn: What would you say is the biggest challenge to doing business in China?

Mr. Rice: The biggest challenge is making sure there is a commitment. If I’m helping one of our U.S. portfolio companies, we really need to make sure they are committed to going there and being involved. You can’t just make a few trips, find a partner and hope it is going to do well.

On the investment side, it is really about due diligence. Just as a benchmark, we spend two or three times as much money on due diligence and structuring a deal in China as we do in the U.S. and they take two or three times as long to close.

But there are now some great consulting firms that can help you evaluate the opportunities, the markets, the accounting. The Fortune 1000 firms have been in China for 20 or 30 years and there is a cadre of middle- and upper-level managers who have been working for foreign firms for many years. And so when we make an investment and need to hire a Controller or Plant Manager or a Head of Sales, we’re often able to find someone that has previously worked for a foreign firm and understands best practices, and financial controls. It is a lot better than it was when we did our first deal in 1994.
By most reports, by 2020 the BRIC countries – Brazil, Russia, India, and China – will have 50% or more of the world’s economic output. They are growing faster than the U.S., and they have large urban populations.

—Sandra Reese, McKinsey & Company

**Ms. Flynn:** Sandra, you’ve been working on deals internationally for more than a decade. What’s changed over that time period in terms of what your clients are looking to achieve?

**Ms. Reese:** In the late ’90s, the work that I was doing was very much focused on U.S.-based companies looking to secure low-cost manufacturing options. Today, they’re now looking to seize markets. And I believe that will continue to happen. By most reports, by 2020 the BRIC countries—Brazil, Russia, India, and China—will have 50% or more of the world’s economic output. They are growing faster than the U.S., and they have large urban populations. These are populations that are very much interested in Western-style goods, as long as you adopt them for local customs and cultures.

But what amazes me the most about U.S.-based companies, is that when they see these great opportunities to grow their revenue lines, they deviate from the normal business practices they’d employ at home. I think that is especially true for middle-market companies.

**Ms. Flynn:** Rachel, are you seeing this also with your clients?

**Ms. Cantor:** From a tax perspective, it takes people a while to get their minds around the fact that the structuring is expensive. If you are coming at this from the point of view of either a U.S. company that is making investments abroad or a U.S. or U.K. private equity fund, you need to set up a structure that is not going to cause you to pay taxes in 16 jurisdictions on the way to getting the cash back. That is going to be more expensive from a due diligence standpoint, and in terms of the lawyers and accountants you need to structure it. But people keep coming back to the table because they realize there are opportunities abroad.

**Mr. Rice:** When we make an investment, we look at two ways of getting money out. One is if the operation is profitable and you want to get some of the profits back as dividends or how to repatriate shareholder loans. The second one is when you want to sell that business. What we and most private equity firms do is to set up a layer of offshore holding companies. So for instance, you have a Cayman Islands-based company that you invest in, and then that company makes the investment in China. If you want to sell the Chinese company, you don’t sell that company, you sell the interest in the offshore holding company. It still requires anti-monopoly approval, but it’s a much simpler process than dealing with 10 to 15 separate agencies for a local deal in China.

**Ms. Cantor:** Sometimes I see people make mistakes, particularly in the smaller middle-market sector, because they think, “I’m just making a small investment. I don’t want to spend all this money to do the diligence or to set up the structure.” It is very difficult to put the structure in place later, so sometimes some capital investment up front is needed.

**Ms. Reese:** I think therein lies one of the challenges. Companies expanding internationally for the first time don’t take a really long-term strategic view of the business. They don’t go in and do an adequate job in the due diligence of understanding what the market potential is, and, just as importantly, what the competitive landscape looks like. Because there are other investors, particularly in countries like China, and they will make it their goal to outdo you. I see a lot of companies not really doing enough on the front end to model scenarios: If this doesn’t happen, what do I do next?
The Art of the Deal:

Key Legal and Structuring Issues to Manage When Raising Capital for an International Transaction

PANELISTS
Richard Kohn, Goldberg Kohn, Moderator
Alister Bazaz, Bank of America Merrill Lynch
Seth Jacobson, Skadden Arps
Chuck Brobst, Bank of America Merrill Lynch
Coley McMenamin, Bank of America Merrill Lynch
Brian Wright, Bank of America Merrill Lynch
Michael Black, Norton Rose

Mr. Kohn: The interesting thing about the cross-border lending market, it has been moving downstream. It wasn’t that long ago that the middle market cross-border expert at the bank was a person who knew how to say no in 50 different languages. And that has really changed. Today, middle market companies need to finance their receivables with customers located in other countries, they’re setting up operations overseas or buying foreign targets.

For this panel, we’re going to discuss some of the issues that the banks consider when you present them with one of these deals — and we’ll be talking about ways in which you can work with the bank to develop solutions for those issues.

Let’s start with a scenario where the bank has been presented with the request to finance the acquisition of a U.S.-based company with subsidiaries in 14 different countries. Brian, there is a very good chance that you will see this deal first. What are you looking at?

Mr. Wright: Typically, the buyer wants to know: What is the maximum flexibility that they can get to finance the acquisition, and how do you minimize the amount of structure around it to maximize the liquidity going forward?

We’ll start by looking at the cash needs of each subsidiary, and the first question that comes to mind for us is: Why is it structured this way and why are they so complex? Then it really comes down to trying to sit and spend a lot of time with the buyers to understand what liquidity needs they have, and which countries we can do lending within.

Mr. Bazaz: From our side of the house it is critical that we are able to ask and probe as to what the actual mechanics of how the business works. What is the global supply chain? What intercompany transactions are going on? Do the suppliers have a claim against the inventory? There are a series of dynamics that go into the balance sheets that one needs to probe. You have to continually dig deeper and understand why a company is in a particular country and what the relationships are with their affiliates, with the suppliers, and with their customers. It is important to diagnose the unique fact pattern of the borrower.

Mr. Kohn: Michael. What is your reaction when you get involved in the deal?

Mr. Black: I think for me the biggest issue is trying to educate people on why it’s easier to lend in certain countries, while you might struggle in others. When you are looking at new jurisdictions, you should consider what happens when it all goes wrong. It is really the bankruptcy law and the treatment that you get in insolvency that drives the decision making when you are prepared to lend in those jurisdictions.

Mr. Kohn: Let’s talk foreign exchange issues and hedging the purchase price. Chuck, is this when it lands on your desk?

Mr. Brobst: If that is the first discussion that we have, we have fallen short. Hedging a purchase price can be an important part of a transaction, depending on the structure. To the extent you are raising capital in the purchase price currency, it is unnecessary to think about hedging it.

We understand there are ample hedge funds and private equity groups that would put up capital. But they are U.S. denominated funds.

—Alister Bazaz, Bank of America Merrill Lynch
Unlocking International Value:
Optimizing Liquidity, Leverage and Operations

PANELISTS
Alister Bazaz, Bank of America
Merrill Lynch, Moderator
Sandra Reese, McKinsey & Company
Richard Kohn, Goldberg Kohn
Michael Black, Norton Rose
Dennis Sweeney, Bank of America
Merrill Lynch
Jim Brannick, Global Treasury Services
Alex Weaving, Bank of America
Merrill Lynch

Mr. Bazaz: Once you've identified an international opportunity and managed to get it funded, you still have to execute as the owner in order to raise the exit value on your investment. Sandy, you are a proponent of making sure that companies keep track of multiple variables when they're charting an international acquisition, rather than just focusing on a one-dimensional issue such as tax structure. Can you expand upon the concept of evaluating multiple variables as you develop a strategic plan?

Ms. Reese: I think if you are a middle market company looking to expand overseas internationally, what we find is that companies will go to their lawyers or a tax accountant for advice. That is a great place to start, but they haven't factored in other considerations that are important to their initial entry into the market. And once they are there, they need to continually revisit their thoughts about the operation.

For example right now, I'm working with a company that has been around for a long period of time. They have been operating internationally for 30 years and they have operations right now that are profitable in some regions and in other regions need to be restructured or transformed — they were losing market share and profits were declining.

And what became very clear is that one of the big hurdles to the transformation is the corporate structure and culture, because they allowed individuals within the countries to operate these businesses on a standalone basis.

Mr. Kohn: That is a nice segue. How deep is syndication markets these days? Are there lots of banks that are interested in participating in these loans?

Mr. McMenamin: There is tremendous liquidity in the loan markets. Banks are eager to book assets. I think we're finding with each multinational deal that we bring to market that the level of interest is increasing. And we're seeing more and more participation from different banks in some of these new deals. Not every transaction is created equal — each of our clients has a different footprint and depth of market can depend on where the issuer is located and what money-center bank relationships they have. The U.S. loan market is much more robust than anywhere else in the world — a lot of what we're trying to do is leverage the capital base and market technology to create single global liquidity solutions for our clients.
There are tax issues involved as well, but the basic concept is a solid one: Instead of having your inventory owned in lots of “bad jurisdictions” from a lending standpoint, treat those entities as sales organizations and have the inventory and resulting receivables in a good lending jurisdiction.

Mr. Black: What you are trying to get to is the situation where, from a secured lender’s point of view, if it goes horribly wrong, you are dealing with bankruptcy laws and bankruptcy laws that would be more favorable.

Mr. Kohn: You see these corporate charts that are really perfect from a tax standpoint — and I’m not minimizing tax planning — but they create a situation that is absolutely horrible for financing. You can’t finance that entity, because inventory and receivables are owned in entities throughout the world and in jurisdictions where the laws are not conducive to financing. The overall theme, Alister, is that it’s important to focus on good lending jurisdictions.

Mr. Bazaz: I’m starting to think about the arcade game “Whack-a-Mole.” You might optimize one variable, but other problems pop up.

Ms. Reese: I think that most organizations when they are expanding internationally are not thinking through the long-term implications of the capital that is going to be required to run that business. They just want to get the deal done.

Mr. Bazaz: That opens up an interesting thought. Can you help our understanding of how to identify the stakeholders early in the process and the challenges that could create internationally?

Ms. Reese: There is a multitude of stakeholders. You have got your customers and the manufacturers and the suppliers. Depending on the countries you are operating in, relationships with the governmental authorities could be very important. And then, your relationship with your lenders and anyone else who has control in the organization — either through voting rights or from a finance perspective.

Mr. Bazaz: This kind of moves us into liquidity. Dennis, what challenges do an executive in the treasury team and the financial team, at a major global enterprise such as G.E. have to face when implementing global financial best practices?

Mr. Sweeney: By the time the treasury and financial teams get involved, the deals are usually already structured and they’re usually very complex, with many legal entities. Clearly there is value that is created through the legal structuring and the tax structuring, but if that becomes overly complex, then trying to manage your cash and move money around becomes substantially more difficult.

There are also cultural challenges. If you are acquiring a company that had its own financial function and treasury function and banking relationships, people don’t like to give that up.

Mr. Bazaz: That plays nicely for you, Jim, because you are engaged by many very well-known private-equity houses as part of that transition. What are those challenges that you are going to face?

Mr. Brannick: The entity that you are going into may be a division where everything has been centralized in corporate headquarters. People may have the title of Chief Financial Officer, but they are divisional CFOs. Suddenly it is not just a question of change, but also that they need to take on added responsibilities.

Mr. Bazaz: The company that has an abundance of cash can hide a thousand sins. What was the changed dynamic when a division is coming out of being owned by a major multinational?

Mr. Brannick: You have to get them to understand that cash management is not just tracking the balance in a bank account. It is how does your credit department manage the receivables? Are they conscious of the payment terms? Does your payable department understand they are not just processing an invoice to be paid, but they are managing that invoice. Am I paying it in 28 days or 45 days? Should I be taking the discount? So you have to educate them to think in terms of the whole idea of working capital management and liquidity management.

Mr. Sweeney: All too often the excuses of why I can’t change and why I can’t simplify, why I can’t change banks or whatever, they are not real. I can’t tell you how many times in my career I have heard and acquired companies telling me “we can’t change banks because our systems are integrated in the bank’s system.” And you start looking at that “integration” and you find it’s a file that anybody could replicate. You have to cut through that. The only way you can do that is if you are on site questioning every defense that they put out.