

**BANKING & FINANCE**

A Foreign Affair with Minnesota Companies

Lured by new markets and a strong tech sector, overseas firms are buying more Minnesota businesses than every before.

July 2008 | by [Ingrid Case](#)



Wolseley, a large U.K.-based industrial distributor that competes with The Home Depot, wanted more U.S. distribution for its products. Rather than expand its own network, in 2006 the company bought a firm that already had the distribution it wanted: Northern Water Works Supply, a Fargo, North Dakota, business that distributes products for water, sewer, and irrigation systems. “Our client had distribution channels they wanted,” says Mike Groppetti, a partner at Minneapolis-based Prestwick Partners, a boutique investment bank and mergers and acquisitions service provider that helped broker the deal.

Wolseley is hardly alone. In 2003, foreign buyers acquired 1,033 U.S. companies. In 2007, it was increased to 1,698, according to FactSet Mergerstat, a California research firm that tracks mergers and acquisitions.

Minnesota is seeing this trend, too. In 2003, foreign buyers purchased eight Minnesota companies. By 2007, that number had increased to 23—a minority of the national deals, but still a growing trend.

Who’s Buying?

The trend toward foreign purchasers is part of an overall growth in global business perspective, notes Ivar Sorensen, managing partner at Minneapolis-based The M&A Group, a consulting firm that helps buy and sell companies. “For the last seven to nine years, we’ve seen a continuum of increasing interaction in everyday business and joint ventures, partnerships, and intellectual property development agreements,” he says. It’s not just foreign companies buying American businesses—it’s businesses buying other firms that fit their needs, regardless of international boundaries.

Acquired from Abroad

See a list of Minnesota companies that we acquired by foreign firms from 2005 through 2007. Get the details on which companies have been sold to foreign firms, and countries that have a growing presence in Minnesota.

Foreign private equity firms were likely buyers for Minnesota companies in 2007, helped along in part by sovereign wealth funds, through which governments invest public money in private equity or hedge funds. Strategic purchasers form the current majority of foreign buyers. They cross borders to get better manufacturing deals, acquire new distribution channels, find specialty manufacturers, take advantage of U.S. strength in such industries as finance and business services, and gain access to new markets.

In doing so, they get a boost from the low value of the dollar against other major currencies. “It’s as if U.S. companies are on sale,” says Mike Stanchfield, a partner in the M&A group at Minneapolis-based law firm Faegre & Benson.

“The U.S. mergers and acquisitions market has slowed down dramatically in the last twelve months, and that means there’s less competition for foreign buyers who have cash and want to make a strategic purchase,” Stanchfield says.

Minnesota, with its strong medical, technical, and financial service industries, is a natural target for buyers. “Investors are looking to pick up technology on the cheap, and the Twin Cities has wonderfully well-developed medical technology,” says Girard Miller, a partner and co-chair of the global alternative energy practice at Fulbright & Jaworski, LLP, an international law firm with offices in Minneapolis.

Minnesota can also offer good picks in biofuels and other renewable energy. “The U.S. is a huge untapped market for renewables,” Miller says. “Foreign companies want a place to use tax credits, which the U.S. has, or a place to have distribution and get a foot on the ground.”

U.S. laws can also help attract foreign companies. They like the American system of protecting intellectual property—laws that most developing countries lack—and appreciate “well-developed corporate law that’s supposed to yield predictable results,” says Joe Humke, a partner at the Minneapolis-based law firm of Lindquist & Vennum.

Most of all, foreign businesses want a chance to extend their operations into new markets. “I think we’ll continue to see foreign companies looking at businesses that are either extensions of what they do, or competitors . . . and fitting them into their strategies,” says Matthew Knopf, a partner in the corporate group and chair of the M&A group at Minneapolis-based law firm Dorsey & Whitney.

Great Expectations

Historically, commerce has caused cultures to mix, and the current mergers and acquisitions market is no different. “If there’s a deal, and you have money, cultural differences aside it will get done,” notes Bob Fafinski, partner and CEO at Fafinski Mark and Johnson, P.A., a law firm in Eden Prairie. It may not get done, however, without an effort to overcome differences in cultural expectations.

It’s been said that Americans and the British are one people separated by a common language. These days, the same might be said of the global business community. “Even though people in foreign countries speak and communicate in English, that doesn’t always mean they understand the fine points of a transaction,” Sorensen says. “You have to take particular care in communications. You can’t explain yourself and the nuances of your business or your technology in dry, contract language.”

The solution is to pack up and visit the people on the other side of the transaction. “You have to go there and meet people face to face, establish personal relationships and rapport. Do it in person, or 80 percent of it in person,” Fafinski suggests.

For the remaining communication, use e-mail to your advantage. “I’m amazed at how much easier electronic document transfer and communication have become,” says Mike McFadden, co-CEO of Minneapolis-based Lazard Middle Market, an investment bank that provides merger and acquisition services.

“Americans constantly underestimate what cultural differences can mean to bringing a transaction together,” Fafinski says. In the worse cases, culture issues can scuttle a deal. In South America, for instance, “their view of the calendar and the clock is very different than ours,” Fafinski says. English and Irish businesspeople are often similar to Americans, but Asian firms “can be frustrating to work with, because their view of an agreement and our view of an agreement are not the same thing. You find yourself renegotiating points you thought were settled,” Fafinski says. Germans sometimes resist varying their forms and methods. “We did a German deal recently in which it took us a month to get the right form of a letter of credit—one that was acceptable to both parties and the correspondent banks involved,” he says.

You may find yourself talking with different people within a foreign organization than you would at home. “Communications with more junior people aren’t as available as they might be here,” Humke says. In the U.S., you’d talk to the controller who monitors inventory to negotiate an inventory reserve issue, for instance. But in some other cultures, particularly in Asia, you’ll negotiate every detail with the senior buy-side negotiator.

In China, for example, “A lot of the legal framework is dictated by the province,” says Bob Frost, a former managing director for mergers and acquisitions at Piper Jaffray, an investment firm in Minneapolis. “Property rights are different, and many companies are state-owned,” he says. Frost notes that some Chinese businesses are becoming more privatized, but they often have different ownership structures than we see in the United States.

Frustrations over cultural differences aren’t just on the U.S. side, either. “I think foreign firms view us as aggressive, shoot from the hip, over-the-top people,” Fafinski says. “Even the most conservative American firms want to make a decision and move on. That can make conservative foreign investors wary.”

Tricky Tax Code

Becoming familiar with American tax code can take a long time for foreign buyers. That sometimes makes firms slow to understand the tax-based decisions American companies make. "Here, we spend an inordinate amount of time deciding whether a deal should be a stock sale or an asset sale," Sorensen observes. "A company headquartered in Paris doesn't understand, and there's no reason they would. We don't understand their laws and particulars, either."

Tax problems can go the other way, too. "We handled a deal last year where the seller was a European company with a U.S. subsidiary, where they incurred substantial operating losses," Sorensen says. "The European company expected that there was value in those tax losses, and so their view of what someone might be willing to pay for these things was completely unrealistic. There was no way for a U.S. company to derive any financial benefit from those carried-forward tax losses." The company ultimately sold its holdings to an American buyer, but only after a professional advisor persuaded them to accept financial reality.

Another European company settled on a European buyer, largely because different tax laws allowed that company to offer 30 to 40 percent more than a competing American bidder on a deal structured to minimize the seller's taxes. "The eventual European buyers were much more able to accommodate the seller's needs, and because of the differences in the tax environment, that accommodation didn't cost the European buyers much," Sorensen says. "It would have been expensive for the Americans to structure the same deal."

Save the Surprises

Litigation involving a target company is another potential complication. "Anytime you have litigation, that's a bigger issue to explain away to a foreign buyer than to a U.S. buyer," Miller says. "They've heard horror stories about punitive damages in U.S. courts." Punitive damages are rare in other parts of the world, and can scare potential foreign buyers.

Because state laws differ, many foreign buyers prefer to learn just one American set. They usually choose New York laws, largely because "there's a sense that New York is a sophisticated market, and not likely to try and take advantage of an out-of-towner," Miller says.

Foreign buyers also prefer to purchase companies that are incorporated under Delaware law. Many U.S. companies incorporate in Delaware simply because its laws are the most commonly used; the rules don't provide a big financial advantage but have been thoroughly tested.

Buyers from abroad often do intensive due diligence, particularly if no company officials are already in the United States and able to lead this process. "If they have those operations, they'll rely on those people," Stanchfield says. "If not, they'll rely on outside advisors, sometimes lawyers and consultants they've never worked with before. That makes them a lot more cautious."

U.S. sellers, then, "have to be even more diligent in packaging a company for sale," Stanchfield says. Find professional advisors with overseas experience, and talk with them about when and how to discuss

sensitive issues. Get records “in pristine order,” trace and verify intellectual property ownership, identify any environmental challenges, and be ready to explain any ongoing litigation. In many other countries, sellers prepare due diligence reports for buyers—just the opposite of the U.S. process. By volunteering more information, you put the buyer at ease.

Get Along Gang

Many foreign companies want an acquisition’s existing ownership and key managers to run the firm after it changes hands. “I can’t think of a time when it hasn’t been important for management and key employees to stay on,” Miller says.

For that reason, Sorensen says, “make sure you like the people, or that you can at least get along. Unless you have a clean-cut sale, where ownership changes and the seller goes to Florida, never to be heard from again, you need to be prepared to work together, perhaps for a year, perhaps for two or three or more.” That might not be easy, particularly if the buyer and seller have different ideas about how to run the company.

If a bidder has done other U.S. deals, ask to talk with references. “It is absolutely okay to ask,” Miller says. “I think you have to ask. If a foreign financial firm says no, I might question their motivation for refusing that request.” While you’re asking the hard questions, show the buyer some of your own courtesy and flexibility. “I’ve seen situations where a buyer has offered foreign language training to employees, or people have voluntarily learned the language through an outside class because they want to stay with the company,” Miller says. “It’s a great way to show folks that you’re part of the team.”

It’s a team that more Minnesotans will join as an increase in foreign purchases will likely continue through 2008. It seems the world’s businesses have taken notice of Minnesota’s good buys.

Getting Paid After the Deal is Made

Executives who are selling their companies to foreign firms must be certain to negotiate how they will get paid—particularly if they’re being paid at least partially in company stock. “If you’re staying on and getting stock-based compensation or accepting a minority interest in the company, that puts more burden on you to find out who [the buyer is], and how they plan to run the company,” says Girard Miller, a partner at Fulbright & Jaworski, LLP. “I’d want to know what kind of budget they have for developing the business. You don’t want them leaving you high and dry if you have equity in there.”

You may also need to accept an unfamiliar compensation structure. If you do get stock, it may be in the parent company and traded on a foreign stock exchange. A foreign company may pay cash compensation in dollars, but its stock may be valued in another currency, leaving you open to fluctuations in currency value.

If you don’t get equity—many privately held foreign companies are reluctant to offer it—you may need to discuss an equity substitute, such as a bonus structure that gives credit for stock appreciation. **Seller beware:** This could come with an added personal tax burden, because it offers ordinary income rather than capital gains.

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