coming to america

Foreign Acquisitions & Investments in the U.S.

Presented by

The Deal

In association with

MERRILL DATASITE™

Contents

Survey Methodology

Merrill Corp. commissioned The Deal to conduct a survey addressing opinions on foreign investment trends in the U.S. In August 2008, The Deal surveyed 235 executives in private equity and venture capital firms, corporations, hedge funds and law firms.

The survey consisted of 18 questions related to the attractiveness of U.S. markets, the types of foreign investors most active in U.S. markets, and the state of the U.S. economy. All results are anonymous. They are presented inside.

Introduction

Mired in a mortgage crisis and a bear market, with corporate valuations further diminished by a plunging dollar, the U.S. economy presents a gloomy picture for American companies, but a host of attractive acquisition opportunities for cash-rich foreign investors.

Sovereign wealth funds, wealthy foreign individuals and investment vehicles from oil-rich countries are now among the most active players in U.S. markets today. In taking advantage of the U.S. economy's slump to establish substantial stakes in American companies, these players have joined a familiar cast of characters–foreign private equity players, hedge funds and foreign corporations–bolstering the balance sheets of U.S. companies and in some cases, making them more global.

How long will the trend continue? What kinds of investments are foreign investors likely to make over the next 12 months? Will U.S. legislators increase the number of regulations that foreign investors must pass to acquire assets? To what extent will a new U.S. presidential administration influence the investment climate? To help answer these questions, Merrill Corp. commissioned The Deal to survey executives of U.S. corporations, private equity and venture capital firms and hedge funds.

Foreign investor appetite for U.S. assets to remain strong

Our survey results and interviews suggest that foreign investor appetite for U.S. assets will remain strong in 2009, in part due to a weak dollar and dried-up credit markets. Matt Herman, a partner in the New York mergers and acquisitions (M&A) group at Freshfields Bruckhaus Deringer, summarized it this way: "The historically weak dollar is making U.S. acquisitions relatively attractive for non-U.S. buyers. Plus, the private equity players who would normally contribute to a frothy, competitive environment in the bidding process are largely absent."

Most survey respondents indicated that limited access to credit has put U.S. investors at a disadvantage vis-à-vis their foreign counterparts. Meanwhile, for cash-rich foreign investors such as Middle Eastern sovereign wealth funds, "liquidity, ownership rights, and a depreciating U.S. currency continue to make the United States a great place for parking excess money," said Michael Maduell, president and founder of the Sovereign Wealth Fund (SWF) Institute, an organization dedicated to the study of government-owned investment funds.

Over the past 12 months, some of the biggest deals have involved foreign government-backed investment vehicles taking substantial stakes in U.S. financial institutions. Examples include Singapore's investment in Merrill Lynch & Co. through Temasek Holdings Pte Ltd., Kuwait's investment in Citigroup Inc. through the Kuwait Investment Authority, and China Investment Corp.'s investment in Morgan Stanley.

Survey respondents suggest that foreign investment will continue to target industries hard-hit by the U.S. economic woes, such as banking and real estate, but there are signs that investors will be fishing more broadly for opportunities. "We don't see growing foreign investment as an industry or sector-specific phenomenon. It's all over the map," says Freshfield's Herman.

Maduell of the SWF Institute believes foreign investors will target a range of industries, including infrastructure, oil and gas, hospitality and commercial real estate sectors.

In many cases, that interest is reciprocal. For example, C. Jonathan Benner, the head of the transportation practice at Troutman Sanders LP, has seen an uptick in interest in foreign investment among public sector companies. "Public infrastructure is in terrible shape, and politically there is no will to find public funds for public highways, interchanges and port facilities. There is interest in the idea of privatization and inviting foreign entities to invest in road and port facilities," said Benner.

A recent example is Pennsylvania's decision to lease the Penn Turnpike to a group of private investors led by Spain's Abertis Infraestructuras. "This is an iconic example because the Penn Turnpike was the first autobahn in the United States," Benner said. While the state legislature still has to vote on the deal, they may face public opposition. "I'm sure some citizens will say that we're selling the family jewels."

While Spain represents one of several Western European countries long active in the U.S., investors from other regions are also increasing their presence here. Survey respondents expected that the rapidly growing economies of China and India, together with the oil-rich Gulf States, would be the most active foreign investors in the U.S. in the coming year. This was confirmed by Freshfield's Herman, who has seen an increase of deal flow from India, China, Russia, Eastern Europe and the Middle East.

In another shift, corporate deals represent an increasingly large proportion of total deal flow. Herman said that 18 months ago, Euro-led private equity transactions comprised about 70 percent of the deals he handled. "Now it's mostly non-U.S. corporations going into the U.S."

Part of the reason is that while private equity and investment funds in Europe and elsewhere have faced tightening credit markets, companies from Asia, Russia and the Middle East are flush with cash and looking to expand.

Increased government activism surrounding foreign investment

Yet as investments from these regions grow, they face intensified regulatory screening in the U.S. due to political concerns about the nature of their acquisitions. For example, Middle Eastern investors may be located in countries that are not U.S. allies. Also, according to Stephen Preston, who co-chairs the Defense and National Security Practice Group at Wilmer Cutler Pickering Hale and Dorr LLP, some units of the U.S. government responsible for defense have identified China as a long-term strategic concern.

In theory, the 2007 Foreign Investment and Security Act (FINSA) should take care of any concerns pertaining to foreign investments in the U.S. regardless of the source. FINSA clarifies processes related to investments by foreign government-backed entities seeking controlling stakes in industries deemed relevant to U.S. national security.

Most legal practitioners agree that FINSA did not significantly alter the regulatory process for foreign investors. For example, Wilmer Hale's Preston says: "I personally feel that the amendments to Exon-Florio provided a political response [to foreign government-related investments in the U.S.], but they didn't change that much about the way the process operates."

Indeed, most people we spoke with agree that although foreign government-related investors may have to go through additional regulatory procedures, the U.S. remains remarkably open to foreign investment.

FINSA, however, did help to usher in an era of increased government interest in foreign investment. As Benner of Troutman Sanders notes, "across [the U.S.] government there is more awareness that this process exists." Yet for political reasons, this awareness may increase the regulatory burden borne by investors from Asia and the Middle East.

Says Preston: "While the CFIUS process on its face provides a level playing field, some Chinese investors—particularly state-owned enterprises seeking to make strategic acquisitions—may have a steeper hill to climb due to political sensitivities." Investors in the Middle East face similar concerns given their proximity to groups the U.S. are fighting in the Iraqi and Afghanistan wars.

Investors that are relatively new to U.S. markets also face the uphill battle of complying with U.S. regulatory processes. "There's no doubt that what a Chinese company faces in terms of compliance issues is different than, for example, what a German company with U.S. operations or a U.S. ADR would face," says Herman, noting that the Chinese company faces a different set of regulatory issues, such as accounting standards, and cultural conditions in the U.S. than it does at home.

Additional regulatory burdens for Sovereign Wealth Funds unlikely

For sovereign wealth funds—and many of the largest SWFs are from the Middle East and China—regulatory issues take on added significance. Over the past year, financial markets have been percolating with questions concerning sovereign wealth funds' lack of transparency, their effect on a country's financial stability and their competition with the private sector.

Sovereign wealth funds act in many respects like private equity firms: they are not bound to disclose holdings nor investment strategies. There are some features, however, that make sovereign wealth funds unique. First, the total amount of assets held by these funds is huge: between $2 trillion and $3 trillion, versus about $0.8 trillion for private equity.[1] SWFs are also cash-rich and do not need to seek leverage for their transactions. The size of these funds and their ties to government raise concerns about their ability to overtake competition. In any acquisition there's a belief that market forces ought to determine the outcome. But some argue that if one of the bidders is state-owned, it may have unlimited resources against which the private sector can't compete.

The fact that sovereign wealth funds are government-owned also raises questions about whether their investments are politically or commercially motivated. That leads to questions about a funds' source. According to Benner, "The opacity of these funds is a big problem. What kind of accountability does the fund have? Does it matter whether the fund is Singaporean or from Dubai?"

In response to these concerns, the International Monetary Fund and a group of 26 SWFs have proposed a voluntary code of conduct for the funds. While the standards have not yet been disclosed, they are likely to include standards relating to funds' governance and investment methodology. Some countries, such as Germany, have already begun implementing legislation pertaining specifically to SWFs.

Whether U.S. legislators will create a new set of investment regulations governing these funds remains to be seen. Although most survey respondents think it likely that the U.S. will pass legislation governing these funds, other market players we contacted remain skeptical. Wilmer Hale's Preston notes that transactions related to foreign investors in the U.S. "already require substantial participation by national security agencies. I don't see how the scrutiny could become more intense."

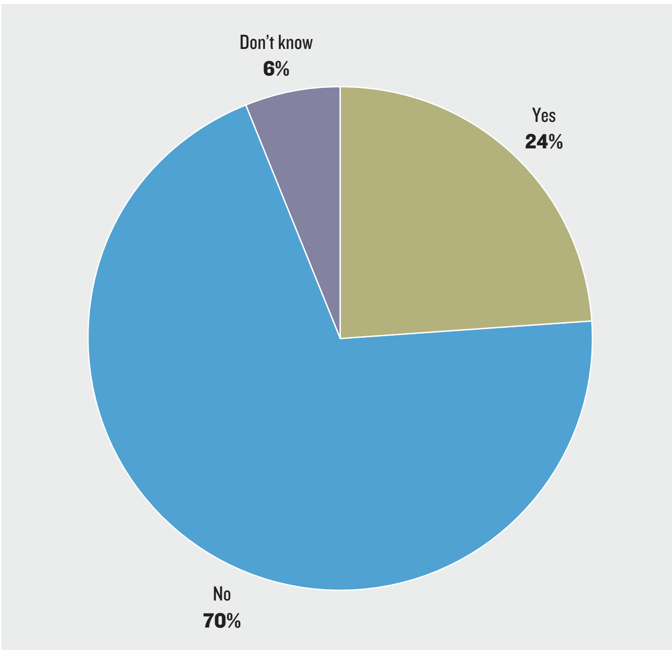
Perhaps the bottom line is that, as Preston points out sovereign wealth investment is "in the hold for the long term, which is a very attractive quality as an investor." And in the near term, U.S. companies need the investment. Like other foreign investors in the U.S., sovereign wealth funds appear to be here to stay.

[1] Diane Farrell and Susan Lund, "The World's New Financial Power Brokers," The McKinsey Quarterly, December 2007.

Survey Findings

Declines in the U.S. dollar and share values will keep foreign investment flowing for the next 12 months

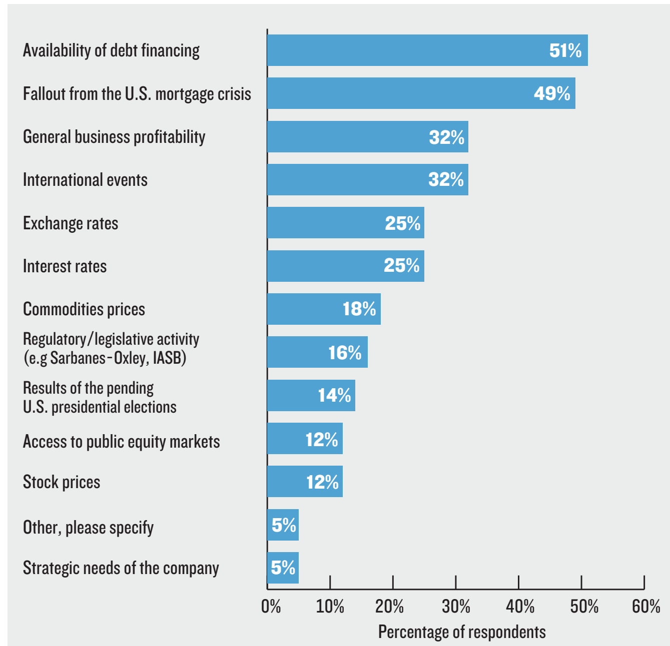
Do you foresee a downturn in overall foreign investment activity in the U.S. within the next year?



- Over two-thirds respondents (70%) see no decline in foreign investment activity in the U.S. over the next 12 months, while 24% say a decline is likely. According to the majority, the downturn in the U.S. markets will continue to drive foreign interest.

- More specifically, when asked to identify which factors will keep foreign investment in the U.S. steady or rising, most respondents cited exchange rates (72%), followed by share prices (35%) and the strategic needs of the foreign corporation (34%). Fallout from the U.S. mortgage crisis (29%) ranked fourth as another motivator for foreign investment.

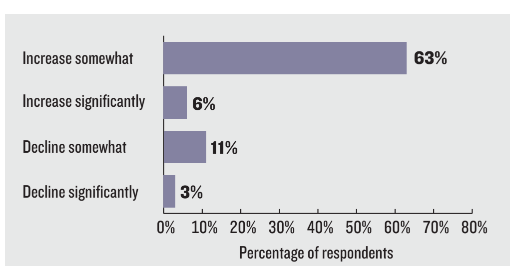
If yes, which 3 of the following factors will be responsible for the downturn?



- Interestingly, when we asked those who said they expect to see a decline in foreign investment to identify the factors responsible, they also identified access to debt financing (51%) and fall out from the U.S. mortgage crisis (49%). These results suggest that respondents have diverging views on how the aftermath of the mortgage crisis will impact foreign investment.

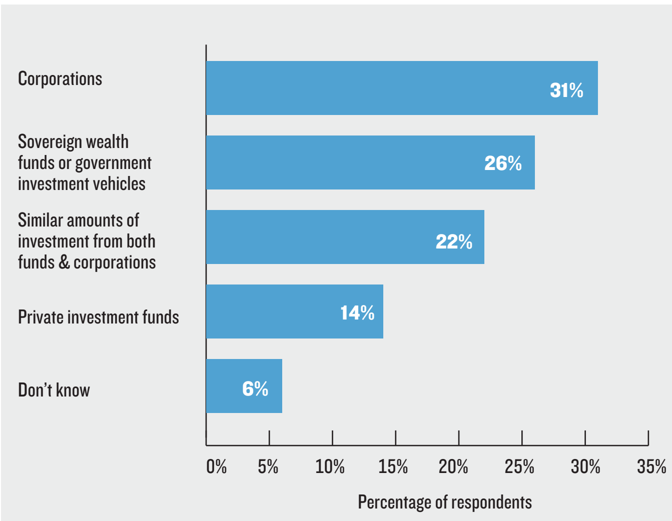
Sidebar: The value of the dollar

The value of the dollar is one factor responsible for strong interest from foreign investors. The dollar declined approximately 20% from Jan. '07 to 'Aug. 08. Most of our respondents think the dollar is done dropping – for now. 63% expect the value of the dollar to increase somewhat in the next 12 months, and 6% think it will increase significantly. Only 14% believe the dollar will decline somewhat (11%) or significantly (3%) over the next year.



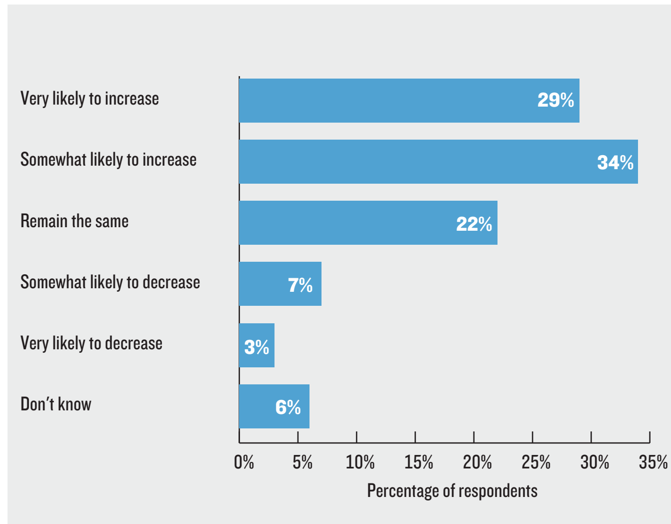
U.S.-based private equity players aren't the only ones suffering the crunch of the credit markets: respondents predict that non-U.S. private investment funds will take a back seat to corporations and sovereign wealth funds in U.S. acquisitions

In general, which type of investor will account for the bulk of U.S. investments?



➤ We asked respondents which type of investor would account for the bulk of foreign investments in the U.S. over the next year: corporations, private investment funds, or sovereign wealth funds. Corporations and sovereign wealth funds received almost equal amounts of votes (31% vs. 26%, respectively), but only 14% of respondents identified private investment funds as the largest source of foreign funds in the U.S. in the near future.

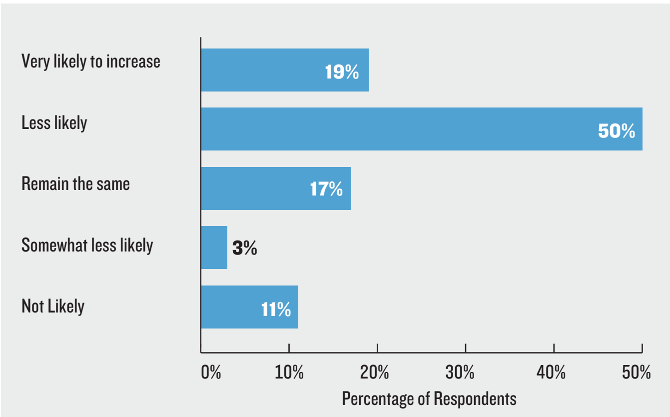
Over the next 12 months, what will happen to competition between non-U.S. private equity funds and corporate buyers over investments in the U.S.?



➤ Respondents also indicated that competition between foreign private equity investors and corporations in the more attractive sectors and industries is likely (34%) or somewhat likely to increase (29%). This may be due to inflows from cash-rich corporations in Asia and the Middle East, but also to the increase in opportunities for strategic investment brought about by a drop in the value of the U.S. dollar and share prices.

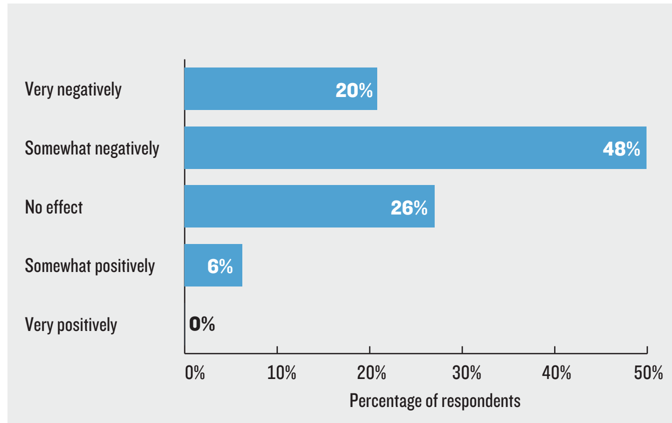
Limited access to debt is hurting U.S. firms

Over the next 12 months, how likely is it that foreign investors' ability to access debt markets abroad will give them a strategic advantage over U.S. investors?



➤ Tighter liquidity in western European markets may explain expectations of that corporations and Sovereign wealth funds will outpace foreign private equity investments in the U.S., but access to liquidity overseas is still not as strict as it is in the U.S. Our respondents certainly think easier access to debt is giving foreign investors a leg up vis-à-vis their U.S. counterparts. Almost 70% of our respondents said it was likely (19%) or somewhat likely (50%) that foreign investors' access to debt capital markets will give them a strategic advantage over U.S. investors in the next 12 months

How has the credit crisis impacted your ability to conduct M&A transactions?

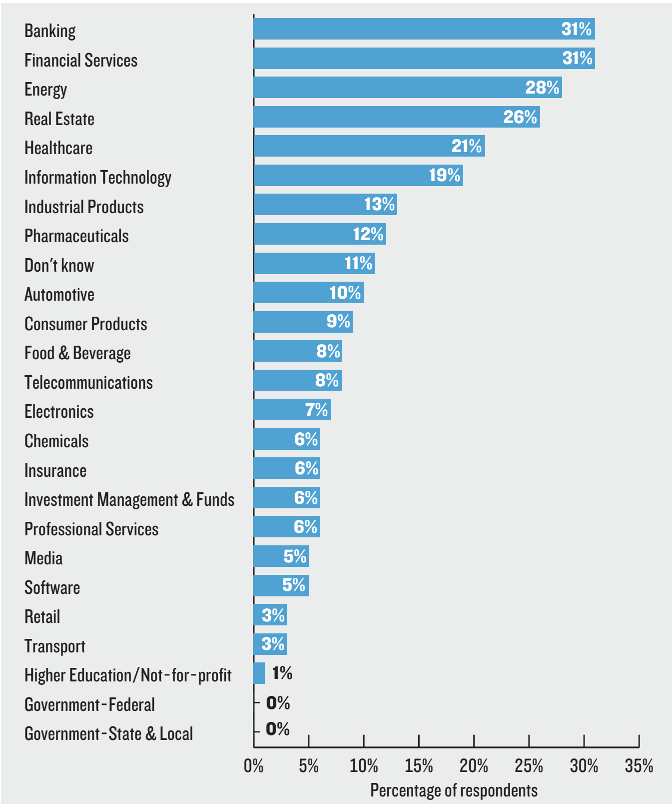


➤ As if to confirm these views, in a separate question our U.S.-based respondents also indicated that the country's recent credit market woes have impacted their M&A business. Almost 50% said that the credit crisis has impacted their ability to conduct M&A transactions "somewhat negatively," and another 20% said the impact was "very" negative. Another 26% said that the credit crisis has no impact.

Judging from answers to questions on the U.S. economy, the outlook for the near term remains bleak. Sixty percent of our respondents believe that the U.S. is in a recession, and another 16% believe the economy will enter a recession within the next 12 months. At the same time, most respondents expect the dollar to increase somewhat (63%) or significantly (6%).

Foreign investors will continue to bargain hunt in the three U.S. sectors hit hardest by the mortgage crunch of the past year: U.S. banking, financial services sector and real estate

Within the next 12 months, which three industries will be most attractive to non-U.S. acquirers/investors?

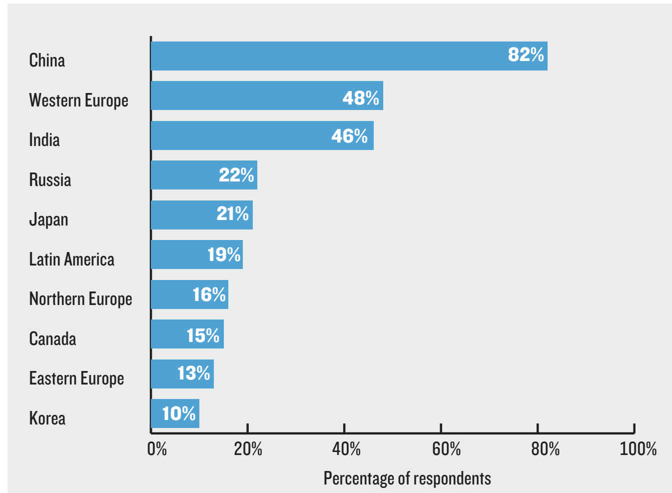


➤ Earlier this year a string of financial institutions including Citigroup Inc., Morgan Stanley and Merrill Lynch & Co. received large amounts of capital from investors in Singapore, Kuwait, the United Arab Emirates, Korea, Saudi Arabia and Japan. Our respondents suggest that foreign appetite for U.S. financial institutions will continue despite the fact that many recent investments have lost value.

➤ We asked respondents which of 25 sectors, ranging from automotive to retail, foreign investors will find the most attractive over the next 12 months. Banking and financial services topped the list, receiving 31% of the votes each. Energy followed a close third, receiving 28% of the votes. Real estate (26%) and healthcare (21%) took the fourth and fifth spots, respectively.

Fast-growing Asian investors are likely to lead foreign account for the bulk of foreign investment in the U.S. over the next year.

Which three regions or countries do you think will be the most active foreign investors in the U.S. in the next 12 months?

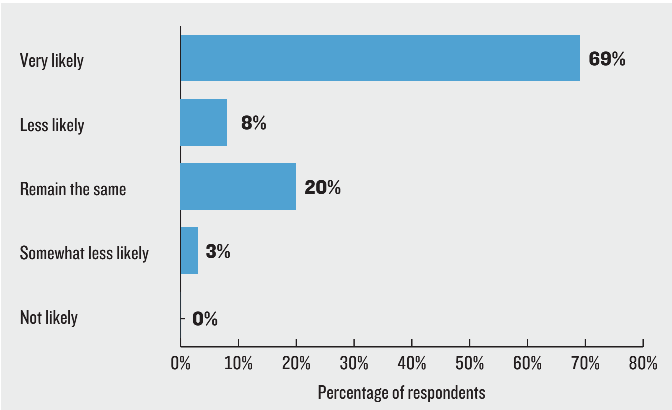


➤ The U.S. Bureau of Economic Analysis Statistics indicate that foreign investment from China, India and the oil-rich Middle East in the U.S. remains paltry when compared with that of Canada, Europe and Japan, but government-owned financial assets in these emerging markets are growing upwards to 20% a year, and need to be put to use. A majority of our respondents (80%) think that China will lead the list foreign investors in the U.S., followed by Western Europe and India.

Not surprisingly, M&A markets in China, India and Western Europe are also considered the world's most active. Forty-five percent of respondents think that China will have the most active M&A markets in 2008. Respondents were split between what will be second and third most active M&A markets, with 39% choosing Western Europe and 36% choosing India.

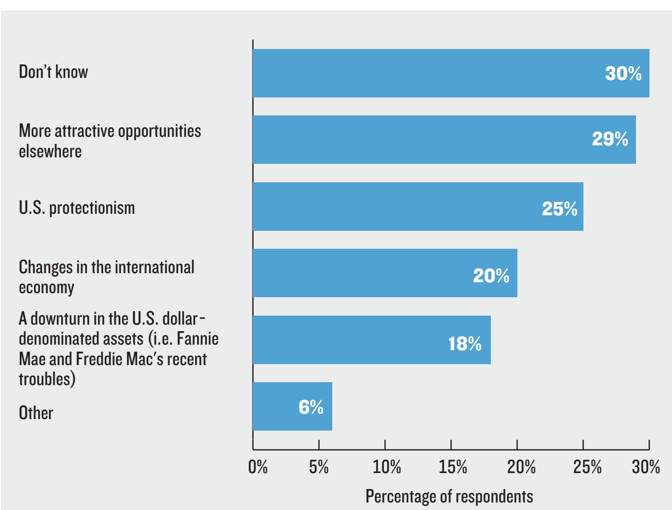
Middle Eastern and Asian Sovereign Wealth Funds will continue to show strong interest in U.S. markets

Which countries' sovereign wealth funds and/or state investment vehicles will likely show the greatest interest in investing in the U.S.?



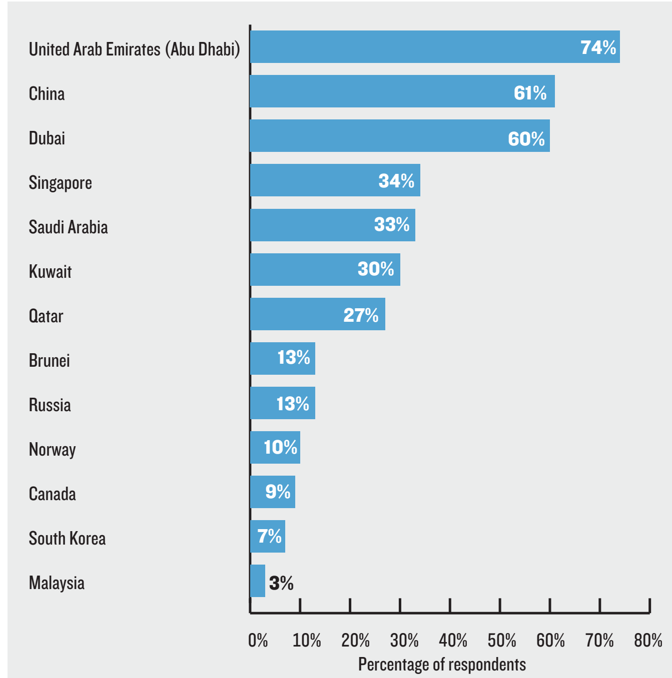
➤ Sovereign wealth funds account for a large proportion of inflows to the U.S. from Asia and the Middle East. According to DealLogic, sovereign wealth funds invested over $48 billion in 2007, representing a 165% increase over 2006. U.S. companies received much of these funds. Our respondents expect the trend to continue despite increased U.S. legislative scrutiny of government-backed foreign investors. Almost 70% of respondents think that foreign sovereign wealth funds will continue to show interest in the U.S.

If you believe that sovereign wealth funds will not show continued interest in U.S. investments, which of the following factors are deterring them? (Choose up to two)



➤ For those who expect a decline in SWF interest in the U.S., respondents were divided on whether opportunities elsewhere, U.S. protectionism or changes in the international economy would be among the primary causes.

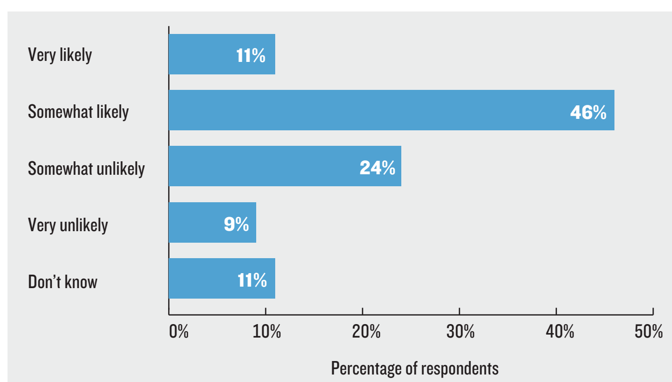
Which countries' sovereign wealth funds and/or state investment vehicles will likely show the greatest interest in investing in the U.S.?



➤ Most respondents think that the sovereign wealth funds of Abu Dhabi, Dubai, and China will be the most active in the U.S. when compared to 10 other countries. (Abu Dhabi received 74% of votes; Dubai received 60%; and China received 61%.)

Political scrutiny of foreign investments is likely to continue

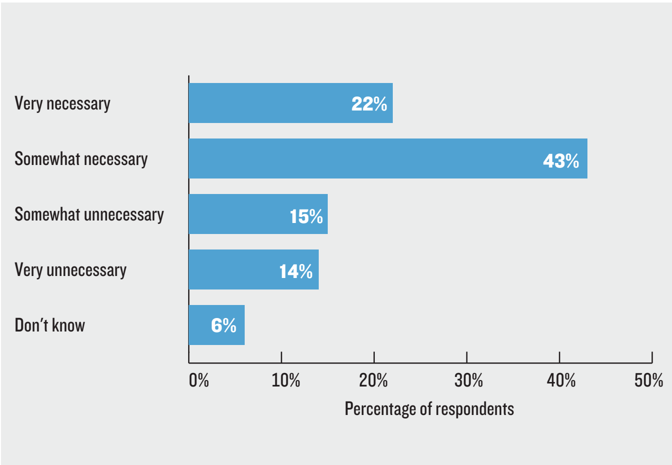
How likely is the U.S. government to enact new political legislation that will impact sovereign wealth funds' ability to invest directly in U.S. companies?



➤ While SWF and other foreign investments remain attracted to the U.S., they may face the threat of greater political scrutiny. Over half of our respondents think that sovereign wealth funds are likely to encounter new political legislation impacting their ability to invest directly in the U.S. Forty-six percent said new political legislation is somewhat likely, and 11% said it was likely.

Monitoring of foreign investments may be worthwhile

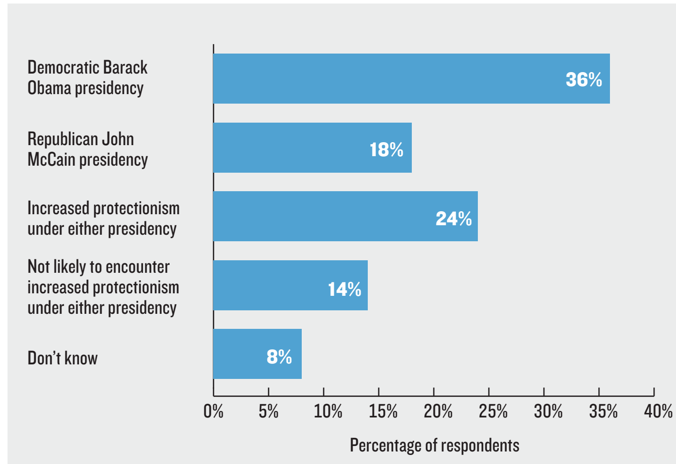
How necessary is U.S. political legislation to monitor and approve majority acquisitions of U.S. companies by foreign entities?



➤ Respondents also suggested that some scrutiny is necessary. When asked whether legislation is needed to monitor and approve majority acquisitions of U.S. companies by foreign entities, most respondents answered "yes." More than half of our respondents said that such legislation is necessary (22%) or somewhat necessary (43%).

A new U.S. presidential administration may impact foreign investment in the U.S.

Under what scenario are non-U.S. investors most likely to encounter increased protectionism?



➤ In August, we asked respondents whether the then impending U.S. presidential elections would influence the foreign investment climate in the U.S.? Specifically, we asked whether an Obama or McCain presidency would raise the bar for foreign investors. On this question, responses were mixed. Thirty-six percent believe protectionism to rise with an Obama presidency, versus 18 % for McCain. However, similar numbers of respondents think that protectionism is likely to either increase (24%) or decrease (14%) regardless of the election's outcome. Eight percent "don't know."

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