AMR INTERNATIONAL

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Local knowledge and experience is the first step to a successful US acquisition

AMR International's US office has been open for three years now and in that time has completed over 60 projects, many for European investors looking to acquire or start up operations in the country. Between the slowdown in domestic private equity activity and the weakening of the dollar, we are seeing a market that is becoming very favourably priced for foreign corporate investors.

Recent US projects conducted by AMR for European clients include market entry studies in the alternative energy, specialty pump, steel alloy, power distribution and support services sectors, as well as strategy projects in online and print media and outsourced maintenance. We have found that as valuation multiples become more attractive for purchasers, the trend towards foreign investment is increasing.

'Think global, act local' is the theme of the first article of this bulletin, looking at the many differences between the UK and the US markets. Whilst exploding some myths about the US market, we show how by having local knowledge and boots on the ground AMR can unlock new opportunities for our clients. A case in point is an acquisition search we carried out in the life sciences sector, where we identified a number of attractive US companies which were previously unknown to our client and which had an excellent fit with their search criteria.

In the second article, we look at some well known and some less well known examples of companies that got it wrong when they tried to enter the US market. Finally we round off this bulletin with a discussion of how thorough preparatory research can prevent the more egregious mistakes and how AMR can help you evaluate and re-position a portfolio company.

AMR's New York office is now a thriving consultancy business in its own right. With the benefit of 17 years of project experience and sector expertise from our London and Frankfurt offices, we are proud to have helped a number of European investors achieve their ambitions in the US market and look forward to continuing to do so.

Denzil Rankine, chief executive

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Local knowledge and experience is the first step to a successful US acquisition

The US market presents a huge opportunity. It is still the biggest market in the world, and they speak English. Surely investing in the US is a no-brainer? It is if you get it right, but getting it right means starting from scratch, assuming nothing, taking nothing for granted, and doing your homework. Just like you would, in fact, before investing in any other overseas market. "The US is a more prescriptive, regulated, and closed market than the UK. It may not be a comfortable place for some would-be new entrants" warns Ross Goralnick, AMR's US country manager.

Local presence maximises local knowledge
Although the mechanics of finding, evaluating and acquiring companies in the US may be similar to acquisition in the UK, there are many subtle differences that can be best handled by having experienced personnel on the ground. AMR has recognised the value of a local presence by opening an office in New York.

"Do not make the mistake of assuming that the US market is like your home market. It isn't. Everything is different," maintains Goralnick "and the scale is immense. The number of customers is massive, potential sales volumes are way higher and the distances within the country are bigger than anything you are likely to have experienced elsewhere. The most common mistake overseas companies make is to see the US as one homogenous market. There are really five markets – north-west, south-west, mid-west, north-east, and south-east."

Breadth of experience and depth of understanding come into their own when looking for acquisition targets. It is fairly easy to find data on listed companies as US regulations oblige them to provide data but private companies can be more difficult to identify. There are about 600,000 privately owned companies in the US about whom very little is known. "There are

many specialist companies over here that do not even have a website. Finding the juiciest acquisition targets is a case of getting out into the market and talking to people. It is the only way to find out who is out there," says Goralnick. "And they are usually open to a deal if they think it makes sense. Owners of private companies warm to foreign buyers because, despite the typical American stereotype, they do recognise that there is a world beyond Fifth Avenue."

However, the scale of the place and the huge number of opportunities means that any would-be acquirer has to focus on finding niches where it can build a clear advantage. "After all", says Goralnick, "this is not only the biggest market in the world, but also the most competitive."

US case study No. 1 – Finding the right target

A leading UK life sciences consulting business was looking to increase its US presence through acquisition, but previous investigation had failed to identify suitable targets. Candidates were either too large and expensive or their service offering did not represent a good fit with our client's specific needs. AMR's approach aimed to track down those below-the-radar companies that met the valuation and service offering expectations of our client.

First, we spoke with experts to understand the background to the industry and to find sources of potential targets. Then, by conducting interviews with these companies and screening them against criteria agreed with the client, AMR generated a list of 12 potential acquisition targets. The majority of these companies were previously unknown to our client and all represented a good or excellent fit with the search criteria.

Abandon hope all ye who enter? US market entry attempts often look like a long list of heroic failures

The tales of UK based retailers' failed attempts to make it "over there" are well known. M&S did not appreciate that Brooks Brothers' understated, unchanging way of doing business was exactly what appealed to its loyal customer base. Laura Ashley, Dixons, and Sainsbury's have all similarly misread the American consumer. Analysts claim they either expanded too quickly or failed to do adequate research before entering the market.

Their assumption, common to many, was that "we are successful in the UK therefore we'll be successful in the US." Their experiences prove the folly of such assumptions for anyone looking to enter the US. The US is not the UK. It is a different country with a different culture, different lifestyles, and different socio-economics. Customers have different values. American consumers like to be sold to. They like stories around the products. The US concept of service and good value are way different to ours. Just to complicate matters further, there are different cultures inside the US itself. However, it is not just retailers that have suffered expensive US failure.

A crocked acquisition

In 1981, Midland Bank acquired a 57 percent stake in Crocker National Bank, the fourth largest bank in California and twelfth largest in the United States, for $820 million. It was the largest foreign takeover, ever, of an American bank. Midland was looking to establish a large direct presence in one of the most prosperous regions in the country and Crocker felt that the increase in capital would allow it to expand. Midland, already the third largest deposit bank in Britain, became the tenth largest banking organisation in the world when the deal was completed.

Unfortunately, Crocker's financial performance began to falter almost from the moment Midland took it over and it collapsed in 1983 when it posted a loss of $62 million for the fourth quarter. Plagued by bad real estate loans and a substantial share of Latin American debt, it went on to lose $324 million for its parent company in 1984. The Midland stuck by its struggling subsidiary, even buying out the rest of Crocker's stock in 1985 after it hit its rock-bottom price of $16.25 per share, down from $90 in 1983. Before long, however, Midland decided that it had had enough. In 1986 it sold Crocker National to one of its California rivals, Wells Fargo & Company, for $1.1 billion, roughly the same amount of money that it had sunk into Crocker.

When the wheels came off

In 2002 Stagecoach, the bus and rail operator, crashed £524 million into the red at the half-year after taking yet another huge write-down on its disastrous Coach USA acquisition. The company paid more than £1.2 billion for Coach in 1999 but by 2002 had written it

down to £377m. The Coach write-downs forced the group to renegotiate its banking covenants.

Coach USA is a major provider of transportation services in North America operating transit, taxi, and coach and bus operations. After a four-month review of its US acquisition Stagecoach decided to close or sell about half of Coach's 85 businesses, spread over 100 sites in 38 US states, including its West Coast activities, to focus largely on scheduled commuter and contract services in the north-east.

Stagecoach found to its cost that the business was too geographically spread, while parts, such as its leisure, travel, and taxi operations, were just too volatile. Critics maintained that the company could have discovered all this by looking at a map of the US. Whatever the truth of that allegation, the company admitted that it had not done its homework before it bought Coach. Early on, £375 million of goodwill had to be written down after a series of black holes were found. Subsequently challenging market conditions, including a bus driver shortage during the summer when demand for tour and charter services is highest, led to a year-on-year sales decline while costs continued to rise as a result of increased labour costs, higher fuel prices, and rising insurance premiums.

Not powerful enough

Scottish Power got it wrong when in 1999 it bought the US electric company PacifiCorp for $10 billion. Scottish Power had entered a market that was fragmented, heavily regulated and slow to liberalise. The company's woes only increased after the acquisition with a weakening dollar and the collapse of US electricity prices. Even more embarrassing for a company that prides itself on its green credentials was the $1 billion writ slapped on PacifiCorp by Native American tribes who objected to a dam that prevented them fishing for salmon. PacifiCorp's promise to catch salmon then truck it upstream for the tribes to re-catch did nothing for either the credibility of the US company or its UK parent.

PacifiCorp was subsequently acquired by Warren Buffett's MidAmerican Energy Holdings Company for $5.1 billion, which was half the original price and Scottish Power lost its independence to the Spanish energy company Iberdrola.

Culture clashes

The merger between Daimler and Chrysler failed on many fronts. Buying the number three in a market is never a great idea but the merger failed primarily due to cultural and strategic differences. Chrysler is a low technology, cost-driven car manufacturer operating in a market that is increasingly being squeezed by Japanese competition with high efficiency and superior technology. Daimler-Benz's strategy of employing superior technology to manufacture high-value cars could not solve Chrysler's problems in the short term. These problems were further compounded by an unco-operative union and a Chrysler pension fund deficit totaling over $1 billion. DaimlerChrysler lost $1.5 billion in 2006 and in May 2007, Daimler sold 80 percent equity interest in Chrysler to Cerberus, a private equity firm.

The right touch?

Another company that acquired in the US with mixed results is Vodafone. Whilst the audacity of Vodafone's "hunt or be hunted" acquisition strategy has paid off in some respects, US market differences have had a negative impact on the company.

In 1999 Vodafone bought San Francisco-based mobile operator AirTouch for $62 billion, beating out Bell Atlantic in the process. Although, this gave Vodafone a toehold in the American mobile market AirTouch was still only a regional player. Vodafone decided to go national and set up a $70 billion joint venture with Bell Atlantic called Verizon Wireless. Although Vodafone only had a 45 percent share of the new joint venture it now had a part of the biggest mobile operator in the US, with 23 million customers and national reach.

Vodafone has always insisted that becoming a larger organisation enabled it to implement economies of scale when buying handsets, software, and network equipment. The US however, uses CDMA wireless technology, which is incompatible with the rest of the world's. Although, it could be argued that the US is a big enough market for economies of scale to be less important, the US position undermines the whole rationale for Vodafone's expansion.

Despite shareholder pressure to sell, Vodafone has decided to stick with its 45 percent stake, claiming that Verizon Wireless is "a market leading business with strong growth prospects". That may well be so, but one must question the strategic benefit of a minority holding in a carrier that uses different technology.

Thorough research is vital for any company considering entering the US market, says Ross Goralnick, AMR's US country manager

The US presents an enormous challenge to many acquirers, particularly new entrants, due to its sheer size – both geographically and in value. The size of the market can blur many of the weaknesses as well as the advantages of a target company. Most of the industrial sectors are highly fragmented, geographically across states, and in product and customer terms the US market is large and diverse. The needs and purchasing behaviour of the affluent, mostly urban north-east are different from the needs of mostly rural mid-west communities. These differences are even more striking when other socio-demographic and cultural differences are considered.

Identifying that the target is the right one, therefore, can be more difficult than it might at first appear, making the need for proper commercial due diligence even more important than ever.

Assume nothing

Commercial due diligence provides an assessment of the present and the likely future commercial performance of the target company. The process prevents the acquirer from overpaying but, more importantly, should also cover how the acquisition should be managed and positioned post-acquisition. Many foreign acquirers have faced post-acquisition problems in the US, either due to the lack of understanding of the market or the culture of the target company. Corporate acquirers who seek to acquire targets in their own, or complementary, sectors are often offenders because of a "we know it all" attitude. They rely only on their internal knowledge based on doing business in the market. While this is a good place to start, most companies are bad at looking outside and benefit greatly from a third party challenging their assumptions.

US case study No. 2 – Repositioning an acquisition

A multi-sector provider of print business-to-business market intelligence had begun to lose its user base. Investors in the business were alarmed, as the company's valuation had more than halved since the acquisition three years previously despite positive feedback about the quality of data on offer. What the acquirer and target had not taken into account was that customer data delivery requirements were changing. AMR spoke with current and lapsed customers and confirmed that users were rapidly moving away from print and switching to online sources of data. More importantly, in some sectors in which the company operated customers appeared willing to pay a premium for online data. However, AMR discovered that online competition was already intense in certain sectors and recommended the divestment of these assets. In other sectors the migration to online was only just beginning and there was a significant opportunity to move existing customers to online delivery while also raising prices.

Compare the usual approach with that taken by Tesco to its US market entry. It spent two years conducting painstaking and unbelievably detailed research into American shopping habits. It even placed anthropologists into 60 homes to follow families' daily routines and built a mocked-up nameless store inside a vast warehouse to observe shoppers.

Leveraging 17 years of European experience

As Europe's leading independent specialist provider of commercial due diligence, AMR brings considerable experience and expertise to North America, while fully appreciating that market conditions on opposite sides of the Atlantic are rarely identical. AMR has brought together experienced consultants with an outstanding track record in the US market. Most bring sector knowledge and industry experience. "One thing we have found to be consistent is the value that we can bring to clients in helping them in their US ambitions," points out AMR CEO, Denzil Rankine.

US case study No. 3 – Using in-depth market knowledge to size the market

A laminated kitchen door manufacturer who wanted to raise funds to enter the US market had difficulty in assessing the potential market size. Whereas there was an enormous amount of data on kitchen cabinets, there was next to nothing on the kitchen door market. The easiest option would have been to assume a correlation with either cabinets sold or manufactured. However, the AMR approach showed that using kitchen cabinet sales would have underestimated the volume of door sales and the subsequent value of the market, as many of the doors are sold to customers who are remodeling their kitchens. We were also able to show that the door market is regionalised according to the type of laminate material used. This allowed our client to present a superior case to its lenders.

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