The decline of the US dollar, emphasised by the subprime crash, has led to a surge in foreign investment in the US. According to data compiled by Thomson Financial, none of the ten largest merger related bids in the US in Q4 2007 had a US acquirer. US investment has been high on the European agenda with the UK topping the global list. The euro and pound are soaring, but with the ramifications of the credit crunch stretching to Europe, buyers from the Middle East and pivotal Asian economies are very much in the race for US assets. Furthermore, the rapid rise of cash rich sovereign wealth funds (SWFs) has added another asset class to the mix which, in the current financial climate, has recently bought stakes in leading US banks. The US economic slump brings with it a wealth of opportunity for the foreign investor but also strict regulations that could hinder investment from certain regions and buyers.

The picture may seem bleak for most US buyers, but some are in a position to capitalise. With private equity funds far less likely to drive up deal values as they have done over the past couple of years, the door is open for strategic buyers to acquire assets at a cheaper price. US sellers are agreeing to lower prices and focusing on a buyer’s ability to pay cash or obtain financing. “An investor must have cash on its balance sheet or at least ready access to cash through existing credit facilities,” says W. Hunter Holliday, a partner at Alston & Bird LLP. “In the current environment the seller will likely be seeking cash rather than equity – in depressed equity markets, a buyer’s equity may simply be too expensive to use as currency. Also, the buyer’s business must be insulated against the forecasted chill in the US economy. For example, a buyer with a strong balance sheet and ample cash may think twice about pursuing even a bargain acquisition if its business is overly dependent on consumer spending or housing.”

The huge impact of the credit crisis on liquidity and the ability to arrange leveraged financing has hit US private equity firms hardest. With large, highly leveraged transactions fading from the market, private equity players have been left with little choice but to turn to the middle market. As a result, deal flow particularly in the lower middle market remains strong, according to David Lonsdale, president and managing director at Allegiance Capital. “The credit crisis has not stopped transactions in the lower middle market, which is almost regarded as a safe haven. A significant amount of the money that was designated for larger transactions is coming down the chain. Although banks are conducting their own thorough due diligence exercises and have tightened up lending criteria, private equity groups have increased their equity stake and company valuations have dropped by 10 percent compared to the second quarter of last year. So while acquirers are modifying the way they structure a transaction, deals are still being consummated.”

Although private equity has been hit globally, European based private equity players have an advantage: the exchange rate. With a strong euro and pound against a weak dollar, some experts suggest that European based investors can purchase US companies at around 30 percent less than two years ago. A savvy investor that picks up a handful of good US companies, and prepares for an exit in four to five years, could capitalise twice – once on a rising dollar value and again on the improved performance of the company. In addition, if trends continue, competition from strategic buyers is unlikely any time soon.

The increased buying power of SWFs has shot into the limelight following investments by Middle Eastern and Asian funds in top US banks including Citigroup, Merrill Lynch and Morgan Stanley. SWFs, which currently have around $3 trillion at their disposal, may surpass $10 trillion by 2015 according to Merrill Lynch and Morgan Stanley. But intense scrutiny over their political motivations, and calls for greater transparency, could hinder future activity by SWFs. But most observers expect that funds from fast growing emerging markets will be keen to gain a foothold in the US. “The emerging market economies that will be best positioned to acquire US assets in the period ahead will be those that enjoy a trade surplus with the US and those that benefit from high commodities prices – particularly oil and natural gas. Under these criteria, Middle Eastern sover-
eign wealth funds seem extremely well placed to acquire US assets,” says Mr Holliday.

China is expected to capitalise on the low dollar, using the US economic slump to recycle its huge foreign exchange reserves, expand its business interests and boost its market knowledge. Chinese manufacturers, for example, see compelling reasons to make acquisitions in the US, as Mr Lonsdale explains. “These companies want three things: brand, distribution and technology. At present, most of the design work is happening in the US. The product is then manufactured at a low cost in China, before being passed back to the US where the marketing and distribution takes place. But Chinese manufacturers are eager to compete along all parts of the spectrum. Current economic conditions give lower and middle market companies the perfect incentive to acquire the design, distribution and marketing capability which they currently lack.”

However, corporate Chinese acquirers may suffer delay in the deal process through additional scrutiny off the back of general fears in the US surrounding Chinese investments. “There seems to be paranoia in the US, that is being politicised by elected representatives in the US congress, about investments by SWFs from China in particular, which may impede some of the investments they would otherwise make,” says G. Michael O’Leary, a partner at Andrews Kurth. “Some of this fear may be justified but the majority are probably not. Nevertheless, the fear is real. But now that other sources of capital have dried up or been eliminated, it is a good opportunity for these countries to invest. Given more time, and if China is willing to work with the US government and adopt more transparency, they may find that the door is opened more widely to them.”

The backlash against foreign investment from certain countries puts European acquirers in an even stronger position. Cultural similarities between Europe and the US are a tremendous advantage over more opaque, unfamiliar emerging markets. Also, in contrast to the strength of the euro and pound, many emerging markets have rising commodity values but their currency is pegged to huge stores of dollars. European investors also have an advantage when acquiring a controlling interest in sensitive or strategic US assets. Perhaps as a result, there are general differences in the way assets are targeted and deals are structured, as Mr Holliday points out. “European investors and investors from emerging markets are, in many cases, pursuing different types of investments in the US. Financially savvy European strategic investors are acquiring US businesses or assets in medium sized transactions to enhance the value of their existing businesses or operations. In contrast, many emerging market investors seem to be making more passive investments, such as acquiring minority stakes in large US companies, like investment banks, or even investing in or partnering with US private equity funds.”

Although Europe has felt the ripple effect of the credit crunch from across the Atlantic, and the availability of debt is restricted, the strength of the euro means opportunities in the US will be too attractive for top European investors to ignore. “Although some European financial institutions were caught in the credit crisis, there remains access to capital for well placed European buyers,” says Wayne N. Bradley, a partner & co-chair of the corporate department at McKenna Long & Aldridge LLP. “Furthermore, as investments by private companies in public projects continue to make their way through the US economy, it will become more likely that there will be European entrants into that space due to European governments and consequently companies, having an established history of such public private partnerships.”

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Legal and regulatory issues
When pursuing transactions, foreign investors have to exercise an increased level of transparency and be willing to face scrutiny from
the Committee on Foreign Investment in the US (CFIUS). In addition, the recently enacted Foreign Investment and National Security Act (FINSA), affecting non-US entities seeking to acquire, merge with, or make an investment in a US business, may involve a government- 
tal review and investigation of such trans- 
actions. As a result of FINSA, CFIUS will 
likely become more active, and the reviews and 
investigations it undertakes more numerous. “Not only will transactions in tradition- 
al defence sectors be reviewed, but FINSA makes clear that national security concerns may be implicated as well by investments in ‘critical infrastructure’, such as transporta-
tion, energy and technology. Furthermore, 
the application of FINSA and involvement with CFIUS is not only a regulatory process, 
but a political process too, where thoughtful 
navigation can mean the difference between 
success and failure,” says Mr Bradley. Non-
US investors must also be aware of US antitrust laws including those governing pre-
merger filings, pre-closing conduct and post-
closing operations. Such laws, not always 
familiar to foreign investors, can play an im-
portant role in determining the success of the 
transaction.

Some of the concerns from US officials on foreign investments are justified, but in the main investments are commercially and 
legally sound. Similar concerns were raised 
about foreign investment back in the 1980s, 
when the Japanese bought several ‘trophy 
properties’. The weak US dollar has prompt-
ed a recurrence by encouraging foreign in-
vestors to flood in. A wave of media and 
political commentary is stoking the fires of 
fear towards foreign investors. Yet most 
experts hope such fears will subside. “People 
will eventually realise that foreign investors are just like any other economic investors – they typically have the same motivation, 
which is to make good investments and gen-
erate returns,” says Mr O’Leary. “Everything 
goes in cycles; the US has had great oppor-
tunities to invest abroad in the past, and now 
the tables have turned. While there are some 
legitimate causes for concern about coun-
tries that may not necessarily respect prop-
erty laws, or trademark and patent laws, for 
the most part this is a positive trend. The US 
needs capital, and while regulators should 
certainly be keeping a close eye on invest-
ment, we hope this does not discourage sound 
transactions.”

Looking ahead

Foreign investment is expected to accelerate, 
predominantly down to the low cost of US 
investment for European investors due to the 
swooning euro and pound. On a global scale, 
as long as the outflow of US dollars to foreign 
countries continues, there is no end in sight 
for foreign investors to re-invest that money 
back into the US, especially when there are 
bargains available. Strategic investors will 
remain the first choice for sellers in a liquid-
ity-starved environment, due to synergies 
with the target and access to cash. SWFs will 
have to play the US regulatory game in order 
to capitalise on low priced US assets. Private 
equity players, for now, will target the lower 
to middle market, but when US buyout houses 
come up against their European counterparts, 
the strength of the euro and pound will put 
them on the back foot. Ultimately, economic 
decline in the US has created a market awash 
with opportunities for savvy buyers with cash 
in hand and a willingness to navigate a poten-
tially tricky regulatory process.

Mike’s practice emphasizes substantial experience 
in all aspects of corporate transactions, including 
representation of public and private companies and 
investment banking firms. His work with financing 
transactions includes public offerings and private 
placements of equity and debt; redemptions and 
exchanges of preferred equity and debt; and 
project financings (including partnership and 
limited partnership financings). Mike also counsels 
on a wide range of strategic transactional matters, 
including formation of partnership and joint 
ventures, including international joint ventures 
and alliances; publicly traded limited partnerships; 
spin-offs; mergers, acquisitions and dispositions 
(by tender offer, exchange offer and otherwise) 
of corporations, divisions of corporations and 
other entities; changes of control and strategic 
alliances; structuring “going private” transactions; 
defensive techniques; director fiduciary duties; 
restructurings; and liquidations. He has particular 
experience with energy and oilfield service 
companies, pipeline transportation, staff leasings, 
royalty trusts, and forest products companies.