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“Is the World Really Flat?”

Middle Market Companies Competing in the Global Economy

ACG Chicago's Conference Challenges Popular Thinking

One of the first priorities of ACG Chicago today, according to Chapter President Mike Sklar, is the delivery of a major conference focused on international best business practices. Conceived of a few years ago, the content-charged event earned resounding plaudits from the start. This year's meeting, on Wednesday, Feb. 28, 2007, at the Intercontinental Hotel, will soar with high-level intellectual capital about a business area of increasing concern, questions and interest, says Andy Rice, Senior VP International, The Jordan Company, and co-chair of the ACG Chicago International Committee that laid the groundwork for the conference.

“ACG Chicago is a dynamic community with a very involved board,” notes Conference Chairman Frank R. Mack, a managing director of the international turnaround advisory firm of Conway MacKenzie & Dunleavy. “Investors and other professionals have flocked to international markets to find low-cost manufacturing, expanding consumer markets, and premium returns on investment. This long-term trend presents extraordinary opportunities-and challenges-for those of us pursuing international investment and business strategies. ACG Chicago leaders believe it is important to create additional value for members by offering an annual world-class conference that addresses international elements and issues, and so we have.”

The intellectual exchange will be rigorous throughout the day as guests hear from highly regarded and globally informed business pundits. Lunchtime keynote speaker, Fareed Zakaria, editor of *Newsweek International* and host of the “Foreign Exchange” show on the Public Broadcasting System (PBS), promises the same probing depth and acumen in his discourse that he displays in “This Week with George Stephanopoulos,” his regular analysis for ABC News, and his own weekly PBS news series, “Foreign Exchange with Fareed Zakaria.” *Esquire Magazine* named Zakaria one of the 21 most important people in the 21st century.

“We are thrilled that someone of Dr. Zakaria's stature will address the group,” says Committee Co-chair Michael Carsella, Senior VP, Cross-Border Finance of LaSalle Business Credit, part of the ABN AMRO/LaSalle Banking Group. “The timing for this presentation could not be better.”

In the last few years, Dr. Zakaria has become a kind of bridge to the Arab world—an Asian-born Muslim with a Yale and Harvard education who seems willing to act as a cultural interpreter. His post-9-11 *Newsweek* cover story, “Why They Hate Us,” put him on the mainstream map as someone who could make sense of an increasingly threatening outside world. And he has continued to win a substantial following with thoughtful critiques of the Bush administration's activities in Iraq, according to *The Village Voice*.



Michael Carsella



Frank Mack



Andrew Rice

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Upcoming Events

February 20, 2007

Luncheon Meeting

February 28, 2007

International Conference

March 8, 2007

Research Program Reception

March 20, 2007

Luncheon Meeting

April 13, 2007

Market Trends Breakfast

April 24, 2007

Luncheon Meeting

May 2-4, 2007

ACG InterGrowth Conference

May 15, 2007

Luncheon Meeting

June 12, 2007

Annual Golf Outing

June 19, 2007

Luncheon Meeting

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Michael L. Sklar

Dear Friends,

Thanks to your confidence and support I'm entering my second year as President of ACG Chicago. The year 2006 was a period of success, growth and change for us as we worked to realize our mission: Becoming the leading authorities on corporate growth and making sure that the broader business community knows who we are.

I want to briefly tell you what your officers and directors accomplished last year and where your new officers and directors want to take ACG Chicago this year as we pursue our mission.

Growth and Membership

2006 was a year of unprecedented membership growth for ACG Chicago. For the 12 months ended November 2006, we added 170 new members and with our high retention/renewal rate we now number well over 800 members strong. One thousand members—once a far-off, impossible dream—now seems within our grasp. Our membership grows because of our strong programming, networking environment and reputation: We are the place where the best and brightest dealmakers, financiers and deal professionals gather.

Your membership committee, headed ably by Mary Lou Bartlett from LaSalle Bank and Tom Jones of Concord Financial Advisors, LLC, has undertaken an ambitious program to maintain existing members and actively seek new member candidates with high-level deal experience and financial sophistication. Mary Lou and Tom are continuing to drive the committee work initiated during 2006 under the leadership of retiring chairman David Bronner with Ungaretti & Harris.

Our growth has resulted in one very visible change. In November of 2006 we changed the venue of our meetings and events from the Metropolitan Club, our home for nearly 10 years, to the larger and more accessible Standard Club in downtown Chicago.

Programming

Good programming attracts good crowds, and that means better networking and enhanced business opportunities for our members. If you came to our breakfast, luncheon and international events in 2006, I'm sure you noticed an increase in the variety of subject matter and the quality of speakers and panel members. This is no accident. In 2006 your Board appointed former ACG Chicago President Paul Krantz of GMAC Commercial Finance to oversee and coordinate the work of our three program committees. Working together with Paul, the committee co-chairs and their members brought you truly valuable and informative events. In 2007 we plan several events co-sponsored with other organizations in order to broaden your information sources and networking opportunities.

Any dealmaker who attended our Capital Connection on October 24 must have thought "they died and went to heaven." The number of private equity people and dealmakers in attendance far exceeded our expectation, and the "action" was something to behold. Last year we initiated our limited invitation DealSource exchange exclusively for private equity and investment bankers. We will expand this popular event next year. Kudos to Susan Wilson of Lincoln International who drove this train. Arnold Davis, of Accenture, Susan's co-chair, was a major player in the event's success. Look for another outstanding Midwest ACG Capital Connection in '07 as Arnold takes on the event chairmanship.

Finally I want to encourage all to register for ACG Chicago's International Conference, titled, "Is the World Really Flat? Middle Market Companies Competing in the Global Economy," to be held on Feb. 28, 2007, at the Intercontinental Hotel. Andy Rice of Jordan Industries and Mike Carsella of LaSalle Bank, our two International Committee co-chairs, along with Frank Mack of Conway MacKenzie & Dunleavy, conference chair,

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The year 2006 was a period of success, growth and change for us as we worked to realize our mission: Becoming the leading authorities on corporate growth and making sure that the broader business community knows who we are.



President's Column

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and their committee have put together a stellar event. Among the panelists and speakers are Julie Sell, financial editor of *The Economist* and Fareed Zakaria, author, lecturer and editor of *Newsweek International*. There is still time to register!

Getting Out the Word

Your Board in 2006 recognized that membership value goes up when the business community knows what ACG is and recognizes the talents and resources ACG members can provide. To launch this effort, your marketing committee, headed by Co-chairs Dustin Weinberger of GE Commercial Finance, and Karen Peters, engaged KemperLesnik Integrated Communications (KL) to raise the public's awareness about ACG Chicago. KL's work began in the summer of 2006. As a result numerous interviews with the financial press have taken place and, most visibly, The Chicago Sun-Times gave our Capital Connection lead story position in its business

section shortly after our event last October. Look for increased activity in this direction in 2007 as we spread the word on ACG, its talented membership and the capital resources they represent.

This year we expect to reap the benefits of our two extensive, ACG-funded research projects with the University of Chicago Graduate School of Business and the Loyola University Chicago Family Business Center. Look for media coverage about these reports.

Administrative Advancement

ACG Chicago is nothing without an effective administrative staff, and we have one of the best. Led by Terry Cobb, our tireless Executive Administrator, our events are planned and take place in good order and on time, registrations are handled for multiple events, membership records are maintained and updated, contracts negotiated with hotels and other venues, new member applications

processed, notices provided to membership, money and finances handled like clockwork, and your questions answered....in short, 101 details are attended to. Last year to ease Terry's growing burden as a result of more members and events, Rachel Klimala joined our staff and has proven to be a wonderful addition.

We also moved into our own office space to Willowbrook, Ill., last year, a move that substantially increased our staff's professionalism and responsiveness. And to complete the picture, we brought our staff "in from the cold" of consultancy to full-time employee status with a full range of health insurance benefits and the availability of a 401K retirement plan.

For ACG Chicago 2006 was a very good year. With all of your help, 2007 will be even better.

MICHAEL L. SKLAR
President, ACG Chicago
Partner, DLA Piper US LLP



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“Is the World Really Flat?”

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THE JOURNAL A publication of ACG Chicago



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International Conference Committee

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Mike Carsella, LaSalle Bank

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Tom Parro, MERK Capital Corporation

Andy Rice, The Jordan Company

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High-Powered Panels Engage Thought Leaders

“Six panel presentations are substantive and offer something for everyone,” adds Carsella. “We are focusing on high-level people to gain maximum insights about the middle-market corporate development business overseas.”

Julie Sell, finance correspondent with *The Economist*, Stephen Pagliuca, Managing Director with Bain Capital, and Jay Jordan, Founder and Managing Principal of The Jordan Company, will start activity with a robust breakfast panel discussion.

Ms. Sell covers international financial services from *The Economist's* head office in London, but her roots trace to Chicago. She began her journalism career in daily newspapers, first in America and later in Asia and Europe. She was on staff at *The Asian Wall Street Journal* in Hong Kong and *The International Herald Tribune* in Paris. Following a stint in international management consulting, she began writing for *The Economist* in 2002 in Chicago where she tracked politics, social trends, and financial news.

Mr. Pagliuca helped build Bain Capital into a leading global private equity firm with over \$40 billion capital under management. Bain Capital is especially well known for its operations focus and the vigorous research it does on companies and industries as investment candidates. Mr. Pagliuca has had a leading role in the expansion of Bain's international business. Among other areas of involvement, he is a Managing Partner and Executive Committee Member of the Boston Celtics.

Mr. Jordan heads The Jordan Company LP (TJC), a New York City-based private investment firm, one of the top middle market private equity firms. Together with its affiliates, TJC has worldwide sales of about \$7 billion. TJC has completed approximately 100 major acquisitions of middle market companies, ranging in value from \$50 million to \$1 billion, supplemented by the purchase of another 200 companies serving as tuck-ins. TJC manages The Resolute Fund I, a \$1.5 billion equity fund it raised in 2002. During the past 10 years, TJC has done more than 50 overseas acquisitions and joint ventures.

Panels Push More Hot Buttons

Following the Sell-Pagliuca-Jordan panel are two other panels that occur simultaneously: *We Need to Find Lower-Cost Manufacturing—But Where?* moderated by Jim Kirk, Associate Managing Business Editor of the *Chicago Tribune*, and *Sourcing Cross-Border Deals*, moderated by David Laverty, Partner of International Counsel, LLC. After these and still before lunch are scheduled two more simultaneous panel discussions: “*What's Under the Hood: How to Avoid Buying a Foreign Clunker: How to Avoid Mis-Valuing, Mis-Analyzing and other Mis-Takes in Assessing the Target Business*,” moderated by Rafi Musher, President of Stax, Inc., New York, and “*Pitting Lions Against Gazelles—Cross-Border Distressed Opportunities*,” moderated by Linc Rogers, Canadian Foreign Legal Consultant, Blake, Cassels & Graydon.

After lunch and Dr. Zakaria's address, discussion will focus on the topics, “*A Look Behind the Curtain: Owning and Operating a Foreign Business*,” moderated by Mr. Rice, and “*From Berlin to Beijing: Finding Financing for Foreign Acquisitions and Expansion*,” moderated by Mr. Carsella. A networking reception from 3:45 p.m. to 5 p.m. will conclude the international event.

Said Chairman Mack, “The 2007 International Conference committee is comprised of world-class international business people who have drafted a comprehensive event covering complex geopolitical, macroeconomic elements as well as basic global business theories and principles. ‘Is the World Really Flat?’ is a must-attend event for all business people pursuing international investment and business strategies.

“Even if your current business model is primarily U.S.-based, some aspect of future business will contain a component of international commerce, so this conference is for you, too. The speakers and committee members are looking forward to exchanging global beliefs and strategies on February 28.”

Networking Steals the Show at Midwest ACG Capital Connection in 2006



ACG Chicago members and colleagues from other chapters “worked” the Grand Ballroom at McCormick Place in October. Some 100 private equity firms with \$50 billion in capital to invest purchased tables at the largest-ever Capital Connection hosted by the chapter.

The Midwest ACG Capital Connection in 2006 exceeded all expectations for networking dealmakers. The din emanating from the Grand Ballroom at McCormick Place stayed constant over the four+ hours as 1,000 ACG members and guests worked the room: swapping information, business cards and even tchotchkes.

We’ve brought together 100 private equity companies with \$50 billion in capital to invest with 1,500 portfolio companies, announced ACG Chicago Executive Vice President Susan Wilson, Advisory Director with Lincoln International, in her opening remarks. The numbers represented a 20 percent increase over 2005 Midwest ACG Capital Connection and reflect its growing importance to the ACG corporate community that participated this year on October 24, 2006.

Co-chair Arnold Davis, Senior Manager at Accenture in Chicago, echoed Ms. Wilson’s sentiments. “I am very happy with our turnout today,” said Mr. Davis. “The number of private equity tables could have increased to 150 had we not closed it off at 100. As it was, some 25 private equity firms were wait-listed.”

DealSource: Important Innovation

“This was a good event, and I mean it,” wrote Mark Jones, partner with River Associates in Chattanooga, Tenn., following the high-profile program. “The Chicago event is still on my list of ‘keepers.’ I especially liked the addition of the DealSource,” noted the Vice President of Private Equity Groups for ACG.

The DealSource “speed-dating” program, offered for the first time this year, drew 30 investment banking firms into a quieter venue to share information with private equity representatives. The private, 15-minute conversations that took place over two hours allowed for more in-depth discussion and heightened the potential for future dealflow between the parties involved.



Quayle Offers Global Insights

Breakfast keynote speaker Dan Quayle, Global Chairman of Cerberus Investments, addressed three topics: his work with Cerberus, among the world's largest private equity firms with \$14 billion under management; global security; and domestic politics. Said the former U.S. Vice President, whose extensive business travel covers Europe and the Far East, the biggest enemy to the markets today is a world fraught with instability and a global inclination to "protectionism" that impacts business development.



2007 Event On The Calendar

Mr. Davis will co-chair the 2007 Midwest ACG Capital Connection scheduled for October 23 at McCormick Place. Mark Grossmann, Partner in law firm Katten Muchin Rosenman LLC, and Joe Davisson, Senior Vice President of GE Commercial Finance, will share the lead responsibility for the occasion, which will mark the seventh consecutive Capital Connection hosted by ACG Chicago.



Former U.S. Vice President Dan Quayle (left) spoke at the opening breakfast session, offering insights on the current political and economic landscapes worldwide. Some 1,000 guests attended the 2006 Midwest Capital Connection, which also staged the first ACG Chicago DealSource event.

Cross-Border Deals

Increasing Globalization or Nationalism or Both?

By Dan Tiemann



Dan Tiemann

About KPMG LLP

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The last few years have resulted in an extremely vibrant M&A market. A flurry of summer deals—about \$110 billion of deals were signed in less than 100 hours in June—has made it likely that 2006 will be the most active global merger year in history.

Globalization and global competition have been partially responsible for this trend. But at the same time, another global force has been creating something of a counterweight to cross-border deals. Nationalism, national security concerns, and perhaps even a little bit of protectionism have recently hindered several cross-border deals. Interestingly, it looks as though both globalization and what the French call “economic patriotism” are on the rise. While both trends can survive in tandem, it seems that certain types of deals will likely be challenged more often. Energy, which has become a particularly politicized commodity, is one area in which deals will likely raise added government scrutiny. And perhaps surprisingly, banking is another area that seems to create feelings of national pride and protectionism.

Legislation in the U.S. and Europe

In some cases it may seem that serious national concerns are at stake. Certain industries have raised red flags in multiple contexts and countries. But in other cases it seems that certain buyers make people uneasy. And some countries seem particularly uncomfortable with foreign buyers. In April U.S. lawmakers were so upset by the prospect of a United Arab Emirates-owned company operating U.S. ports that they began hearings to overhaul the review process of acquisitions by foreigners of U.S. companies that are vital to national security. In June the White House announced that it was creating a government post to coordinate security reviews of foreign-led deals (previously the review was conducted by the Committee on Foreign Investment at the Treasury Department). Political pressure also ended the Chinese company Cnooc's bidding for Unocal in August 2005. Of course, restric-

tions on foreign control are not new—there have been long-standing regulations that restrict foreign ownership of U.S. media outlets.

Recently, European countries have been particularly vocal in raising concerns about cross-border acquisitions. In February, Spain gave its energy commission new powers to approve takeover bids after the German energy company Eon made a bid for Endesa, a Spanish energy company. In July when the Spanish stock exchange operator Bolsas y Mercados Espanoles became a public company, the Spanish government required anyone who wanted to purchase more than one percent to receive regulatory permission. It took a six-month takeover battle for ABN Amro to become the first foreign bank to acquire a large Italian bank. The chief of the Bank of Italy was eventually forced to resign amid criminal investigations of suspected abuse of power in handling takeover bids for Italian banks.

A French decree passed at the end of 2005 gives that government the right to veto or impose conditions on foreign takeovers in 11 “sensitive” sectors, ranging from defense to casinos. When faced with a bid from the Italian company Enel, the French government, which owns a majority of the energy company Suez, arranged a merger with Gaz de France instead. In fact, the French Prime Minister, Dominique de Villepin, has made “economic patriotism” a campaign issue in the run-up to the presidential race next year. In June, French President Jacques Chirac stated that he preferred a merger between the Deutsche Borse and Euronext, the French-based exchange, as opposed to the one agreed to between Euronext and the New York Stock Exchange. And last year, the French govern-

ment scared off a potential bid by PepsiCo for Groupe Danone by describing the yogurt maker as a national “jewel.”

Britain received the largest amount of foreign direct investment in 2005 and has been one of the least protectionist countries. However, even Britain has shown some resistance to foreign deals. Public concern surfaced last year when the Russian company, Gazprom, stated its ambition to acquire the British energy company, Centrica, and The British Department of Trade and Industry announced that any such deal would come under “robust scrutiny.”

Globalization May Be Part of the Cause

What is causing countries to act like unhappy targets and effectively issue their own forms of poison pills? One possible cause of this type of defensiveness may be the very success of the global M&A market. With the merger market in the midst of what some describe as a “frenzy,” perhaps it is not surprising that certain countries are feeling that their assets are going to the highest bidder in a process that they sometimes can’t control. This feeling may be heightened in industries and countries that are moving from government ownership to private ownership, and governments may be tempted to act when companies that they previously owned and managed are now being auctioned off to “foreigners.” Another reason for the unease may be increasing competition from emerging markets, coupled with slowing growth rates at home. Although the deal was ultimately completed, some were uneasy when the Chinese company Lenovo announced the acquisition of IBM’s personal computer business in 2004.

Conclusion

Although markets may seem volatile, it appears that the global M&A market is extremely robust, and the trend towards globalization is likely to continue. Funding sources are still plentiful although the cost of capital is rising. Corporate debt issuances have been increasing, interest rates remain low by historical standards, and the market for high-yield debt continues to be strong. In addition, private equity firms are sitting on huge amounts of uninvested capital, and bigger and bigger funds are being raised. In July Blackstone announced that it had attracted \$15.6 billion for what is now the world’s

largest fund. At the same time it is likely that in some countries, and in sensitive industries such as energy, economic patriotism is also likely to be a factor. Cross-border dealmakers should be aware that government regulations can always thwart a planned takeover; reviewing historical precedents and current trends will help gauge which deals are more likely to be viewed as sensitive.

DANIEL D. TIEMANN
Partner, KPMG, LLP

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-Benjamin Disraeli

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Finding a World of Opportunity in a World of Risks

An International Perspective on Due Diligence

By John Schmidt, William Spizman, Frank LeBihan



John Schmidt



William Spizman



Frank LeBihan

About RSM McGladrey (RSM)

RSM is the fifth largest accounting and consulting firm in the United States, and the largest focused on companies on the move. Through our national Private Equity Practice RSM provided due diligence on more than 150 engagements for more than 60 funds nationwide. We also audit more than 50 private equity funds and are the auditors for many private equity fund portfolio companies.

RSM McGladrey is the largest member firm of RSM International (RSMi), the world's sixth largest organization of accounting, tax and business consulting firms according to the International Accounting Bulletin. RSMi has office locations in more than 70 countries, including nearly all of the key markets of the world. We have more than 24,000 professional staff members and combined revenues in excess of \$2.7 billion. Through our unique International Office in Chicago, we have supported more than 1,200 international transactions in the last year alone.

Mention due diligence to most American business people, and they think of the traditional close examination of financial statements, projections and other representations involved in determining the appropriate purchase price for a target business.

While that examination remains vital in an international transaction, a much broader range of concerns must be addressed . . . starting with where those numbers come from to begin with.

In the U.S., transaction professionals are accustomed to accurate, transparent financial information governed by robust, mature accounting principles. That isn't the case everywhere in the world. Consider, for example, China, a key destination in today's global transaction marketplace.

While China has made tremendous progress in recent years in upgrading its accounting environment, the overall accuracy and reliability of financial statements in China is low. A recent article in the *Financial Times* points out that the Chinese Institute of Public Accountants has only 140,000 members. By most estimates, China needs at least 10 times as many trained accounting professionals. And it is still not unusual for a Chinese business to keep different sets of books for taxing authorities, investors, and its own management.

Nor is China alone in that regard. In developing countries the consistent application of financial regulations and accounting policies is an area that is still developing. Companies considering deals in such climates need to do considerable work to ensure the accuracy of financial statements before they even begin the type of financial due diligence that would characterize a deal with an American target.

Nor are financial statements the only areas that need more scrutiny. So, too, do the owners and managers of target companies or potential partners.

In the U.S. you can learn a tremendous amount about anyone involved in a deal in a few minutes. Credit history, criminal history, civil judgments, and bankruptcies—all are just a few clicks away. Not so in China. The personal reputations and histories of those with whom you will be doing business are vital. Professionals who have been reading up on business in China have all reviewed the stories of lower-level plant managers' living lifestyles far beyond the means afforded them by their salaries. While the Chinese government is taking steps to try to rein in corruption and fraud, the legal environment in China is still at an early stage of development when compared to the U.S.

Nor is bad news all you should look for. In any market, and especially in China, having connected business partners is vital. Guanxi, the Chinese version of networking, is vital to success in China. Part of the investigation of potential partners, investors or managers involved in a deal in China should be to establish and verify their connections within the business community and with any appropriate governmental entities. Those connections can be crucial to the success of your deal.

Be aware, however, that business traditions and ethics in China can be different from our own. While you want well-connected partners, you don't want partners engaged in activity that will run afoul of the Foreign Corrupt Practices Act. That caveat applies to your business relationships anywhere overseas, not just in China. And corruption isn't the only issue. With international terrorism a concern, capital flowing into the wrong hands could have your enterprise running afoul of the USA Patriot Act.

The human factor isn't all that needs to be examined; human resources should be closely taken into account as well.

Consider the following scenario: An American business spots a European company with similar products and markets but suffering from poor results due to overstaffing and other inefficiencies. The American business plan? Buy the company, take advantage of operational synergies to reduce the workforce, close a few locations, and use the new, leaner European operation to break into the EU market.

While it sounds like a solid strategy and models an approach successful in the U.S., a variety of labor law concerns will make it far more expensive in most locations of Europe than in the U.S.

For example, many European countries require severance packages by statute, and these packages are often tied to longevity. In France labor laws make it more difficult to lay off more senior workers than more junior employees regardless of performance levels. Labor laws also may have strict rules about exactly how layoffs are conducted. If your restructuring plans are leaked during negotiations, you could run afoul of those rules and end up with legal liabilities before you've even closed your deal.

Some European countries also have state-mandated pension plans. Depending on the details of those plans and the demographics of a target company's workforce and retiree population, pension obligations could be a significant factor or even a deal-breaker for a cross-border transaction.

Even in locations without mandated pensions or onerous employment laws, there may be other employment-related expenses that could trip up companies which fail to investigate local practices. In China, for instance, companies are sometimes required to provide housing, transportation, even food, for their workforces. While China is attractive for its low labor costs, understanding exactly what

those costs are, including any non-payroll expenses, is important to gaining an accurate economic picture of any deal.

The due diligence implication? Investigate local labor laws and practices to quantify their potential economic impact and to negotiate an appropriate purchase price.

Any cross-border transaction raises issues related to effective local tax compliance, appropriate deal structuring and efficient global strategies to best take advantage of tax laws and regulations in both the U.S. and the target company's country. Other concerns, such as transfer pricing, also may be an issue. It is impossible here to provide specifics, which vary with each location and each deal. The important thing is to work with advisers who have a comprehensive tax knowledge and breadth of experience necessary to transform local knowledge into an appropriate, cohesive global tax strategy.

International differences can affect deals in a variety of other unexpected ways. For example, when buying a privately held company, U.S. companies are used to structuring deals in ways that would most benefit a business owner in the U.S. Yet those same

structures may not be as beneficial in other countries that may have more paternalistic attitudes toward employees. A U.S. buyer pushing to close a deal quickly may alienate such an owner, who is waiting to get a better feel for the new management team that he is entrusting with his people.

The key to effectively addressing the numerous issues that make the difference between a successful international deal and a financial black hole is effective advice from professionals. Seek out those experienced in working on cross-border transactions who have direct access to foreign experts well-versed in the full range of issues that can affect your deal.

JOHN SCHMIDT
Managing Director, RSM McGladrey

WILLIAM SPIZMAN
Managing Director, RSM McGladrey

FRANK LEBIHAN
Director, RSM International

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Perfecting the Art of International Management and Investment

By Ireland J. Stewart



Ireland Stewart

The generally accepted definition of a well managed company is one with high consumer satisfaction, good employee ratings, strong earnings, a solid balance sheet, an increasing worldwide market share, and a record of continually successful product development coupled with innovative marketing.

Additionally, the company's record of success must extend over a period of at least 10 years (20 is even better), and it has to show continuous improved performance in its key indicators relative to its nearest competitors.

How is it that some companies not only achieve a reputation for being internationally well managed, but a record that signifies the reputation is deserved, while other companies fail? Why is it that some countries show higher rates of increasing real growth compared to other nations?

Management must be committed to ideas of competitiveness, continuous improvement, performance measurement, customer satisfaction, and a willingness and capability to take risks. Creativity and the ability to correlate some not-too-obvious relationships, particularly in the marketing arena, are other key determinants of corporate success. The ability to motivate people to work not just intelligently, but with an outward-looking focus (especially in a global sense) is another key element in generating success.

It also can be argued, at least on a global basis, that, by itself, even possessing the most outstanding management may not be sufficient for a company to be successful. Elements such as infrastructure, general education levels, willingness of the workforce to be effective producers, government non-interference in areas in which it lacks expertise, and a non-corrupted reward system are vital considerations for a well-managed company in a global context.

In many instances, if an inefficient or inadequate central system poses too many constraints on an individual's ability to grow in the context of international market opportunity, migration of talent occurs. Management and entrepreneurial talent tend to move where it has the most likelihood of the greatest return. Thus, it is not surprising, in the absence of significant language or other barriers, that talented people usually go where there are the fewest roadblocks to success. The U.S., with its largely open economy, has been quite proficient in drawing outstanding people from all over the world to its shores.

Israel, too, has benefited from the importation of talent. Despite its small size, Israel has one of the world's most advanced economies, specializing in computers, medical and information technology development, defense systems, and biological sciences. This process of becoming a high-tech society was spurred significantly by the large migration of well-educated Russian Jews to Israel after the collapse of the Soviet Union in the late 1980s. Clearly, people moved for the opportunity to be free politically, but also by the desire to participate in an open economy that could provide market-based income for their talents.

Ireland's Resurgence

The Republic of Ireland is another example of a country's undergoing significant social and economic change. For years Ireland had suffered extensive mass migration of its young people. The result was a stagnant economy and a sense of futility—both about

staying in Ireland and the value of education. However, thanks to changes that encourage free enterprise, such as the introduction of a 12.5% corporate tax rate, Ireland has become one of Europe's fastest growing economies. That nation's current problem is to maintain its present position in the face of intense wage and general cost issues from the newly competing economies of Eastern Europe, with their lower labor and infrastructure costs (plus good technical capabilities) and the application of some free-market concepts.

If a political economy can be organized so that there is minimum negative intervention into normal economic activity, a number of different political systems can become serious economic competitors in world markets. This phenomenon is best illustrated by a look at the Far East economies of Taiwan, Hong Kong, Korea, Malaysia, Singapore, Thailand and China. It is possible to compile a chart showing degrees of political freedom within this group. Its ranges would include China, with increasing economic freedom but very limited political freedom, to Taiwan, where there is much political and economic freedom. Yet, they are strong export-based economic competitors in world markets, and each represents significant economic opportunities and challenges in various ways for the U.S. In other words, freedom and individual enterprise are critical determinants of international competitiveness, and these sometimes are distinct from the political environment.

These Asian nations each seem to manage their political systems to reflect their view of social order. Management of their economic sectors, however, more closely correlates with the Western model of a free or quasi-free market. In fact, in many cases, government actions have been repressive in the political arena but have been aimed at expanding opportunities for economic growth and opportunity. What they seem to have done is co-opt certain elements of Western democratic systems, such as the concept of free market

(with their own variations, but, as a general rule, they have not integrated the Western democratic model into their political systems. In time, as they move along the longitudinal spectrum with this approach, they have the capability to be very troublesome global competitors for American companies.

U.S. firms must keep in mind that nations with an orientation to a free-market approach but with strong nationalistic overtones and a non-democratic system of government can produce very difficult competitors. Within this framework, a high level of technical and managerial capability can be attained, which, in turn, can be supported by a government system that tends to interfere arbitrarily in favor of its domestic firms.

Two recent examples in which U.S. companies have faced this type of situation involve Cisco and Microsoft. Cisco had sued its Chinese competitor, Huawei, accusing it of copyright infringement of Cisco's technology. Cisco won a preliminary injunction against Huawei in a Texas court. Huawei agreed to stop selling the disputed routers and switches, including the changing of user manuals and part of Huawei's source code. As a result, Cisco suspended its lawsuit. As in other areas, piracy of foreign intellectual property can be a serious problem. However, there seems little doubt that, where the basic technology is available, legally or otherwise, Chinese manufacturers can produce high-tech products at significantly lower costs than their Western competitors.

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has acquired all of the issued and
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Microsoft is facing a different dilemma. In spite of its high visibility and the presence of a technology center in China, the Chinese government is attempting to reserve 70% of local and central government spending on electronic communications budget activities for domestic companies. In addition, according to *The Wall Street Journal*, 50% of most other types of software would have to be bought from domestic vendors. This obviously reduces the market opportunities available to Microsoft and other U.S. and foreign software companies. Moreover, Microsoft has had to address the Chinese government's insistence that certain words such as "democracy" automatically be eliminated from Internet blogging.

American firms have to be very circumspect with regard to capital investments and intellectual property since investment rules can be changed even after investments have been made. Some people use this argument for increased assistance to American companies operating in non-democratic countries. Nevertheless, it remains important to recognize the development of a highly skilled entrepreneurial and managerial class and good inexpensive labor, especially in the Far East. Sometimes these companies actively are supported by a regime anxious to bring economic prosperity to its nation.

Many Asian countries have mirrored the entrepreneurial development enjoyed by Japan in the years after World War II. Meanwhile, many others have failed to develop. Several African nations have not advanced at all economically during the past 20 years, and until recently South America was affected negatively by uneven growth, high inflation, currency issues, and deep recession. In the case of Africa, countries suffer from intense corruption at almost every level. These economies are more focused on managing the public sector and dealing with income distribution issues. As a result, not much consideration has been given to the development of a relationship among the forces of local and international business competition, entrepreneurship, and the political economy. Education, typically the pillar for economic growth, has been sadly neglected. In many places, the political economies and business sectors have been at odds over resource allocation and

utilization. As a consequence, much of Africa has degenerated significantly in the arena of international competition. Zimbabwe is a prime example of a country virtually bankrupt because of the pursuit of non-economic goals coupled with corruption.

Tough Times in Africa

The African continent is a very complex arena, and there are many competing theories and rationales to explain its lack of economic growth. It is recognized that the political and business economies have been out of sync in most African states for more than 50 years. Corruption also has run rampant in many nations. This cannot be reversed overnight. However, awareness of the relationship among the political economy, economic growth, general education level, health of the population, and development of entrepreneurs and managers of international competence is essential. This only can help in making those decisions that determine the allocation of national resources.

Clearly, when significant corruption is present—either within the government operations or the business sector itself—the probability of an efficient allocation of resources decreases. This is not to imply that there is corruption solely in African countries, but it does say that if Africa hopes to make economic progress it must reduce the impact of any practice that distorts the allocation of resources.

Vietnam, too, has had to deal with plenty of corruption, as the government brought charges against over 150 people, including members of the Communist administration and its security operation. Apparently, the Vietnamese government finally realized that its tolerance for corruption was hurting economic progress and the country's reputation internationally, especially in the financial world.

There is an increasing gap in wealth, infrastructure, and social well-being between those

countries with highly developed economies based on free or quasi-free market systems, where economic corruption is not an overwhelming problem, and those with high levels of corruption. In the latter case, the infrastructure to compete internationally is retarded, a serious flaw since world markets have become more competitive. For example, the difference in expected quality levels (and therefore performance) of automobiles in the U.S. in 2005 compared to 1980 is astonishing. Any country trying to enter the American auto market today would have to meet very exacting standards compared to even 10 years ago. The same is true of communications, electronics, software development, and other technical arenas.

Access to new markets for developing nations is more difficult now than ever before. The developing economies of the 1960s, 1970s, and 1980s, including those of Japan, Korea, Taiwan, and China (in the 1990s), have become tough international competitors. This toughness relates to existing countries and new sources as well.

This suggests that firms must have an understanding of the relationship between the political and business economies, especially when attempting to operate in developing nations. Preference for investment should be given to those nations where the relationship between governments and industry is based on an understanding of the requirements of an internationally competitive world. The political economy should do everything possible in terms of infrastructure to ensure that the

Preference for investment should be given to those nations where the relationship between governments and industry is based on an understanding of the requirements of an internationally competitive world.

companies are able to compete internationally. If there is insufficient indigenous competent business or industrial management, it poses very severe constraints on any nation hoping to be competitive. The absence of rampant corruption is a prerequisite for any country trying to develop an internationally competitive position. Even in the U.S., public corporations must comply with the Sarbanes-Oxley provisions in addition to the Foreign Corrupt Practices Act.

For U.S. corporations competing in the international arena, the message is clear: It is important to understand the link between the host business sector and the host government when manufacturing, marketing or selling overseas. These links are not always immediately obvious from outside the country but often can determine the success or failure of investment projects. In certain places regional or local governments are more important than the central government in terms of business development and must always be a factor in any situation analysis.

The activities of American corporations within any foreign country must be compatible with U.S. laws and regulations. In particular, where corruption, and sometimes extortion, is rampant, an American firm may be forced to forego certain foreign business opportunities. If the mode of operation within a particular nation is such that it is inconsistent with a reasonable interpretation of the standards required by U.S. regulations, then American firms have limited options.

These scenarios pose serious difficulties for U.S. companies in Russia and certain other

Eastern European countries that for several years have been attempting to recover from the mismanagement and corruption of their respective economies under totalitarian rule. This period of transformation, as these nations attempt to develop fundamental institutional structures, has prompted an economic power vacuum. Even today, American firms in Russia and adjoining countries—and Russian companies, too—deal with a largely unstructured economic environment that allows the forces of corruption to play an active role. If Russia is successful in developing its infrastructure and the business skills of its people, it can become a strong competitor and a solid market opportunity for new businesses. If it cannot deal with these forces, it will achieve only a small portion of the possible benefits of a free market economy. American companies hope that the transformation is completed soon. It would be a boost for worldwide consumption and production and a challenge to U.S. marketers.

Business ethics, economic efficiency, and the allocation of resources got off to a rocky start in the U.S. at the beginning of the 21st century. Those at Enron, World Com, Adelphi,

Tyco, and others behaved in a manner akin to that found in a third world corrupt economy. This disservice to the country went beyond the hardship experienced by stockholders, employees, suppliers, and others. It demonstrated an atmosphere of personal and corporate greed and corruption, which ultimately resulted in the introduction of the Sarbanes-Oxley Act.

If the generally accepted free-market concepts of economists Adam Smith and David Ricardo are to result in an efficient allocation of resources, there has to be an implicit belief in transactional integrity. Even a quasi-free market economy requires a certain level of transactional integrity in order to progress. In theory and in practice, every transaction should have integrity. This has to be the belief that American companies carry with them—no matter where they operate.

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Hot Market, Cold Market— A Financing Force that Cannot Be Ignored

By Joseph J. Fobbe



Joseph Fobbe

“Asset-based lending is counter-cyclical. When a strong economy has the banks and cash flow-lending shops lending aggressively, asset-based lenders go to the beach (or golf course).”

—Source: many professionals in the financing industry

This contention couldn't be further from the truth.

A number of well established *commercial-finance*, *asset-based* and *business credit* shops are on their way to record years. A *business credit* shop is generally a lender that is more likely to have a structured product in its quiver that will permit it to give equal weight to a borrower's assets and cash flow—particularly when a private equity investor is involved in the underwriting. This typically has the lender providing a cash flow component—a/k/a air ball, Overadvance, etc.—to a borrower to support a leveraged buyout, recapitalization, or high growth situation.

A few notes from the Commercial Finance Association's Annual Asset-Based Lending Survey 2005 (www.cfa.com) will also help refute the common belief that asset-based and business credit financing is completely counter-cyclical.

- The U.S. asset-based lending industry grew 16% in 2005 to a record level of \$420 billion total asset-based loans outstanding at year-end.
- Double-digit industry growth has not been experienced by the industry since 2000. There has been only one down-year since 2000: 2001 saw an 8.3% year-over-year decline. The previous down-year was 1991.
- Improved industry profitability was achieved in terms of higher ROA and ROE.

- For 30 years the asset-based loan industry has grown from \$11.9 billion in outstandings to approximately \$420 billion in outstandings.

I think we'd all agree that there was no economic downturn in 2005. In addition, the evidence of excess liquidity both in 2005 and still today is abundant. As just one example, second lien loan volume from 2002 to 2005 increased from \$570 million to \$16.3 billion. (Source: Standard & Poor's LCD).

Why is it true that these asset-based approaches to financing are so consistent?

The answer is quite simple. In good times or bad, a business-credit or asset-based approach to financing U.S. borrowers frequently provides greater liquidity, consistency, and flexibility, as described below.

LIQUIDITY

Business credit lenders provide cash first and foremost by lending against a borrower's fixed assets, accounts receivable, and inventory, and secondarily against the borrower's cash flow. This primary focus on assets is frequently without regard to a borrower's balance-sheet leverage and often without regard to a borrower's cash-flow leverage (which many refer to as Funded Debt to EBITDA). The result is frequently more borrowing available than a multiple-of-EBITDA approach may provide.

About PNC Business Credit

PNC Business Credit is a division of the PNC Financial Services Group that provides leveraged financing solutions to middle market companies through 27 offices nationwide. Total financing commitments exceed \$11 billion. Product offering includes B loans, industry leading treasury management, EXIM products (including Super Delegated Authority of \$25 million), capital markets, and institutional trust capabilities.

CONSISTENCY

A primary focus on a borrower’s assets first and cash flows second permits a borrower to be more confident the lender will be there when needed. This is a result of the lender’s taking less risk with each deal due to the asset coverage and ongoing monitoring. A corollary is that the lender overall has less portfolio risk and will better tolerate macro swings in the economy. (Hint to potential borrower: ask your lender to walk you through the diversification of its existing portfolio and its trends the past five years. This should be an interesting exercise!)

FLEXIBILITY

The stronger reliance on assets permits the lender to require fewer financial covenants. This is particularly important when a borrower is challenged with customer concentrations (i.e., big box retail, automotive) or sells to customers in cyclical industries (i.e., steel, paper).

In addition to the above consistency, following are a couple of related points.

Commitment to Buyout shops: In good times or bad, many business credit shops with a cash flow capability routinely see 25% to 33% of their annual new business in the form of private equity-driven platform financing, portfolio refinancing, or add-on financing for a fund’s existing portfolio investment.

Choosing a Lender: Choosing a Business Credit lender (or any lender for that matter) is no different than choosing any other type of vendor. Indeed, since a company’s senior debt outstandings are frequently the largest, most concentrated liability on its balance sheet, it’s not hard to argue that the process should be more thorough. Do your homework. Make sure you understand your lender’s *investor* commitment and how your lender has (or preferably *hasn’t*) changed its focus as the economic cycle ebbs and flows.

Final Note—An International Asset-Based Financing Growth Opportunity

Most everyone knows the overwhelming impact international developments have had on mid-sized domestic companies. One way many diversified financial service providers are assisting their borrowers is through the Working Capital Guaranty program of the Export-Import (EXIM) Bank of the United States.

This form of financing enables U.S. exporters to obtain loans that facilitate the export of goods or services. These loans are provided by both asset-based and commercial lenders and are backed by the guarantee of the EXIM Bank. They increase a borrower’s liquidity to accept new business, grow international sales, and compete more effectively in the international marketplace.

Exporters may use guaranteed financing to:

1. Purchase finished products for export
2. Pay for raw materials, equipment, supplies, labor and overhead to produce goods and/or provide services for export
3. Cover standby letters of credit serving as bid bonds, performance bonds or payment guarantees
4. Finance foreign receivables

EXIM Bank generally guarantees 90% of the bank loan, including principal and interest. Generous advance rates under the program permit exporters to borrow more than they otherwise would with a traditional asset-based loan, for example:

- Up to 75% of inventory cost may be advanced, including work in process, which typically gets completely excluded in a traditional borrowing base.
- Up to 90% of Foreign Accounts Receivable

Needless to say, this can be a powerful sub facility of an asset-based revolving line of credit, untapping important liquidity for borrowers with growing international sales.

Also, it is important to note that only a handful of lenders have Fast Track Authority and are able to commit the government’s guaranty for facilities up to \$25 million. This special authority greatly reduces the processing and closing time of a transaction.

We appreciate your taking a few moments to read about this often forgotten financing force in strong economies, the Business Credit lender. Next time you review financing options for a leveraged buyout, merger, acquisition, recapitalization, debt consolidation, or expansion financing, don’t forget about this valuable lending source. You’ll most likely be pleasantly surprised by the overall creative package presented to you.

Note: For additional terms, conditions, and fees, contact your lender or visit www.exim.gov/products.

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PNC Business Credit

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DORIS CHRISTOPHER RECEIVES LIFETIME ACHIEVEMENT AWARD

Doris Christopher, founder and chairman of the Pampered Chef®, a Berkshire Hathaway company and the premier direct seller of high-quality kitchen tools sold through in-home demonstrations called Cooking Shows, recently received ACG Chicago's most esteemed individual award for Lifetime Achievement. The award is given for a long and successful business career that includes buying and selling businesses, according to ACG Awards Co-Chairman John Weber.

Ms. Christopher started her career as a home economist and educator. In so doing, she recognized the need for quality kitchen tools designed to make cooking quicker, easier and more efficient so that families could spend less time in the kitchen. In 1980, with a \$3,000 loan from an insurance policy, she founded The Pampered Chef in the basement of her suburban-Chicago home. Today The Pampered Chef is a multimillion-dollar international corporation serving 12 million customers annually.

A strong advocate of the traditional family dinner, Ms. Christopher is the author of *The Pampered Chef: The Story of One of America's Most Beloved Companies* (Currency/Doubleday, 2005), a top-selling book about the founding of her business. She also authored the book, *Come To The Table: A Celebration of Family Life* (Warner Books 1999).

In 2006, Ms. Christopher was made a lifetime member of the Horatio Alger Association of Distinguished Americans. These are individuals from humble beginnings who have achieved extraordinary success.

Outstanding financial performance is a leading criterion in the highest corporate awards given annually by ACG Chicago, but innovation, leadership, and social responsibility rank nearly as high, according to ACG Awards Co-chairman John Weber.

As such, it may come as little surprise that R.R. Donnelley & Sons (RR Donnelley), the largest provider of printing and print-related services in the world, received the ACG Chicago Outstanding Corporate Growth Award for 2006, and RC2 Corp., a 16-year-old company known for creativity and successful innovation in a highly competitive industry, the Emerging Company Award.

"We considered about 60 companies nominated by various members of the chapter," said Mr. Weber, Senior Vice President, National City Bank. "We did an extensive financial analysis of each candidate and reduced the list to about 10 companies. The process took two months, starting in the spring when year-end earnings are released."

RR Donnelley, headquartered in Chicago with approximately 50,000 employees, annual revenues of more than \$8 billion, and nearly 600 locations around the world, opened its doors in 1860. Today the company operates in three segments: publishing and retail service; integrated print communications; and forms and labels. Its recent acquisition in June 2005 involved The Astron Group, a firm that provides transactional print and mail services, data and print management, document production and marketing support services primarily in the United Kingdom.

Mark Angelson, RR Donnelley CEO, will accept the award at a chapter meeting this month. Before assuming his current position, Mr. Angelson served as Chief Executive Officer of Moore Wallace Inc., the third largest printing company in North America. He was a principal architect of the merger of RR Donnelley and Moore Wallace and the earlier merger of Moore Corporation and Wallace Computer Services.

RR Donnelley joins past winners Fortune Brands, which won the national ACG Outstanding Growth Award last year, Household International, Alberto Culver, Biomet, and others of equal stature.

RC2 Corporation: Emerging Company Award Winner

RC2 Corp, based in Oak Brook, designs, produces and markets branded infant, toy and collectibles products. It was chosen because of its year-over-year growth and its sophisticated business strategy of achieving organic growth and growth through acquisition.

Curtis W. Stoelting, RC2 CEO and Director, accepted the award from the chapter in November and described how the diversified, multi-channel consumer products company has matured. RC2's stock price has soared nearly 400 percent in the last five years, helped by strategic acquisitions and organic growth through new product development. The company even hosts an online "Mom" community to stay abreast of children's interests in toys and to help fuel the creative process.

The company employs 750 people globally, 100 of whom work in Chicago area.

"RC2 Corporation is known for its creativity and innovation," said Ray Daly, long-time Awards Committee Co-chair and Business Development Executive of IBM Credit LLC. "The company has made four major acquisitions over the past seven years to help drive growth and create a sustainable portfolio of leading brands including The First Years infant products, Learning Curve toys and Johnny Lightning / Ertl collectibles."

RC2 joins the ranks of past ACG Chicago Emerging Company Award winners, including Arthur J. Gallagher & Co.; DeVry, Inc.; Tellabs, Inc.; and Zebra Technologies.

The two ACG Chicago winners will compete against candidates nominated by other ACG chapters in contention for the national ACG awards for Outstanding Corporate Growth and Emerging Company. They will be given at the ACG InterGrowth Conference in May.



Raymond Daly



John Weber

‘High Finance’ for Lower End Middle Market Deals

By William G. Harlan



William Harlan

It is no secret that the “deal business” is robust. Many would say frothy. Industry publications report a steady stream of activity at both well established firms as well as recent entrants. Merger and acquisition activity is intense, and the financing requirements of these transactions have consumed staggering amounts of capital in recent times. With daily reports of multi-billion dollar deals, there is no end in sight.

Coincident with the growth in the “deal business,” increasing amounts of financing have become available, including participation from finance companies established in recent years as well as hedge funds.

While it attracts less publicity, the lower-end middle market deal business is also alive and well. Though no formal definition exists, companies with \$8 to \$10 million EBITDA or more are generally considered “middle market,” and companies below that level are often described as “lower-end” middle market companies. This segment, which buyers have historically pursued for its less efficient processes, has experienced the “trickle-down effect” of many trends in the larger deal market.

The process of buying and selling lower-end businesses has become increasingly efficient. Transactions that historically would have been ‘non-auction’ generally now involve an intermediary of some sort. In fact, some investment banks have moved down market and stand out compared to less experienced intermediaries similarly engaged. Some buyers have also moved down market. According to Terry Bressler, Managing Director at middle market investment bank, Stout Risius Ross,

“The growth in activity at the lower end of the middle market has been substantial. Sellers have become increasingly informed about the capital markets, and more and more groups are becoming active in deals under \$10 million in EBITDA, which also supports the growth in activity.”

The financing for these transactions has also evolved. Senior lending for lower-end transactions has historically been dominated by national and regional banks, with some finance companies playing a role. Over time lower-end lenders have expanded their appetites for financing under-collateralized deals. However, senior lenders actively funding lower-end deals continue to require significantly tighter amortization requirements than are available in the credit market for \$10 million EBITDA-plus companies. Funded debt multiples, which currently fall in the range of up to 5.7X EBITDA for the leveraged loan market as a whole, are currently in the 4.0 to 4.5X EBITDA for deals at the lower end.

Why hasn’t the lower end caught up? While the financing of lower-end deals has become more efficient, the market tends to factor in the generally higher level of business risks associated with lower-end businesses. Among others, these risks include size of company, significant customer concentration, depth of management, sophistication of systems, niche-nature of market, etc. With business risk higher, lenders often look to place less financial risk (risk associated with a leveraged capital structure) on these companies.

Joe Gaffigan, Co-founder and CEO of MFC Capital Funding, a provider of leveraged finance capital including both cash flow and asset-based financing, is familiar with the tradeoff. “We are very active at the lower end of the middle market. There are many strong companies in that segment, but they usually have more business risk than larger companies, and we factor that into our underwriting.”

A combination of factors resolves the financing gap between lower-end and core middle market deals. The single most significant factor is the reduced transaction multiple lower-end companies typically trade at. Investors active at the lower end understand and generally endorse the reality of this tradeoff. In fact, that very dynamic is one of the key factors that continue to fuel activity. Specifically, one of the key exit strategies adopted by investors at the lower end is to drive such growth in the business that the business is no longer considered “lower end” at the time of exit and therefore commands a higher multiple.

According to Steve King, Co-founder of Prairie Capital, which focuses on companies with cash flow of \$3 million or more, “There’s

no question that business risk is generally higher in smaller companies, and we expect valuations at the time we invest to reflect that. One of our priorities as investors is to reduce this risk during the course of our investment—and get compensated for doing so at exit. If we are successful at professionalizing the business while also generating good

growth, it is very likely the investment will turn out well for us.”

As intermediaries, investors, and lenders will tell you, there is strong activity at the lower end of the middle market and plenty of competition as well. While activity at this level often involves different valuation and lending parameters, if you can accept the higher business risk and are successful mitigating these risks during your investment, you may find yourself with a great deal come exit time.

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“The process of buying and selling lower-end businesses has become increasingly efficient. Transactions that historically would have been ‘non-auction’ generally now involve an intermediary of some sort.”

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