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Continued global expansion is the inevitable path toward sustained success for U.S. manufacturers, both public and private, as they tap into fast-growing economies with emerging middle-class populations and developing infrastructures.

Just a decade ago, most companies derived the bulk of their revenues from domestic operations, often viewing business outside the U.S. as experimental; today, foreign markets are considered an integral part of their growth strategy.

Those were the key messages provided by large and middle-market manufacturing company executives, bankers, private equity investors and attorneys participating in panel discussions at Lincoln International’s 2008 Global Industrial Conference in September.

“These economies, on their own, are taking on a life of their own, with or without us,” Douglas R. Oberhelman, group president at manufacturing giant Caterpillar Inc., told conference attendees at Chicago’s University Club. “The good news, bad news is that the U.S. represents only about 5 percent of the world’s population, and we’ve got to figure out a way to deal with this with respect to our growth strategies.”

International markets have become even more important in recent months, as the growing U.S. financial crisis has made for an uncertain economic future at home. Stock markets have fallen sharply, major U.S. banks have failed and the federal government agreed in October to a $700 billion economic bailout package. Consumer and corporate spending has softened.

The grim domestic outlook was underscored by a keynote address from former Chicago Federal Reserve President Michael H. Moskow, who forecast that the U.S. economy is in for a rough ride, at least in the near term, as it works to recover from a period of massive overleveraging and a slowdown in the housing market.

“That’s the heart of the problem, where this credit crunch influences the real economy,” said Dr. Moskow. “Banks are being more conservative now; they’re holding onto their capital.”
Manufacturers and bankers specializing in the industrial sector said their increasingly global perspectives offer them a more hopeful view of their prospects. Throughout the conference, panelists outlined bright spots for growth in emerging markets such as China, Russia, India, South America and Vietnam.

Companies are ramping up their presence in these markets through a host of investment strategies, including minority stakes, acquisitions and joint ventures. Their approaches vary, ranging from calculated studies of markets and target companies to determine fit within an overall corporate structure to looser responses to opportunities as they present themselves.

Panelists shared best practices on how to navigate roadblocks such as cultural differences, regulatory and legal challenges, and threats to intellectual property.

Regardless of the process, the panelists agreed that one thing is certain: there is no turning back.

Said Larry W. Gies, Jr., President and CEO of Madison Capital Partners: “Many of our customers came to us and said, ‘Hey, we want global sourcing, we want systems solutions, we need you across the globe. We can’t just have you providing this widget in North America.’”
Keynote Address

What’s Ahead for the U.S. Economy?

In his keynote address, former Chicago Federal Reserve President and CEO Michael H. Moskow laid out his view of the credit crisis that has roiled worldwide financial markets and led to the $700 billion bailout package for the U.S. economy.

The United States is headed for a period of unprecedented change in government regulation and monetary policy, Dr. Moskow told a room full of industrial executives, bankers and private equity lenders gathered at Chicago’s University Club for Lincoln International’s 2008 Global Industrial Conference.

“It’s really on-the-job training,” said Dr. Moskow, speaking on the same day that U.S. Treasury Secretary Henry M. Paulson, Jr. and Federal Reserve Chairman Ben S. Bernanke presented a version of the Emergency Economic Stabilization Act to the Senate Banking Committee. “I do think this is going to help but we’re going to learn as we go along. We’ve never done this before.”

In his comments, Dr. Moskow characterized the near-term economic climate as uncertain, adding that it will be marked by a period of painful de-leveraging of the massive debt taken on to fuel sub-prime lending and unsustainable growth in the U.S. housing market. Despite troubling recent events, Dr. Moskow said that he remained hopeful the U.S. financial system would recover.
“Long-term, I remain optimistic about the U.S. economy,” said Dr. Moskow, who retired from his post at the Federal Reserve in August 2007. “We have very strong productivity growth. We have an entrepreneurial culture – it’s innovative, it’s creative. We have the characteristics that make the United States a desirable place to be.”

Providing a chronological overview of the steps leading up to the current crisis in the financial markets, Dr. Moskow traced its roots to the 1990s and a period of “over-exuberance” that spurred trends such as the dot-com technology bubble and a rapid surge in U.S. housing valuations that continued until 2006. The period also saw massive overleveraging by companies, financial institutions, and Main Street consumers.

Since 2006, housing prices have fallen 19 percent, Dr. Moskow said, and he predicted another 10 percent decline before the market hits bottom. And while he lauded the overall increase in home ownership as positive for U.S. communities, Dr. Moskow decried the host of innovative financial products that allowed previously unqualified borrowers to enter the market on unsustainable terms.

“Some of the people who borrowed and got those loans never should have,” he said, adding that the securitized mortgage products used to power the housing boom were “sliced, they were diced, they were put into different kinds of bundles and sold off.” “The financial institutions that own these don’t fully understand them,” he said.

The risk associated with these derivative instruments spread, resulting in contagion in the securitization of automobile loans and credit card receivables. Surprisingly, Dr. Moskow noted, many sub-prime mortgage products were given top marks by credit ratings agencies. Furthermore, the loose accounting treatment of some of these instruments as off-balance-sheet assets exacerbated the problem.

Before the U.S. economic recovery can begin, he said, the eleven-month inventory glut of unsold homes must be cleared out, an objective that may actually benefit from the slowdown in housing starts. Dr. Moskow cited “a glimmer of hope” in recent data on home prices, noting that of 20 major markets tracked by an S&P/Case-Shiller home price index released in late August, four indicated prices that were either stable or increasing.
“That hasn’t happened in a while, so that’s a good sign,” he said, adding that he believed the housing market will begin to stabilize by mid-2009. “It’s not all bad news.”

Dr. Moskow said one of the most vexing challenges facing the federal government is how the Treasury Department will assign values to the troubled mortgage-backed bank assets it plans to purchase, noting that regulators were considering moves such as reverse auctions to set prices.

“No one knows exactly what these assets are worth; that’s the problem,” he said. “One of the key questions is, ‘What’s the price you pay for these assets?’”

Dr. Moskow said the government was moving at a “dizzying” pace to shore up the economic system, citing steps ranging from the Fed’s series of aggressive cuts in interest rates to the bailout of Fannie Mae, Freddie Mac and several prominent investment banks. Most recently, the government provided large guarantees against losses for money market funds and regulators instituted a ban on the short selling of some securities.

“They’ve made it easier for banks to borrow from the Fed, removed the stigma of borrowing,” he said. “They’ve opened it to investment banks to borrow, as well, and have extensive coordinated efforts with other central banks – the European central banks, the Bank of England and so forth.”

In addition, the Financial Accounting Standards Board (FASB) is reviewing regulations that will require companies to put their off-balance-sheet assets back on the books for greater transparency, he said.

“There’s a lot of details to be worked out and, as always, the devil is in the details,” said Dr. Moskow, adding that he believed the Federal Reserve would continue to push already-low lending rates down in coming months.

Another major move, the government’s push to take equity stakes in major U.S. banks, could be beneficial, he said, if executed carefully. Such a plan should not be compared to the bailout of U.S. thrifts after the savings-and-loan crisis of the 1980s through the formation of Resolution Trust Corporation. Instead, Dr. Moskow said, it more closely resembles steps taken by President Herbert Hoover during the Great Depression.

“The government took stock in these banks, preferred stock,” he said, “and that did help.”
While he predicted that the government bailout would indeed help to stabilize the financial markets, Dr. Moskow pointed out that problems beneath the credit crunch still needed to be addressed.

“The fundamentals under that cloud are weak,” he said. “Real incomes are down, down because energy prices are so high and employment is down,” he said. “The outlook for consumer spending is not good going forward.”

Export growth, he said, is slowing as European and Japanese economies slow, and as developing countries such as China and India buy fewer American-made goods.

Dr. Moskow forecast weaker GDP growth in the third quarter, likely negative growth in the fourth quarter and a “very weak first half,” adding that this period in U.S. history will probably be later cast by economists as a recession.

In summary, Dr. Moskow said the U.S. economy is headed for a rough ride.

“We’re going to get through this crisis. We have before and we’ll get through this one as well,” he said, before adding, “Short term, fasten your seatbelts.”
Panel 1

Navigating Growth in a Global Environment

Manufacturing companies are accelerating their push into international markets. They are pursuing regions that offer faster sales growth due to emerging economies with increased wealth and spending power, and meeting demand from multi-national customers requiring more efficiencies from suppliers in those parts of the world.
The conference’s first panel brought speakers with both domestic and European perspectives about markets that offer them the best prospects for near-term growth, methods for establishing a presence and avoiding pitfalls, and strategies to combat hurdles such as the prevailing U.S. political winds toward trade policy.

The panelists said they continue to be bullish about growth outside the United States, maintaining that a diverse approach left them with a favorable view of the global economic outlook, despite the crisis in U.S. financial markets in recent months.

The panel was moderated by Robert B. Barr, Managing Director and President for Lincoln International’s North American business, and Patrick von Herz, Managing Director for Lincoln International’s German offices.

**Beyond Domestic Borders**

Caterpillar Inc., which opened its first international plant in Brazil in 1953, made a conscious shift to expand domestic borders about four years ago when it revamped its growth strategy and laid out plans to reach yearly sales of $50 billion by 2010.

The publicly-traded company is running ahead of schedule, due largely to its expanded presence in foreign markets, which accounted for some two-thirds of 2007 sales of $45 billion.

“We’re on a very quick ramp up,” said Douglas R. Oberhelman, Group President at the world’s largest maker of earth-moving equipment. “We realized we really have to get going – the BRIC countries are where we have to be.”

In China alone, Caterpillar has added 13 plants in the past five years, he said, as the country’s rapidly expanding infrastructure fuels an appetite for Caterpillar’s bulldozers. “It’s a play for their infrastructure business,” he said. “When you go to China and India, you see it happening before your eyes.”

Caterpillar, which Mr. Oberhelman characterizes as “not very acquisitive,” has also diversified beyond its core equipment offerings into supply chain services. Recently the company gained a presence in Russia, where it now has one manufacturing plant.

Global expansion at privately-held Atlas Material Testing Technology LLC was initially driven by pressure from increased competition, said Rick Weiler, CEO of the maker of industrial weather-
testing equipment. That prompted Atlas to purchase its biggest German competitor, Xenotest, in 1995.

“We’re a very small multinational with two manufacturing locations,” he said. “We have a long way to go.”

Even so, an international focus has become more important since the private equity firm Industrial Growth Partners purchased the former family-run Atlas in 2007. The new ownership brought with it a shift in perspective from one of capital preservation toward a proactive growth strategy and search for global opportunities, he said.

“A good start is with a sales presence,” Mr. Weiler said. “If you’re a manufacturer, you need to be in China.”

About three years ago, German-based packaging company Gerresheimer AG began to expand beyond its primary markets of the United States and Europe in search of economies with strong population growth and increasing consumer wealth, said Dr. Axel Herberg, the company’s President and CEO.

Gerresheimer, which under Dr. Herberg’s leadership has become a world leader in packaging for the healthcare industry with some $1.3 billion in annual sales, is looking to China and South America as its near-term targets for expansion, he said, noting that they offer growth in excess of 15 percent a year.

“That’s where we bet our money, and where we will be going forward,” Dr. Herberg said.

The company is also closely watching India and Russia, he said, but the low pricing structure and poor product quality in India and the lack of well-developed healthcare systems in Russia make those markets less attractive to Gerresheimer in the near term.

CC Industries Inc., an arm of privately-held Henry Crown and Co., has been studying China for at least three years, said William H. Crown, President and CEO. But the family-run business is taking a more cautious approach to expansion, he says.

CC Industries stuck its toe in the Chinese market by investing in and building a Chinese furniture factory for one of its portfolio businesses. CC Industries later sold the plant but retained an interest.

“As far as other places around the world, we have the luxury of thinking about our growth in a very measured way,” Mr. Crown said. “We’ve really done most of our selling from the U.S., and from small sales offices elsewhere. And we are still looking at opportunities, really mostly in China.”
All Eyes on China

China, by far the largest of the BRIC economies, dominated the panel’s discussion, as speakers shared insights about lessons learned and opportunities.

Mr. Weiler, who joined Atlas in January 2008, said he will apply lessons learned from his experience early in his career at Otis Elevator, a company with a long-established presence in developing markets.

“Otis was very smart,” he said. “When they sold an elevator in remote places, they hired and trained local talent to support the systems going forward.”

Mr. Weiler added that you need to think about your standards in markets such as China, which is characterized by loose regulations and pressure from copycats selling cheaper products. For example, PerkinElmer Optoelectronics purchased a Chinese factory from Siemens AG to produce a high-tech component used in consumer products. Meanwhile, Chinese producers of lower quality products – “good enough” for the local markets – emerged. They weren’t interested in products with as long a life.

“Emerging markets don’t necessarily want to pay for extra longevity,” said Mr. Weiler, noting that you need a well thought through plan that balances brand versus quality to win in emerging local markets without tarnishing your brand worldwide. “That was one mistake where we created some potential problems for the future.”

Mr. Crown said the lack of uniform quality standards in China may actually offer U.S. businesses such as CC Industries an advantage when supplying multinationals in those markets. For instance, he sees demand in China for improved refrigerated truck trailers from CCI’s Great Dane trailer business, noting that logistics costs as a percentage of GDP in China are about double those of the United States, largely due to spoilage of perishable goods.

“We thought we could add significant value on the refrigerated side of the business,” said Mr. Crown. “Our belief is that there may be a place for us with a higher quality product, where people will pay more for the kinds of products we are willing or able to build, than the current solution to the problem over there.”

CC Industries is working with large multinationals to explore the possibility of bringing these products to the Chinese market, he said.
Mitigating Risk

When entering an emerging market, it’s important to take control early on, stressed Dr. Herberg, who only executes transactions in developing markets where Gerresheimer is able to take a majority stake. The company, which spent nearly a year on due diligence in China before making its first move, favors a cautious approach.

“Don’t put too much money at stake,” Mr. Herberg said. “If it gets too expensive, I say no. Don’t put too much in. Don’t put too much at risk.”

Besides financial risk, another major worry is the United States’ volatile stance on trade policy, said Mr. Oberhelman. Caterpillar has been lobbying hard in Washington to keep trade between the United States and its trading partners flowing freely, but he is concerned about potential changes in policy that may occur when a new administration takes control.

“You can’t go very far in this country without somebody having a very strong opinion on products that come in from the outside, jobs that we move – or perceive to be moved – from here to Mexico, from here to China,” he said. “And with a change in Congress coming up, the drumbeat of trade talk – primarily anti-trade talk – that there was during the campaign is not going away.”

Besides lobbying, Mr. Oberhelman said Caterpillar maintains a “multi-pronged approach” regarding its stance on free trade, including taking steps such as posting the destination country on each piece of equipment it produces in its domestic plants.

“We try to get a dialogue going … with our hourly workers who are members of the UAW that locally, their jobs are dependent on that export,” he said. “All we can do is try to keep the information and dialogue going, and work with those that are in the same boat as we are.”
Panel 2

**Acquisition Strategy and Integration Best Practices**

Corporate development executives from Dover Corporation, Emerson Electric Co., Siemens Corporation, detailed a variety of approaches used to identify and evaluate potential acquisitions, ranging from calculated measures that consider a target’s fit within the overall corporate strategy and geographic expansion goals to a looser process that relies on a “gut response” to opportunities as they become available in the marketplace.
Panelists agreed that the free flow of information within the corporate structure is essential to ensuring a steady flow of origination ideas, whether generated by senior executives at headquarters or mid-level managers in the field who are keeping their ears to the ground on a day-to-day basis.

Panelists said accountability is becoming increasingly important within their corporations, and they stressed the need for well-identified procedures that access the value of a potential purchase, as well as benchmarking measures to track a new unit’s progress during integration and beyond.

The panel was moderated by Thomas R. Williams, Managing Director for Lincoln International’s North American business and Julian Tunnicliffe, Managing Director for the firm’s U.K. operations.

Identifying Targets

Acquisition strategy at Emerson Electric Co., a global manufacturing and technology company, is a proactive process that calls for open communication between corporate management and the executive vice presidents in charge of the company’s five divisions, said Frank J. Dellaquila, Senior Vice President in charge of acquisitions and development.

In addition to operational responsibilities, division heads are responsible for staying on top of purchase opportunities, he said.

“This has really been an ongoing process, whereby the business leaders, the division presidents, are very much engaged in their space,” he said, adding that Emerson fosters a non-bureaucratic environment and free flow of information. “Opportunities, ideas, we talk about them as they come and evaluate them on their merits.”

Deals originate from all levels within Emerson’s structure, ranging from corporate strategy groups to managers in the field that have regular contact with customers and suppliers. Senior headquarters staff is also on the watch for candidates that “may not have been on the radar screens of the individual business leaders,” Mr. Dellaquila said.

Siemens Corporation, among the world’s largest electronics and industrial engineering firms, also takes a deliberate approach to the assets it considers adding to its extensive portfolio, said Kenneth R. Meyers, Vice President of Mergers and Acquisitions. Its strategy is driven by demographic trends in favorable markets, such as the aging of a population and urbanization and migration toward cities, especially in developing nations.
“So around these large global trends, we’ve structured our sectors – energy, industry and healthcare,” he said. “We look for acquisitions that fit into the growth stories of those sectors, as we’ve designed them.”

Diversified manufacturer Dover Corporation, which oversees more than 40 companies, takes a more reactive approach, favoring businesses that the company will buy and hold, said Robert A. Tyre, Dover’s Vice President of Corporate Development. Likening the company’s strategy to that of a private equity firm, he said Dover has “an institutional bias” against selling.

“We’re very acquisitive, and we rely on acquisitions to grow,” said Mr. Tyre, adding that Dover’s acquisitions have tended to be niche manufacturers. The company employs no hard-and-fast strategy for identifying targets, he said, but instead responds to opportunities it believes will be a good strategic fit.

“I’d love to say we’re proactive, we have strategies, and we know exactly what we’re looking for. But with us, it’s more, we know it when we see it,” he said. “Most of the situations we do are things that are for sale. You’re going to get competition, but the decision has already been made to change the ownership.”

A candidate must be large enough to be nimble on a global footprint, but not massive, he said. Synergy is an important requirement, with opportunities to trim costs high on the priority list.

“Everybody’s out here buying,” said Mr. Tyre. “The only way to differentiate yourself is to bring more value to the situation.”

Panelists agreed that evaluating potential purchases in China and India present more thorny issues than in Western economies, mainly because of inconsistencies in government regulations, transactional procedures and the application of accounting standards.

“I think these are challenges that many people are facing in the environment,” said Siemens’ VP Mr. Meyers.

Integration

Dover has been somewhat of a “slow learner” regarding integration practices, said Mr. Tyre. The company recently instituted a formal process for managing integration that includes presenting a scorecard to the company’s board and senior management every three months to track goals and milestones for the acquired company. In addition, there is one corporate executive whose full-time
job is to monitor the progress of the newly acquired companies.

“There’s a great deal of ownership,” said Mr. Tyre, adding that the management of each acquisition is responsible for directly reporting to a sponsor within the company.

Emerson has installed disciplined procedures to manage the progress of new additions to its portfolio. In addition, a high level of due diligence goes toward estimating the potential cost savings from a potential transaction, Mr. Dellaquila said.

“The division people carry a very heavy burden,” he said. “They basically have to come in with a very detailed integration plan and sell it to our CEO.”

All acquisitions priced at $10 million or higher must be brought to Emerson’s board for approval, he said, noting that the process creates a high level of accountability for the division leaders.

“I think there is a lot of value in that, which is why we consciously did not raise that enterprise value threshold over many, many years,” said Mr. Dellaquila.

During the integration process, Siemens frequently uses its extensive scale to bolster operations at acquired companies, providing a new unit with a technology, skill or process that was lacking, said Mr. Meyers. The company also brings economies of scale to back office operations, employee benefits, human resources and real estate management, he said.

Siemens recently purchased a metallurgical business in China that included a factory with cutting-edge technology but gaps in its project management procedures. Because it has been conducting business in China for decades, Siemens was able to tap into its existing project management talent, marketing channels and distribution, Mr. Meyers said.

“We thought we could take this tangible asset and combine it with the infrastructure and acumen that we had in place and make it more successful, make it more profitable,” he said.

Occasionally Siemens will purchase a company with no synergies, he said, breaking into a market for competitive reasons. That was the case with the company’s 2004 purchase of US Filter, a water treatment business.

“We saw our competition getting into the business,” Mr. Meyers said. “And it fit within our view of the large global demographic trends.”
The retention of existing management at the acquired company, at least for the near-term, is often extremely beneficial during a new business’s transition into the larger corporation’s fold, panelists noted.

“Really a big critical success factor is having a management team who has the interest in staying on to help us integrate the company,” said Mr. Meyers.

Fitting In

Operational synergies are often easier to achieve than administrative ones, especially in a large corporation like Siemens, said Mr. Meyers. Sometimes bringing new employees under the parent company’s administrative umbrella proves to be a distraction to management teams and a drain on morale.

“Migrating people onto Siemens benefits, for example, or getting people to fully participate in our treasury programs or corporate purchasing programs – that’s where we sometimes run into a bit of inertia and some road blocks,” he said.

To ease the integration, Siemens has in recent years frequently relocated up-and-coming managers overseas, giving them a chance to prove themselves with the responsibility for running integration at a newly acquired foreign business. Divestment is sometimes the best course when a company no longer matches the overall characteristics of the broader portfolio, said Mr. Meyers. For instance, most of Siemens’ products are sold to industrial buyers that purchase capital equipment; that was the main reason the company sold its consumer-oriented cell phone unit to Taiwanese electronics maker BenQ in 2005.

“In every case, it’s a bit wrenching, because everything is a sacred cow to somebody in the company and institutionally it’s a bit hard to get over the psychological hurdle of parting with something, particularly if that something is profitable,” he said.

Mr. Tyre agreed. By the late 1990s, Dover’s namesake elevator company, one of the company’s four original holdings, was no longer a good fit. The unit created confusion for Wall Street analysts and its expansion into developing markets lagged larger competitor Otis Elevator Co. Dover ultimately sold the business to German steel giant Thyssen in 1998.

“Otis beat our pants off in figuring out how to go to developing markets like Mexico, China and Europe,” said Mr. Tyre. “We were very late in that game – too late to catch up.
Panel 3

Private Equity Portfolio Companies – Enhancing Global Effectiveness

In the past decade, middle-market private equity firms have progressively added foreign assets to their portfolios, allowing them to keep pace with rivals, wring cost efficiencies from supply chains and meet demand from increasingly global customers.
Executives from the third panel brought the differing approaches of four private equity firms Bluepoint Capital Partners, Industrial Growth Partners, Madison Capital Partners, Pfingsten Partners, L.L.C. – each with substantial interests in non-U.S. markets, including Europe, Asia and South America.

Their investment and diligence practices have varied, but they agreed that global sourcing has become essential to the continued success of manufacturing companies, both within and outside of the United States. As they gain expertise in foreign markets, they are investing in international concerns for their growth potential, navigating a complex web of regulatory and government hurdles to gain a stronger presence in developing markets.

With several years of overseas investing under their belts, the panelists shared the lessons of hindsight, stressing the need for a cautious approach to new markets and an awareness of often-dramatic cultural differences.

The panel was moderated by Eric D. Malchow and Sean C. Bennis, both Managing Directors of Lincoln International’s North American business.

**Global Approach**

San Francisco-based Industrial Growth Partners, a private equity firm with some $825 million under management, has placed increasing importance on whether potential acquisitions offer opportunities for international growth, said Eric D. Heglie, a Partner at I.G.P.

A decade ago, the firm derived 90 percent of its aggregate revenue from North American businesses and its approach to foreign markets was primarily defensive, ensuring that the platform companies it purchased were insulated from competitive threats overseas.

Today, I.G.P.’s investment thesis puts a greater emphasis on companies with direct international operations; some 40 percent of revenue in its third investment fund is derived from outside the United States.

“I think we are willing now, as we’ve developed more experience and built up more confidence in our ability, to grow businesses through international growth initiatives,” said Mr. Heglie. “We are still looking hard at this in our due diligence, at foreign competitive threats, but are comfortable underwriting a bigger portion of our return driven by international opportunities.”

International expertise is considered essential background for senior executives at target companies under Industrial Growth Partners’ review, he said, whereas seven or eight years ago it was just an added plus.
Larry W. Gies, Jr., President and CEO of Chicago-based Madison Capital Partners, echoed a similar progression for his firm, noting that 15 years ago its international reach extended only to Canada and Mexico. But the overseas presence has steadily grown in response to demand from customers that wanted more global sourcing and systems solutions, he said.

“We started looking at joint venture opportunities and partnerships all over the world,” said Mr. Gies, whose acquisitions today focus largely on the global benefits they can bring to customers. “It’s to the point where we’ve done platform acquisitions all over the world.”

**Global Sourcing**

Global sourcing has become increasingly important, said Thomas S. Bagley, Senior Managing Director and Founder of Chicago-based private equity firm Pfingsten Partners L.L.C., which has $1.2 billion under management. The firm maintains offices in Hong Kong and Shenzhen, China to assist its portfolio businesses with direct sourcing in Asia.

“As the world has shrunk over the last ten years, we have gotten much more aggressive with respect to looking at opportunities offshore,” he said. “If you look at it from a product improvement standpoint, it directs you to sourcing products, whether it’s a raw material, a component, or a finished product – overseas.”

And while the search for cheaper product sourcing initiated the firm’s overseas expansion, Pfingsten now frequently reviews international opportunities strictly on the basis of their stand-alone growth potential.

Mr. Bagley pointed out that Pfingsten’s China operations have become progressively more hands-on in recent years. The firm initially sourced through partners, then purchased factories and most recently entered into a joint venture.

“Our two offices there, in addition to helping our portfolio companies source … also troubleshoot issues with the direct sourcing relationships that our companies have in China,” he said, stressing that role of the private equity firm should be to bring value-added services to its portfolio companies.

Blue Point Capital Partners, with offices in Charlotte, Cleveland, Seattle and Shanghai, also began its offshore push because of sourcing opportunities, but now the firm is focused on following the path of its customers to rapidly developing markets such as China, said John A. LeMay, Partner.

More recently, Blue Point, which manages $400 million in its current fund, has been developing an outbound strategy from China where it partners with a local entrepreneur and assists the business in moving beyond Chinese borders.
“Those entrepreneurs face as many or more challenges getting to the U.S. as our entrepreneurs here have to get to China,” Mr. LeMay said.

Having offices in China also allows Blue Point to weed out potentially problematic transactions much earlier in the deal cycle, he said.

An established presence in China also offers a competitive advantage in bidding for middle-market companies that can benefit from a private equity firm’s sourcing capabilities, said Mr. LeMay, adding that it helped tip the scale in Blue Point’s favor during its acquisition of Dry-Ease, a maker of industrial grade blowers and dehumidifiers.

Gaining Traction

Industrial Growth Partners has not yet made a direct investment in China; instead it has relied primarily on setting up sourcing alliances and joint ventures, said Mr. Heglie, emphasizing the importance of local relationships to the firm’s success.

“You’ve really got to have people with their feet on the ground, that understand the business, the customer, the business practices, the government dynamics,” he said.

The firm, which has also expanded into South and Central America, has built up an extensive database of local advisors that it taps, based on specific need.

“We call it our ‘FaceBook,’” Mr. Heglie said, “which is really our database of all our international operations advisors, executives, contacts, people that can help us with due diligence, financing relationships. And we’ve refined it in such a way that you really can search by individual geography, type of business.”

At Madison, the firm’s partners, who are comprised of former manufacturing CEOs with extensive operational expertise, often serve as the temporary C-suite following an international acquisition until the new company is stable enough to continue on its own accord, he said.

“That’s helped us out significantly, to show management teams that we can be helpful, sending our guys to run an operation or build an operation overseas,” Mr. Gies said.

Blue Point favors a cautious approach, said Mr. LeMay. In China, Blue Point spent two years sizing up the market before making an investment. Ultimately, the firm decided to outsource operational due diligence, conceding it was nearly impossible for its English-speaking partners to do the necessary market research themselves.
Cultural Differences

Regardless of the international market, it’s important to be aware of cultural differences, especially after a deal has closed, said Mr. Gies, shifting the panel’s discussion to Europe.

“Europe is a heterogeneous conglomeration of many different countries,” he said. “And if you’re in Italy, it’s very entrepreneurial. If you’re in Holland, they’re very consensus-oriented. In Germany, the management team looks at themselves as serving the company, not the shareholder.”

Organizational changes in Europe tend to be slower and more costly than similar moves in the United States, Mr. Heglie said. American buyers need to pay particular attention to the timing of major initiatives in that market.

“They’ve obviously got a lot more holidays,” he said. “You don’t realize when you make an investment that they’re not going to be around in August.”

On the plus side, Mr. Heglie continued, Europe has become a better market to navigate in recent years due to initiatives such as a unified currency, making it easier to attract good management. Comparatively, it is also a higher-margin market, as Europeans tend to place greater emphasis on product quality and are willing to pay more for well-engineered products, he said.

As doing business in China has becomes more costly due to price inflation, markets such as Vietnam, India and Central America are becoming more attractive to Pfingsten, said Mr. Bagley, noting that Pfingsten remains skittish about South Africa, where he said it has become more difficult to do business in the post-Apartheid era.

Mr. Gies said Madison would remain somewhat agnostic to specific geographies, focusing instead on companies it believes it can improve. Even so, he and the other panelists remain bullish on China, despite increasing labor costs.

“I see a lot of great things on the horizon in China,” he said, noting successive improvements in the country’s educational system. “The next 20 years – it’s going to be just a fantastic place to be.”

Mr. Heglie said Industrial Growth Partners is hopeful about prospects for its operations in India and Eastern Europe, but the firm remains open to solid opportunities throughout the world.

“There’s not one particular geography we’re going after, or are necessarily afraid of,” he said.
U.S. manufacturers have steadily increased their stakes in the BRIC countries, which economists believe may become the four most-dominant economies by the year 2050. These countries encompass over twenty-five percent of the world’s land coverage, forty percent of its population and a have combined GDP of more than $15 trillion.
Executives on the fourth panel brought a range of perspectives about why they entered BRIC markets and how their approaches to doing business have evolved to become more proactive in recent years.

In addition, they shared useful anecdotes about how to build relationships on the ground, mitigate risk and navigate regulatory hurdles that can slow or sometimes curtail the deal-making process.

The panel was moderated by Edward A. Hanlon, a Managing Director of Lincoln International’s North American operations, and Jean-Rene Hartpence, a Managing Director of the firm’s French operations.

**Strategy**

Alcoa, among the world’s largest producers of aluminum for the aerospace, automotive, and construction industries, has over the years made significant investments in Brazil, Russia and China.

“We make investments based on where we can find our natural resources – or where we can gain an asset position,” said Barbara S. Jeremiah, an Executive Vice President and member of the company’s Chairman’s Counsel.

Alcoa spent several decades strategically building a presence in Brazil, drawn by the country’s rich bauxite deposits and energy sources. More recently the company invested in a greenfield operation jointly with other companies to build hydroelectric facilities.

By contrast, acquisitions in Russia and China have been more opportunistic, Ms. Jeremiah said, noting that both nations built up their metallurgical infrastructure during the Cold War. For example, she continued, after the fall of the Berlin Wall, Russia was left with several large, formerly state-run facilities that lay fallow for several years.

Two of those plants later came under the control of an oligarch who tried for several years to secure business from Boeing and Airbus – major Alcoa customers – but neither plane maker would risk working with him, and the plants were losing money. Alcoa was able to purchase the facilities in 2004 for $200 million, and win the business.

“This is an example of the kind of opportunity you can find in Russia and China,” said Ms. Jeremiah. “Even though enormous growth is taking place globally, there can be a mismatch between the assets on the ground and the markets that are there to serve them.”

Terex Corporation, a maker of construction and mining equipment, is expanding into the BRIC countries to meet demand for infrastructure development, said
Brian J. Henry, the company’s Senior Vice President of Finance and Business Development. The strategy is similar to that of its larger rival Caterpillar Inc., he said.

Mr. Henry cited a recent Morgan Stanley research reporting showing that spending on infrastructure in developing markets over the next 10 years is likely to reach $22 trillion, with 75 percent of the amount being spent in the BRIC countries.

“Despite the dislocations we have here,” he said, referring to the current financial crisis, “that’s really forming our world view.”

Terex currently has three joint ventures in China and is in the process of starting up several greenfield operations, Mr. Henry said. Terex’s long-term goal is to have one-third of its business in Asia, one-third in Europe and one-third in the Americas, with dedicated manufacturing operations for each market.

India, he said, remains somewhat more challenging, noting that for his industry, entry into that market requires a greenfield operation; China, by contrast, offers the company acquisition candidates with more inherent value.

Not unlike some earlier panelists, investment firm Jordan Company L.P. began its expansion into the BRIC countries in the early 1990’s as a move to help its portfolio companies follow major customers, said Andrew W. Rice, Jordan’s Senior Vice President of International Business. The New York City-based firm, which has owned a large number of telecoms equipment and other industrial products companies, leveraged its centralized U.S.-based operational staff to assist its portfolio companies with their overseas growth.

In the past 15 years, Jordan has done 20 deals in Russia and six in Brazil. In the late 1990’s it entered a joint venture with India’s Bharti Telecom, one the country’s leading telecom companies. And over the summer, Jordan closed its 23rd investment in China in 14 years, where most of its deals are acquisitions or majority-controlled joint ventures.

Lately, Jordan has been exploring stand-alone opportunities in China, Mr. Rice said. The firm is expanding its staff in China.

“We figured we’ve learned enough to look at stand-alone opportunities that come our way,” he said, adding that second- or third-tier cities often offer more value. “Because we’ve been there so long, we have a long-term view.”

**Local Support**

When doing business in China, it’s essential to win the support and participation of the Chinese
government early on in the transaction process, said Jon L. Christianson, a Hong Kong-based attorney who specializes in international M&A and Partner with the legal firm Skadden, Arps, Slat, Meagher & Flom LLP & Affiliates.

“You’re going to be looking at government approvals when you want to expand your production, or you want to move into new cities,” said he said, stressing the importance of building strong personal relationships. “You’re going to be dealing with government agencies on a constant basis, and you’re going to need their support and approval for many of the things you want to do.”

Careful due diligence is essential, Mr. Christianson added, noting the importance of conducting background checks before hiring local executives and managers. He also advised acquiring companies bring in a mix of both local talent and ex-patriots.

Echoing the sentiments of earlier panelists in the day, Mr. Christianson recommended taking control in an investment as early as possible, adding that he would avoid joint ventures whenever possible.

“You need to figure out what you need to get control of and be certain that you get it,” he said.

Local contacts are indeed critical to success, agreed Mr. Rice. In 2004, Jordan reluctantly agreed to Partner with two individuals with extensive connections in China for the purchase of two of the largest coal-mining equipment companies in the country. The deal closed in 2006.

It proved to be an important new market entry for Jordan. One of the executives was an American who resides in Beijing and formerly chaired the powerful lobbying group AmCham; the other was a former secretary of the Chinese Minister of Coal. Both men had deep local connections they put to work on Jordan’s behalf.

“The more we got into this, the more we started looking at this as a strategic foothold in the growing energy sector of the economy,” said Mr. Rice, noting that 80 percent of China’s electricity comes from coal-fired power.

The deal, which faced some regulatory hurdles, was done without much fanfare, said Mr. Rice, who said Jordan believes in maintaining a low profile in China until after transactions are completed.

Jordan negotiated directly with the Chinese government to eliminate 6,000 pensioners from the coal companies’ books, to reduce the amount of unpaid taxes owed, and to extend the repayment period.

Though it took more than six months to get a handle on the controls, the investment transformed a break-
even business into a profitable one; Jordan has since done three related add-on acquisitions that are growing in excess of 30 percent a year.

“It doesn’t hurt that coal prices have doubled in the past year and a half,” Mr. Rice added.

Trade Secrets

While joint ventures are common in Russia, Alcoa insisted that it would only enter a deal where it could own 100 percent of the acquired company, said Ms. Jeremiah, noting there were sensitive manufacturing processes at stake.

“We were looking at moving aerospace technology into Russia,” she said. “We knew we were taking a risk and did not want to have a partner that had any kind of ownership claim on how we make parts, or how the transfer of technology was going to take place.”

To help gain a better understanding of the Russian political climate and potential for resistance to the deal, Alcoa hired an intelligence agency. It was hard to determine who was in charge, she said, noting that there was no Russian counterpart to CFIUS (Committee on Foreign Investment to the United States), the Federal government body that reviews inbound deals to the U.S. for potential threats to domestic security.

Alcoa also purchased political risk insurance for the first time in its history, a costly but necessary hedge, said Ms. Jeremiah, adding: “We knew we were taking a chance.”

Taking steps to protect intellectual property is critical in the BRIC countries, particularly China, which has become adept at copycatting Western processes in shorter periods of time. For instance, in just 10 years China has taken control of more than 30 percent of the world’s smelting capacity from a previous 9 percent, she said.

“In the West, it takes you four to five years to build a smelter. In China, they can do it in 10 to 18 months and at less than half the cost,” said Ms. Jeremiah, noting that these worrying trends are the main reason Alcoa is reluctant to transfer its aerospace technology to the Chinese market.

Jordan gets around the problem by taking careful control over the subcontracting of components, said Mr. Rice. One of Jordan’s Portfolio Companies, recently used its local Chinese engineers to develop a new product. It keeps the contract manufacturers that build the new product in the dark, he said, identifying the parts as components for a different product and doing final assembly in its own plant.

“Here in the U.S. and Europe there’s a trend toward sharing as much information as possible with workers,” he said. “In China, we sometimes flip-flop that process.”