

Transaction Services

Current Drivers and Main Challenges in M&A activity

Tzur Fenigstien, Partner
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M&A Activity Today

- While credit markets are easing, financing will remain the dominant challenge to M&A activity this year
- Strategic buyers and smaller LBOs showing signs of increased activity
- Divestiture activity expected to increase
- Decrease in cross-border transactions
- Distressed acquisitions to continue
- Valuations remain depressed relative to historical levels

Value of announced US transactions
(\$ in billions)



Volume of announced US transactions



* 2009 figures represent 11 months ended November.

Source: Thomson Reuters

Strategic buyers will dominate the M&A arena in 2010

- M&A activity in 2010 will be driven by strategic buyers who have access to capital and excess cash following drastic cost-cutting measures during crisis
 - According to The Wall Street Journal, non-financial firms on S&P 500 held almost \$1 trillion in cash and short-term investments at the end of 2009, up 31% from a year ago
- Following aggressive cost cuts, the low hanging fruit is gone and to drive further efficiency companies will look to combine with similar players
 - Focus on synergies that will enhance productivity, enable cost-savings, increase margins and add revenue volume

Private equity

- Private equity players have been building up their debt, hedge and distressed funds, to take opportunities in distressed environment
- Expect to see more IPOs coming to market in 2010 as a viable exit vehicle for private equity investments
 - More than half of IPOs completed during 2009 were by financial sponsor-backed (primarily private equity) companies, a trend expected to continue in 2010
- Continue to participate in distressed acquisitions and buyers of divested businesses

Divestiture market will be a factor in fueling deals

- The economic slowdown has placed increasing pressure on companies to revisit their operational strategies and their portfolio of businesses
- Divestiture may be viable solution for pressing business issues such as
 - Cash needs
 - Underperformance
 - Business requires capital infusion or specialized knowledge
 - Business unit / product line does not fit overall strategic plan
- Sellers' market is gone, valuations are lower → preserving value as a seller is critical in today's volatile environment → thorough self-diligence is key
- Impossible to overprepare: strong pro-forma model, transparency of cost structure incl. corporate allocations, quality of management

Cross-border considerations

- Expect to see new financial services regulation, especially in the US and Europe
 - New capital standards that will be applied globally could have significant effect on lending
- Review by governments of foreign investment from national security perspective, particularly in sensitive industries
- Top three industries for cross-border deals globally: energy and power, materials, financial services but depends on geography
- Consider local legal & regulatory environment – critical areas include taxes, labor practices, exports, trade, environment
- Understand local customs and practice

Sectors that present opportunities

- **Consumer products** – branded companies look to gain scale and negotiating leverage with retailers while enhancing their scale to drive productivity
- **Technology** – large & mature players to continue to absorb smaller companies who provide IP that can be leveraged
- **Energy** – the seller/buyer gap is slowly narrowing
- **Financial services** – expect to see consolidation; asset management sector popular
- **Healthcare** – will see consolidation driven by need to reduce costs and increase productivity; pharmaceuticals sector to explore areas less government dependent (consumer product applications, animal health, vaccines, biologics)

Impact on deal environment

- Slower pace for many reasons
 - Tighter credit markets
 - Scrutiny by lending banks
 - Additional diligence required
- Analyzing a deal has become more complicated
 - Historical results less reliable in the wake of a recession
 - Difficult to determine target's projected profitability
 - Analyzing the entire value chain is essential
- Smooth post-merger integration critical
 - Understand how the cultures will mesh
 - Plan how the two companies will function operationally, technologically and financially

Additional diligence considerations

- Commodity price fluctuations – understand impact of price volatility on target and its financial statements
- HR issues changed dramatically in past two years – consider impact of recent lay-offs, bonus/salary cuts on historical and future performance
- Enhanced due diligence required by lenders
- Specific issues relevant to cross-border acquisitions, such as
 - Healthcare reform in the US – effect on employee benefits
 - New legislation on climate change – commitments to cut greenhouse gas emissions create uncertainty

Preparing for an upturn in M&A activity – steps to improve the DD process

- Engage the DD team in deal process before DD begins
- Determine the target's financial strength
- Identify and address most common deal killers
- Emphasize customer due diligence
- Analyze how the new company will impact workers' performance
- Avoid overconfident synergy estimates
- Seek out expert external advice

Tzur Fenigstien
Valuation & Strategy Partner
PwC Israel

Office +972-3-7954588
Mobile +972 -54-4954429
Tzur.Fenigstien @il.pwc.com