

Assembling value

First-quarter 2010 global industrial manufacturing
mergers and acquisitions analysis

Making smarter deals in a changing environment: Due diligence



Welcome to the first quarter 2010 edition of *Assembling value*, PricewaterhouseCoopers' (PwC) quarterly analysis of mergers and acquisitions (M&A) in the global industrial manufacturing industry. In addition to a detailed summary of M&A activity in the first quarter of 2010, we supplement this issue with a special report on performing better M&A due diligence in a recovering economy and the ever-increasing importance of considering how cultures will mesh and function financially, technologically, and operationally. The discussion includes emerging and existing areas that might call for more careful attention in today's due diligence process such as healthcare, climate change, changing tax laws, information technology, and human resources.

Special report:

Making smarter deals in a changing environment: Due diligence

As the global economy begins to recover, deal making might offer the leverage industrial manufacturing (IM) companies need to push ahead of the competition. And it will be the companies with strong balance sheets and robust cash reserves that are in the best position for strategic M&A opportunities.

As strategic buyers take advantage of their ability to maneuver in a challenging environment, PwC predicts they will pursue deals with a focus on synergies that will enhance productivity, enable cost-savings, and add revenue volume to their businesses.

“Those who have built their balance sheets for a rainy day might come out of last year’s storm to find the rainbow, and at the end of it, nicely valued acquisition targets that provide opportunities for revenue growth and enhanced productivity,” said Bob Filek, partner with PwC’s Transaction Services Practice. “As a result, M&A activity in 2010 will be driven by strategic buyers who have access to capital and the strategic vision to capitalize on some of the best values we have seen in recent times.”

To make the right deal, IM companies must consider how two years of economic contraction have altered the balance of supply and demand within the value chain and significantly changed and elevated the importance of due diligence. Healthcare, climate change, commodity prices, pension plan structures, changing tax laws, company culture, and the role of human resources must be factored into today’s due diligence process.

Prior to the economic collapse, sellers had the leverage to pressure buyers to move quickly to close. The current deal environment dictates a slower pace for many reasons, including tighter credit markets and scrutiny by lending banks. However, the most important reason is the additional diligence required to properly assess the value and risks associated with a transaction. Analyzing a deal has become more complicated in the wake of a recession that has lessened the reliability of historical results and led to permanent changes in some segments because capacity has been taken offline and may or may not ever return. Consequently, the need to analyze the target as well as the entire value chain is essential.

Still, M&A activity inevitably generates a certain amount of immediacy, so it pays to be prepared. Companies that might be rusty in the area of due diligence because few (if any) deals were completed during the past two years may need to dust off their existing processes and make sure the right resources are in place so they are ready when opportunity knocks.

“First, assess the processes that were in place before the downturn because when deals become available, you won’t have time to do that,” said Brian Vickrey, a PwC Transaction Services partner. “Next, make sure you know where to turn for additional information if you need it. If you think you might be interested, it’s also time to be thinking about how to prepare.”

The recession alters the M&A landscape and creates new areas for diligence

The economy is improving—albeit slowly—making it difficult to determine a target company’s projected profitability. During the downturn, many companies cut production capacity, reduced workforce, and slashed inventory to make their operations as efficient as possible and to maintain cash flow. Now that the economic climate is improving, these companies are pressured to make strategic business decisions about when to open a closed plant, add a second shift, or lift a hiring freeze. They also must contend with scaled-down supply chains, which lack the flexibility and depth to meet the needs of a growth spurt should it occur.

Healthcare and climate change

Governmental influence in the form of legislation on climate change and healthcare is also new to the M&A landscape since the recession. Two years ago, no one considered healthcare or climate change as influential in making or breaking a deal. But today, both issues create material uncertainty that should be considered as part of a buyer’s due diligence process.

Supply chain initiatives to cut greenhouse gas emissions are of particular interest to the IM industry. Recent announcements by Wal-Mart that it would drive carbon reduction and energy efficiency through its supply chain and the federal government’s plan that would force government

contractors and suppliers to cut carbon emissions 28 percent by 2020 are major initiatives that create the kind of uncertainty that demands further diligence. Wal-Mart's initiative impacts industrial manufacturers because Wal-Mart is requiring more efficient store components, such as display cases, lighting, HVAC equipment, energy management systems, and construction material and components, and will also favor suppliers who improve the carbon footprint and energy efficiency of their own facilities.

Anticipated consolidation within the health industry because of healthcare reform in the United States must be evaluated to determine whether there will be an effect on a company's employee benefits. This trend, and its potential to affect the target and acquirer alike, must be considered during the due diligence process.

Commodity price volatility

Commodity price fluctuations also present complexities to acquirers, who must understand the impact of price volatility on the target company and its financial statements. It is becoming increasingly apparent that raw material constraints and rising global demand have the potential to exacerbate price volatility and underscore the risk that companies may not have access to the necessary raw materials to continue operations.

Human resources due diligence

Human resources issues have changed dramatically during the past two years. Acquirers must be aware of a target company's record on compensation and take into account whether raises and bonuses were curtailed to cut costs or whether employees are doing multiple jobs to compensate for laid-off co-workers. Often, acquirers focus only on melding the two company compensation structures into one, without considering how that might change the financial statement. Pension funds and other postemployment benefit plans (OPEB plans), and how they are funded, are of particular interest to companies in the IM industry because they commonly provide these employee benefits.

Tax due diligence

The tax code changed substantially during the past two years. Additionally, target companies likely altered their handling of taxes to help mitigate the financial effects of the recession. Furthermore, in today's corporate environment, acquisition transactions often are on an aggressive schedule and, at times, tax practitioners are not consulted about tax-sensitive aspects of the transaction until the final stages of the deal. For this reason, familiarity with the basic tax framework for analyzing acquisition documents is essential.

A tax due diligence generally focuses on the tax returns and tax examinations of the acquisition candidate and serves the purpose of satisfying the buyer that the tax liabilities of the business being acquired are properly stated on the seller's books. In addition, the tax review should focus on the buyer's ability to amortize a portion of its investment through proper tax planning strategies and utilize the seller's tax attributes and similar tax opportunities.

In conducting the tax portion of the purchase investigation, as well as the overall purchase investigation, consideration should be given not only to the hidden "liabilities" of the target, but also to the hidden assets or planning opportunities of which the target and other competitive bidders may not be aware.

Overseas acquisition due diligence

During the prolonged downturn, companies grew accustomed to doing business in survival mode. But as a recovery begins to look imminent, Wall Street and other stakeholders soon will be asking companies how they intend to grow. Consequently, many companies will be incorporating M&A activity into their growth strategies. Because of the higher growth potential in emerging markets, companies need an understanding of foreign-entity due diligence, which can often be elusive in emerging economies.

Along with economic opportunity, IM companies considering an investment in an emerging country must weigh the risks and effort involved in ensuring the integrity of compliance. Critical issues include ensuring that the deal falls in line with US regulations such as the Foreign Corrupt Practices Act (FCPA) and a wide range of foreign laws relating to critical areas such as taxes, labor practices, exports, trade, and the environment.

"The question boils down to whether a company is prepared for an overseas acquisition and what that means," Vickrey said. He said companies are mostly motivated to buy in an emerging market because of the opportunity to grow product lines and to expand geographically.

Lender and capital market due diligence considerations

As lenders consider changes resulting from two years of economic contraction, the following questions may be asked as they go through an enhanced process of due diligence:

Industry considerations

- To what extent is the sector cycle synchronized with gross domestic product (GDP)? How strongly was the GDP decline amplified in the company's subsector? Based on this, what are the expectations of timing and strength of recovery?
- What stage of the business cycle is the industry in? Do downturns in the industry typically lead or lag the general economy? How long do downturns typically last in the industry relative to the macro-economy? What can we learn from this in terms of revenue and production planning?
- What is the level of excess capacity in the industry? What will be normalized demand levels? Depending on the company's cost position, what are the implications for the company's total capacity? What investments are required to reactivate idle capacity or what are the costs of dismantling inefficient plants?

Company-specific considerations

- Are the company's volume projections reasonable based on the macro-environment and its customer base? How do they compare to independent projections?
- What is the outlook for the company's specific customer and geographic portfolio? Is the region/customer base lagging the macroeconomic recovery?
- Is the company positioned to take full advantage of the up-cycle? Is the company advantaged or disadvantaged from a cost standpoint versus key competitors? Are their advantages sustainable or the disadvantages reversible?

Beyond perfunctory due diligence

To drive further efficiency and meet stakeholder demands for growth, IM companies are challenged to seek combinations with similar players to drive scale and enhance productivity. These types of mergers will be a driving force in 2010 as companies look to increase revenue and enhance margins.

Successful acquirers within the IM industry must supplement their financial due diligence by directing it toward understanding how the cultures will mesh and how the two companies will function operationally, technologically, and financially. They must look at human resource due diligence, including external and internal stakeholders. By focusing on how to resolve issues that will arise when the businesses come together to form the new, larger entity, leading IM companies lay the groundwork for more accurate competitive pricing, more potential synergies, and faster, smoother post-merger integration than achieved by companies that treat the process in a purely perfunctory manner.

Perspective:

Thoughts on deal activity in the first quarter of 2010

Moving into the first quarter of 2010, we expected that sequential improvement in deal activity would be challenging because of the strong activity in the preceding period (31 deals were announced in the fourth quarter of 2009). However, we believed that year-over-year improvement was attainable as only 16 deals were consummated in the first quarter of 2009. Surprisingly, on a year-over-year basis, the level of deal activity during the first quarter of 2010 was weaker than the level experienced during the same period last year. With only 11 transactions announced in the first quarter, 2010 is off to a slow start. In terms of value, deals totaled \$1.9 billion in the first quarter of 2010 compared with \$2.0 billion and \$9.6 billion in the first and fourth quarters of 2009, respectively. Although deal volumes and values trended lower, during the first quarter of 2010, average deal values increased on a year-over-year basis.

During the period, mega-deals (transactions of at least \$1 billion) were nonexistent. This has been the case for some time and we do not expect to see a quick turnaround in this trend. We believe the lack of mega-deals remains a consequence of lower firm valuations resulting from weak demand and higher risk premiums assessed for firm assets. During the period, financial investor participation increased meaningfully relative to previous periods. This bodes well for deal activity in the near term if recent trends are sustained. Although credit availability remains tight relative to pre-economic crisis levels, there are signs corporate lending is improving. Also, increasing equity and bond issuances suggest that risk aversion is moderating. For context, Wall Street banks sold \$1.93 trillion of stock and bond offerings to investors during the first quarter of 2010, up from \$1.61 trillion in the fourth quarter 2009 and \$1.79 trillion in first-quarter 2009¹. Furthermore, US high-yield bond deals set a quarterly record, with \$67 billion of issuances in the US, up from \$57 billion in fourth-quarter 2009 and \$11 billion in first-quarter 2009². The two largest transactions during the period were US-based private equity firm Warburg Pincus LLC's \$452 million acquisition of UK-based Survitec Group Ltd., a defense company that makes safety equipment; and US-based Georgia-Pacific Corp.'s \$400 million agreement to acquire certain assets of bankrupt Grant Forest Products Inc., a US-based wood products manufacturer and wholesaler.

Targets located in North America, Asia and Oceania, and the UK and Eurozone regions were the primary drivers of deal activity in the first quarter. We believe deal activity will continue to be driven from these regions as each generally benefits from factors conducive to M&A, including more efficient capital-market systems and favorable regulatory environments that support both foreign investment and domestic consolidation.

Looking ahead, we believe fundamentals are ripe for a recovery in the deal environment. In many global markets, credit is loosening, equity markets are advancing, and economic growth rates are stabilizing. The economic growth factor is particularly noteworthy since mergers and acquisitions are fundamentally correlated to GDP growth. Although many macro-factors have improved, others continue to show weakness, such as pervasively high unemployment and weak housing fundamentals. Nevertheless, we believe buyers are increasingly optimistic in their near-term economic outlooks. Cash conservation, cost containment, and margin expansion all remain relevant considerations. However, as valuations remain depressed relative to historical levels, we believe companies with stronger relative share prices, stronger balance sheets, or affordable access to capital markets may view M&A as a way to expand into new markets, innovate, or broaden products or capabilities at a time when their peers may be struggling to improve fundamentals. The calendar year is off to a slow start, but we believe fundamentals and buyer optimism could drive a strong recovery in deal activity as the year progresses.

¹Aaron Lucchetti, "Wall Street Underwriters Gorged on 'Junk'" Wall Street Journal, Thursday, April 1, 2010.

²Ibid

Commentary

2010 starts slow

For the first quarter, both the volume and value of transactions above \$50 million declined both on a year-over-year basis and sequentially. We expected results to be weak relative to the fourth-quarter 2009 results; however, we believed that year-over-year trends would improve. But this was not the case. Nonetheless, although the year is off to a slow start, we believe the deal environment will improve throughout 2010 as credit availability continues to loosen and risk aversion continues to moderate.

Deal activity by number and value of deals

Measured by number and value of announced deals worth \$50 million or more

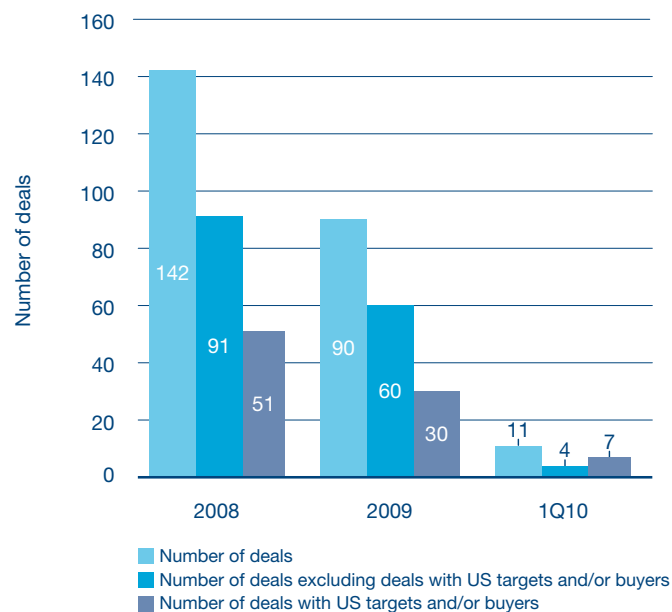
	2008				2009				2010			
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q
Number of deals	43	47	41	11	16	11	32	31	11			
Total deal value (\$ billions)	8.0	18.8	8.2	2.3	2.0	2.5	7.5	9.6	1.9			
Average deal value (\$ billions)	0.2	0.4	0.2	0.2	0.1	0.2	0.2	0.3	0.2			

US-affiliated transactions drive deal activity

Transactions involving both US targets and buyers were the key drivers of deal activity during the first quarter, reversing a long-standing trend. Of the 11 transactions announced during the period, seven (64 percent) involved a US entity. This compares with an average of 39 percent over the last four years (2006-2009). Similarly, 79 percent of total deal value during the first quarter was attributable to US-affiliated activity compared with an average of 50 percent over the last four years.

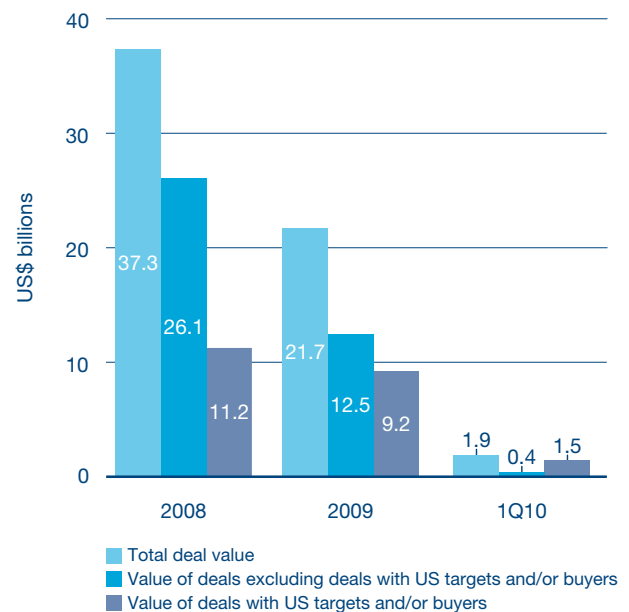
Deal activity by number of deals

Measured by number of announced deals worth \$50 million or more



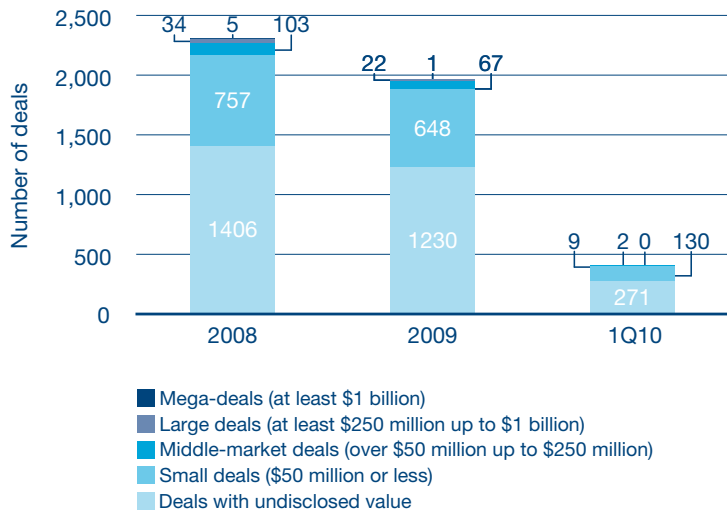
Deal activity by total deal value

Measured by value of announced deals worth \$50 million or more



Deal activity by volume and range of deal value (including transactions with undisclosed values)

Measured by number of announced deals

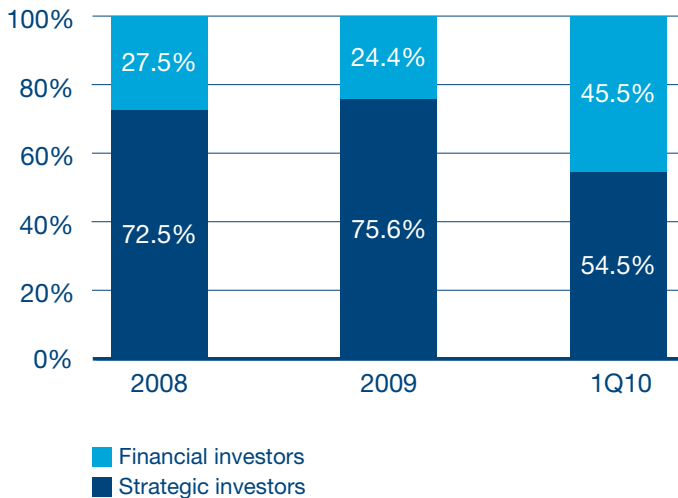


Small remains the name of the game

Although global macroeconomic trends are improving, smaller deals and transactions with undisclosed values continue to dominate overall activity, which has historically been the norm. The level of middle-market, large, and mega-deal activity continues to be constrained, although the near-term outlook for a turnaround is favorable.

Deal activity by investor group

Measured by number of announced deals worth \$50 million or more



Early indications suggest that the financial investor is back

In the first quarter of 2010, financial investor (i.e., private equity, pension funds, and equity income funds) contributions increased substantially relative to earlier periods. Over the past few years, private equity firms, especially, have faced considerable fundraising challenges, which deterred their participation in deals. Meanwhile, strategic investors have driven M&A activity. As financial investors have adapted to the changed landscape, the types of transactions in which they participate has changed. For instance, the pace of leveraged buyout activity has slowed dramatically but distressed transactions (i.e., creditors assuming ownership), asset divestitures, and minority stake and incremental stake investments have all increased. Although the volume of deals was disappointing—particularly following the strong performance during the back half of 2009—the return of the financial investor could be the catalyst needed to drive a strong recovery in the deal market.

Mega-deals still missing

Mega-deal activity (transactions \$1 billion or more) was nonexistent. The two largest transactions during the period were US-based private equity firm Warburg Pincus LLC's \$452 million acquisition of UK-based Survitec Group Ltd. and US-based Georgia-Pacific Corp.'s \$400 million agreement to acquire certain assets of bankrupt Grant Forest Products Inc., a US-based manufacturer and wholesaler of wood products.

In our view, the absence of mega-deals continues to be a consequence of lower firm valuations resulting from weak demand and the higher risk premiums assessed for firm assets. But as returning optimism fuels an increase in buyers, valuation multiples expand because of increasing demand, and risk premiums contract to account for auspicious outlooks, the number of mega-transactions should increase. Easing credit markets and increasing financial investor (especially private equity) interest in M&A will likely further fuel accelerated mega-deal activity in 2010.

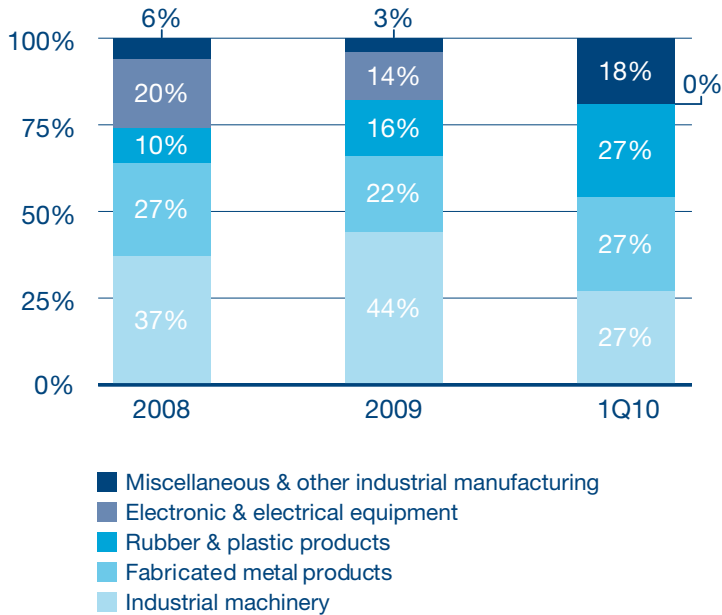
Top five transactions for first-quarter 2010

Month announced	Target name	Target nation	Buyer name	Buyer nation	Status	Value of transaction in US\$ bil.	Category
Jan	Survitec Group Ltd	United Kingdom	Warburg Pincus LLC	United States	Completed	.45	Rubber & Plastic Products
Jan	Grant Forest Products Inc-OSB Facilities(2), South Carolina	United States	Georgia Pacific	United States	Pending	.40	Miscellaneous & Other Industrial Manufacturing
Jan	Pretium Packaging LLC	United States	Castle Harlan Inc	United States	Completed	.20	Rubber & Plastic Products
Feb	PWP Industries	United States	Pactiv Corp	United States	Pending	.20	Rubber & Plastic Products
Mar	Sungjin Geotec Co Ltd	South Korea	Posco Co Ltd	South Korea	Completed	.14	Fabricated Metal Products

Mega deals in 2009

Month announced	Target name	Target nation	Buyer name	Buyer nation	Status	Value of transaction in US\$ bil.	Category
Nov	The Black & Decker Corp	United States	The Stanley Works	United States	Completed	3.47	Industrial Machinery

Deal volume by industrial manufacturing category[†]
 Measured by number of announced deals worth \$50 million or more



[†]Percentages may not sum to 100% due to rounding

Multiple industrial products categories drive activity

PwC segments the industrial manufacturing sector into five categories by comparing SIC codes to our internal classification system. Based on this process, we group deals (measured by number) into five product and service segments:

- Industrial machinery
- Fabricated metal products
- Rubber and plastic products
- Electronic and electrical equipment
- Miscellaneous and other industrial manufacturing

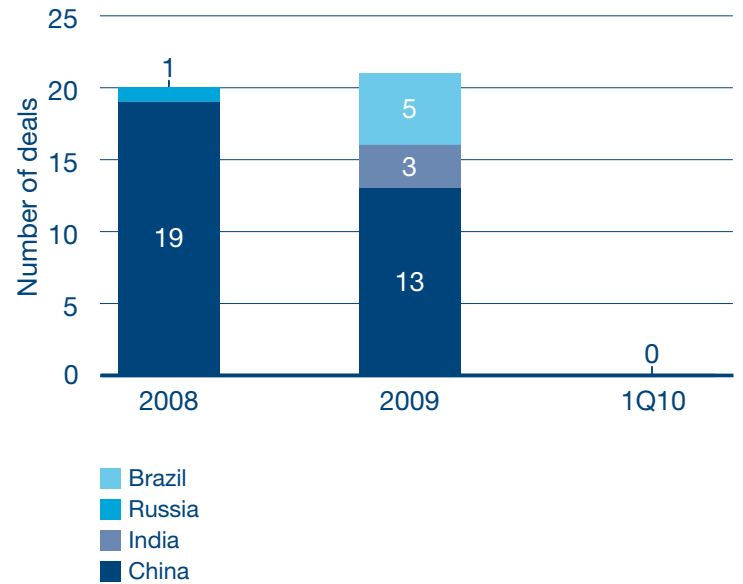
Based on this methodology, during the first quarter of 2010, targets classified as industrial machinery manufacturers, fabricated metal products manufacturers, and rubber and plastic products manufacturers were the primary deal drivers. Industrial machinery's contribution to deal activity declined in the first quarter relative to recent history as rubber and plastics products and miscellaneous and other industrial manufacturing targets increased in the deal mix.

Surprisingly, BRIC-affiliated transactions nearly nonexistent

Not only has deal activity been weak into 2010, the level of activity affiliated with BRIC countries was almost nonexistent. The only BRIC transaction involved Brazil-based Industrias Romi SA's (Romi) unsolicited offer to acquire the entire share capital of US-based Hardinge Inc., a manufacturer of turning and milling equipment, for \$92.2 million. On February 18, 2010, Hardinge rejected Romi's offer, stating it was "grossly inadequate, opportunistic, and not in the best interests of Hardinge and its shareholders." Romi has since embarked on a tender offer to buy Hardinge's shares from willing shareholders. Romi's unsolicited offer for Hardinge's shares highlights the opportunity that buyers flush with cash or access to cash have to build share in existing and new markets. At a time when many industrial manufacturing companies have ready access to plentiful cash (while others watch their shares trade at historical low points) we expect the level of hostile deal activity to continue to increase.

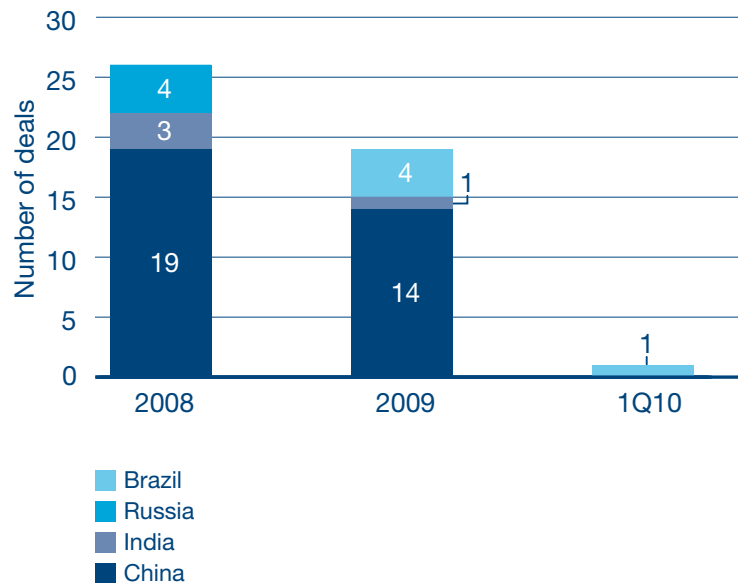
Distribution of BRIC deals by target nation

Measured by number of announced deals worth \$50 million or more



Distribution of BRIC deals by acquirer nation

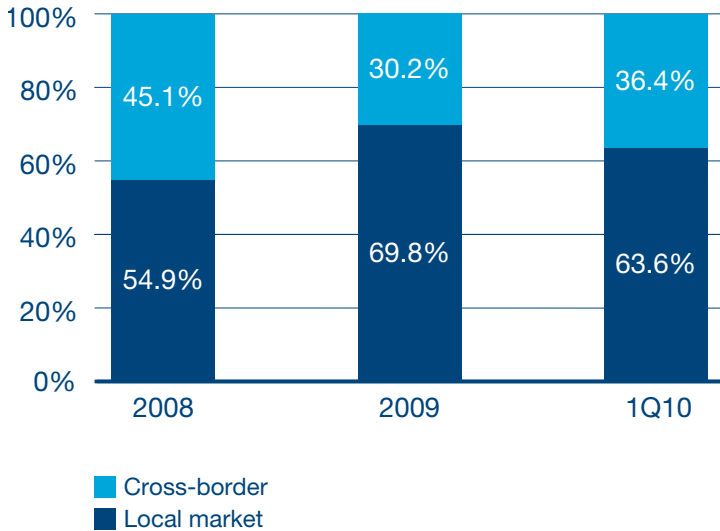
Measured by number of announced deals worth \$50 million or more



Regional analysis

Local market versus cross-border deals (all nations)

Measured by number of announced deals worth \$50 million or more

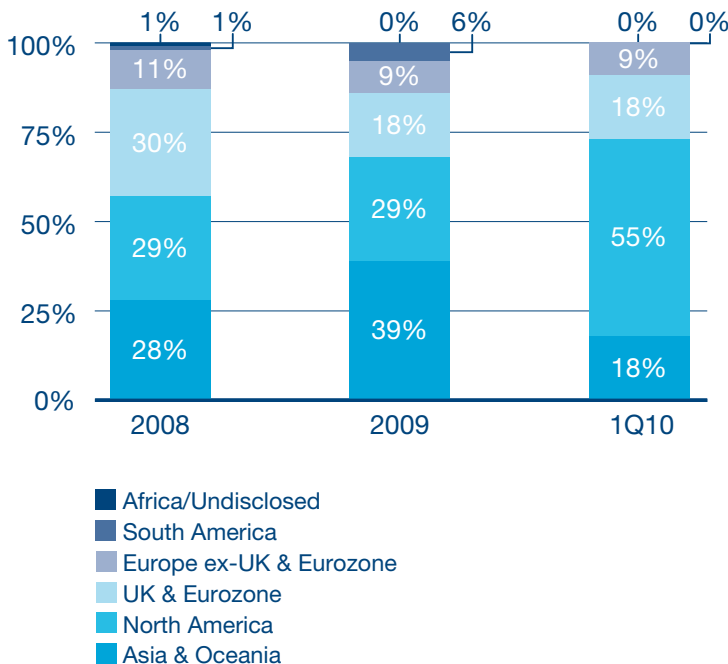


Allocation of cross-border deals shows modest improvement

Cross-border transactions have always been an important part of the M&A story and although recent trends reveal a lower concentration of cross-border transactions are taking place compared with historic levels, the contribution of cross-border activity remains an integral driver of transactions. From 2006-2008, on average, 41.6 percent of transactions were classified as cross-border compared with 30.2 percent in 2009 and 36.4 percent in the first quarter of 2010. Due to political, socioeconomic, and currency risks, cross-border transactions generally involve greater risks than do local market transactions, so the greater concentration of local market activity during 2009 and into 2010 relative to the historical record is not surprising. Although we believe buyer optimism is rising and risk aversion is moderating, this view applies to local markets, which tend to be familiar markets from a buyer's perspective. For foreign markets, we believe these concerns explain ongoing buyer cautiousness. As a result, we expect local market activity will continue to be the primary driver of deal activity as the year progresses.

Regional distribution of deal volume by target region[†]

Measured by number of announced deals worth \$50 million or more



North America the hotbed for deal activity

During the first quarter, targets located in North America were the primary drivers of deal activity, as 55 percent of transactions were announced in the region. All six transactions announced in the North American region were in the United States. In relative terms, Asia and Oceania remained a strong region for deal activity. However, on an absolute basis only two transactions were announced in the region compared with 35 in 2009. Similarly, the UK and Eurozone region contributed meaningfully on a relative basis, but in absolute terms, only two transactions originated in the region.

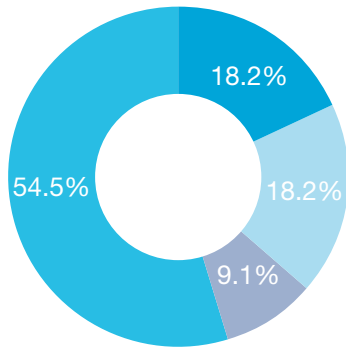
North America, Asia and Oceania, and the UK and Eurozone regions were drivers of geographical trends for acquirers. We believe deal activity will continue to be driven by these regions as they benefit from regulatory environments that generally support both foreign investment and domestic consolidation, as well as more efficient capital-market systems and infrastructure relative to the other regions (South America and Africa), which makes it easier to raise capital (secondary offerings, spin-offs, etc.) for M&A transactions.

[†]Percentages may not sum to 100% because of rounding

Regional distribution of 1Q 2010 deals

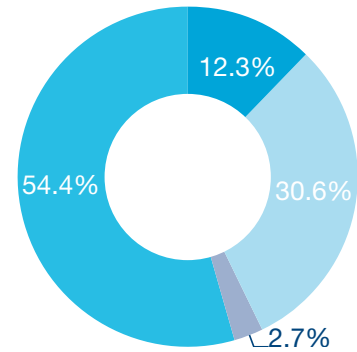
Deal volume by target region

Measured by number of announced deals worth \$50 million or more



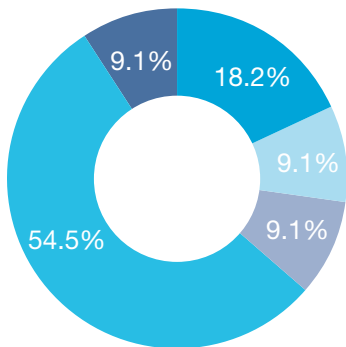
Deal value by target region

Measured by value of announced deals worth \$50 million or more



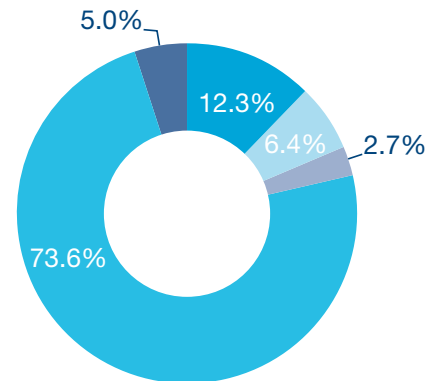
Deal volume by acquirer region

Measured by number of announced deals worth \$50 million or more



Deal value by acquirer region

Measured by value of announced deals worth \$50 million or more



■ Asia & Oceania
 ■ North America
 ■ UK & Eurozone
 ■ Europe ex-UK & Eurozone
 ■ South America
 ■ Africa/Undisclosed

Preparing for an upturn in M&A activity

Despite the recent slowdown in the economy, M&A continues to be high on senior executive agendas worldwide. Seen as a powerful growth mechanism, M&A can offer a stronger cash position, a broader customer base, higher market share, opportunities to reduce overcapacity, and access to better technology, products, and distribution channels. Looking forward, factors that will drive deal making include a downward adjustment of prices, greater industry consolidation, increased competition, and more semi-distressed companies opting to sell themselves.

Because all the indicators for increased M&A activity appear to be present, companies out of the market during the downturn should reassess their due diligence processes.

Leading IM companies take a holistic and integrated approach to due diligence. Team members represent a cross section of different functional areas and comprise not only finance experts but legal, tax, marketing, and operational specialists, as well as compliance and regulatory specialists, all working as one group to identify a broad range of risks. This team conducts not only financial due diligence but also human resources due diligence, including external and internal stakeholders. And the team conducts soft due diligence, which is strategic rather than tactical, focusing on how to resolve issues that will arise when the businesses come together to form the new, larger entity.

By bringing all of these analyses to the fore, leading companies lay the groundwork for more accurate competitive pricing, more potential synergies, and faster, smoother post-merger integration.

Steps to take toward better due diligence

To potentially improve a company's due diligence process, IM companies may consider the following steps:³

- Engage the due diligence team in the deal process before due diligence begins.

Strike a balance between making sure the due diligence team is close to the people doing the deal and yet remains independent and objective enough to be good corporate stewards, uninfluenced by the potential for others' desires to get the deal done no matter what.

- Determine the target's financial strength.

Review and document results of the target company's three previous years' audited financial statements, public registrations statements, tax returns, and management letters. While this review typically includes a comprehensive reading of all annual and quarterly reports, financial statements with generally accepted accounting principles may not provide sufficient detail to evaluate deal drivers.

- Identify and address the most common deal killers.

Look for potential warning signs that may signal the need for a deeper analysis, such as:

- How well does the target company support the company's corporate strategy?
- What cultural clashes might arise as the two companies come together?

- How competent is the target company's management? How easy will it be to work with?
- How skilled are the workers?
- Was revenue restated, and if so, why?
- Is the brand name listed as a major asset, and if so, who assessed its value?
- Is the company involved in litigation?
- Are there any inconsistencies in the numbers, such as artificially ramping up revenue at the end of the year by selling excess inventory at deep discounts to customers?
- Are there any warranties — written statements from the seller that confirm a key fact about the target's business?
- Are there any indemnities — commitments from the target company to reimburse the buyer in full in certain situations?
- What is the potential for product cannibalization?
- How effective is the target's anticorruption compliance program?
- Can the company mitigate its risk through deal structuring and/or contractual protection?
- Does the buyout or merger plan spell out offshore sourcing issues?
- Does one of the merged companies have products with a quality or reputation that can harm the reputation or perceived value of products offered by the other merged company?

³PricewaterhouseCoopers, Global Best Practices, 2010

- Will there be overlapping sales territories, which can cause turf battles between sales representatives?
- If a massive system upgrade is planned, will the legacy systems run parallel until the new system is running smoothly? Are the risks of the technology expenditures clearly laid out and thought through?

- Emphasize customer due diligence.

Due diligence teams can gain a better understanding of the solidity of customer relationships and the mix of customers whose relationships were strong (loyal), moderate (neutral), or weak (vulnerable). This understanding helps them better predict revenue streams.

- Analyze how the new company will impact workers' performance.

After announcing the transaction, create specific goals for the post-merger integration and communicate them to the target company's employees so that they will have a clear understanding of how the transaction will affect them, including whether they will retain their jobs and, if so, whether their pay and benefits will change.

A successful deal

Gaining a true picture of a target company requires overcoming deal biases. Successful acquirers also must avoid overconfident synergy estimates by assessing their projections for the current deal against those completed in the past. The more deals they do, the better the data they accumulate to arrive at a realistic set of expectations.

These companies also seek out expert external advice. They know even the most well intentioned due diligence specialists may occasionally, perhaps even unconsciously, become partisan in their thinking.

How PricewaterhouseCoopers can help

Deciding which acquisitions will create shareholder value may depend on the rigor and quality of due diligence performed on the transaction. The PwC Transaction Services team's approach to diligence goes beyond traditional accounting and financial analysis to assess the key assumptions underlying the deal.

Our experienced teams help clients:

- Gain a deeper understanding of the total performance of the target business
- Negotiate favorable deal terms
- Uncover real opportunities for capturing post-deal value
- Address key tax and financial reporting implications and the related impact on the communications strategy for the transaction
- Make purchase price adjustments post-acquisition
- Enhance overseas and cross-border capabilities
- Perform carve-out assessments

Buy-side (and sell-side) due diligence services include:

- M&A tax due diligence—whether it's a stock or an asset transaction, understanding the tax implications of the proposed deal and determining the optimal tax structure are critical to creating deal value.

- Human resources due diligence—adequately evaluating the impact of human resources on a potential transaction is crucial to assessing the viability of a deal.
- Insurance risk management—insurable risks such as workers compensation and product liability, insured or not, affects the immediate and prospective economics of a transaction.
- Commercial due diligence—identifying commercial risks or upsides in a deal will frequently have a material impact on either price negotiation or deal viability.
- Information technology (IT) and operations due diligence—identifying systems and processes can influence deal price and viability.
- Financial due diligence—focusing not only on sustainability of historical earnings, cash flows, and quality of assets, but also on the plans and projects, purchase agreement negotiation issues, integration challenges and opportunities for the total performance of the business.

Specialty case study: Coordinating two contingent acquisitions

Client: A private equity company acquiring two manufacturing companies

Client issue

A leading global private investment firm engaged PwC to conduct financial, tax, human resources, IT, operational, synergy, and insurance due diligence related to complex deals to acquire two companies—one a \$1.6 billion revenue division of a larger, multinational corporation and the other, a \$300 million to \$400 million private company—and combine them into a single corporate entity.

Initially, the smaller company was acting as a partner to the private equity client and was involved as a buyer in the preliminary analysis of the carve-out. To assist our client, PwC provided the smaller company much-needed guidance throughout this process. The private equity client wasn't interested in just the carve-out on its own, though when viewed with the opportunity to add it to the smaller, synergistic, private company; it became intrigued by the possibilities for the combined businesses.

Approach

PwC created two cross-functional teams throughout the country, including financial, tax, human resources, IT, operational, synergy, and insurance, to facilitate the smooth flow of both deal processes.

Challenges revolved around finding a common denominator between the two companies because there were multiple plants across the country, and a large part of the synergies were based on overlap in the plant footprint. PwC worked in concert with management and production experts to reflect facility-level profitability and other key metrics on the same basis. As a result of the PwC analysis, the private equity client had a basis to make more informed decisions as they moved to quickly realize opportunities for improvements in the businesses.

Impact

With visibility into both deals and seamless communication among the PwC teams, attorneys, financing sources, and other advisers, the private equity client gained a solid understanding of the cost basis for the two companies plus the potential cost structure of the combined entity, post-close. The team was able to help the client accomplish this despite complications of the different corporate structures, varying acquisition time frames, and complex purchase formats of the two target companies.

Given this insight, the private equity client agreed to combine the two companies into a standalone business. After some time and refocus on this company, it eventually merged with a public company competitor, positioning itself as the largest single shareholder of this new public company and gaining an even greater value in the long term.

PricewaterhouseCoopers' industrial manufacturing experience

Deep industrial manufacturing experience

Our Industrial Manufacturing practice is comprised of a global network of industry professionals who provide assurance, tax, and advisory services to public and private companies around the world. Central to the successful delivery of our services is an in-depth understanding of today's industry issues, in addition to a wealth of specialized resources and "best practices" that help solve complex business challenges. Our highly skilled team encourages conversations on top-of-mind trends and issues through active participation in industry conferences and associations, as well as through industry-focused publications and Web forums. To address your industry needs wherever they arise, our professionals are concentrated in areas where the industrial manufacturing industry operates today and in the emerging markets where it will operate in the future.

Quality deal professionals

PwC's Transaction Services practice, with more than 6,500 dedicated deal professionals worldwide, has the right industry and functional experience to advise you on factors that could affect a transaction, including market, financial accounting, tax, human resources, operating, IT, and supply chain considerations. Teamed with our Industrial Manufacturing practice, our deal professionals can bring a unique perspective to your deal, addressing it from a technical aspect as well as from an industrial manufacturing industry point of view.

Local coverage, global connection

In addition to the approximately 9,300 professionals who serve the industrial manufacturing industry, our team is part of an Industrial Products group that consists of 31,000 professionals, including approximately 15,800 providing Assurance services, more than 9,000 providing Tax services, and 6,200 providing Advisory services. This expands our global footprint and enables us to concentrate efforts in bringing clients a greater depth of talent, resources, and know-how in the most effective and timely way.



Methodology

Assembling value is an analysis of deals in the global industrial manufacturing industry. Deal information was sourced from Thomson Financial and includes deals for which targets have primary SIC codes that fall into one of the following SIC industry groups: millwork, plywood, and structure; wood buildings and mobile homes; partitions, shelving, and lockers; gaskets, packing, and sealing devices; fabricated rubber products; miscellaneous plastics products; heating equipment, except electric air; fabricated structural metal products; bolts, nuts, screws, and other machine products; metals forgings and stampings; coating, engraving, and allied services; miscellaneous fabricated metal products; engines, and turbines; farm and garden machinery; metalworking machinery; special industry machinery; general industrial machinery; refrigeration and service industry machinery; miscellaneous industrial and commercial machinery; electric transmission and distribution equipment; electrical industrial apparatus; electrical lighting and wiring equipment; miscellaneous electrical machinery and equipment; and miscellaneous manufacturing industries.

This analysis includes all individual mergers and acquisitions for disclosed or undisclosed values, leveraged buyouts, privatizations, minority stake purchases, and acquisitions of remaining interest announced between January 1, 2006, and March 31, 2010, with a deal status of completed, intended, partially completed, pending, pending regulatory approval, unconditional (i.e., initial conditions set forth by the buyer have been met but deal has not been completed), or withdrawn.

Regional categories used in this report approximate United Nations (UN) Regional Groups, as determined by the UN Statistics Division, with the exception of the North America region (includes Northern America and Latin and the Caribbean UN groups), the Asia and Oceania region (includes Asia and Oceania UN groups) and Europe (divided into UK and Eurozone and Europe ex-UK and Eurozone regions). The Eurozone includes Austria, Belgium, Cyprus, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Malta, Netherlands, Portugal, Slovenia, and Spain. Oceania includes Australia, New Zealand, Melanesia, Micronesia, and Polynesia. Overseas territories were included in the region of the parent country, and China, when referenced separately, includes Hong Kong. The term “deals,” when referenced herein, refers to deals with a disclosed value of at least \$50 million unless otherwise noted.

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PricewaterhouseCoopers Industrial Manufacturing practice

Our Industrial Manufacturing practice, strategically located in more than 30 countries around the world, comprises a global network of industry professionals serving manufacturing clients. We bring experience, international industry best practices, and a wealth of specialized resources to help solve business issues.

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