Engineering growth

First-quarter 2010 global engineering and construction industry mergers and acquisitions analysis

Making smarter deals in a changing environment: Due diligence

Welcome to *Engineering growth*, PricewaterhouseCoopers' quarterly analysis of mergers and acquisitions (M&A) in the global engineering and construction (E&C) 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 engineering and construction (E&C) companies need to push ahead of the competition. It will be the companies with strong balance sheets and robust cash reserves that are in the best position for strategic merger and acquisition opportunities.

As strategic buyers take advantage of their ability to maneuver in a challenging environment, PricewaterhouseCoopers (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, E&C 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, closer scrutiny by lending banks, and additional review by sureties. 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 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.

Well-capitalized construction companies looking for strategic opportunities in today's economy also must consider changes in how mergers and acquisitions are reported as they negotiate deals to expand, acquire weakened competitors, or enter into joint venture agreements. In late 2007, the Financial Accounting Standards Board (FASB) issued two new accounting standards to make company information on M&A activity more relevant to stakeholders. FAS 141 (R), *Business Combinations*; and FAS 160, *Noncontrolling Interests in Consolidated Financial Statements*, change the accounting, disclosure, and planning for business combination transactions.[1]

"First, assess your M&A processes that were in place before the downturn because when deals become available, you won't have time to include new processes," said Brian Vickrey, a PwC Transaction Services partner. "Next, make sure you know where to turn for additional resources and assistance if needed. Trying to decide how to run your M&A process in the middle of a deal will result in inefficiencies and lack of focused execution and will lessen your ability to be competitive in a managed auction process."

The economic recession alters the M&A landscape and creates additional 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 economy is improving, these companies are pressured to make tactical and operational business decisions about when to open a closed facility, 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.

[1] PricewaterhouseCoopers, *Unraveling new business combination standards,* May 2009

Healthcare, climate change, and government spending on infrastructure and new buildings

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.

The E&C industry also is greatly affected by the $787 billion economic stimulus bill passed by Congress in February 2009. The massive spending bill aims to finance large infrastructure projects such as public buildings, roads, and bridges and in the process improve the employment picture for US construction workers.

Recent announcements by Wal-Mart to drive carbon reduction and energy efficiency through its supply chain and the federal government's plan that targets suppliers and government contractors to cut carbon emissions 28 percent by 2020 are additional initiatives that create the kind of uncertainty that demands further diligence.

Anticipated consolidation within the health industry as a result 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 plans, union benefit plans, and other postemployment benefit plans (OPEB plans)—and how they are funded—are of particular interest to companies in the E&C industry because they commonly provide these employee benefits.

Tax and information technology (IT) due diligence

Two years of economic recession were compounded by dramatic changes to the US tax code and to tax regimes around the world. This required E&C companies to rethink their tax strategy and the recognition of taxes. Further, in today's corporate environment, acquisition transactions often are on an aggressive time schedule, and tax practitioners are sometimes 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 investigation 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, a prospective buyer should consider not only hidden "liabilities" of the target, but also hidden assets or planning opportunities, of which the target and other competitive bidders may not be aware.

Buyers also need to thoroughly evaluate the IT platform of the target business early in the due diligence process. Effectively planning an integration of the platform requires significant lead time because of the complexities involved. Buyers not only must gain an understanding of the major business systems that support and automate core operating processes, but also they should consider the role IT plays in financial and management reporting, the business supply chain, sales and marketing, services execution, manufacturing, and human resources and payroll. Further, an acquiring company must understand whether the target's systems and respective hardware platforms have the stability and scalability to support management's current and future business plans.

The IT due diligence process also includes analysis of significant, capital-intensive existing and planned IT projects. The analysis should evaluate the project timing and budget to identify areas of potential risk of failure and the effect on the acquirer if the acquisition is successfully completed.

Overseas acquisition due diligence

During the prolonged recession, companies grew accustomed to doing business in survival mode. But as a recovery takes hold, 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 strategy. 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, E&C companies considering an investment in an emerging country must weigh the risks and the work entailed to ensure the integrity of compliance. At issue is falling into 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. The key issues companies address, he said, are the ability to oversee the operations post-transaction, adopt policies and procedures to meet the buyer's requirements, and handle financial reporting requirements under different generally accepted accounting principles.

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:

E&C industry considerations

- How strongly was the GDP decline amplified in the E&C sector? Based on this, what are expectations of timing and strength of recovery?

- In what stage of the business cycle is the E&C industry? Do downturns in the E&C industry typically lead or lag the general economy? How long do downturns typically last in the E&C industry relative to the macroeconomy? What can we learn from this in terms of revenue and production planning?

- What is the level of excess capacity in the E&C industry? What will be the new normal for 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 macroenvironment and its customer base? How do they compare with 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 well positioned to fully take advantage of the up-cycle? Is the company advantaged/disadvantaged from a cost standpoint versus key competitors? Are the advantages sustainable or the disadvantages reversible?

Beyond perfunctory due diligence

To drive further efficiency and meet stakeholder demands for growth, E&C companies are challenged to look to combine 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 E&C 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 business entity, leading E&C 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 were concerned that recent sequential improvement in deal activity would end, owing to the strong activity in the previous quarter (49 deals worth $50 million or more were announced in the fourth quarter of 2009). Nonetheless, we believed that year-over-year improvement was possible because only 15 deals were announced in the first quarter of 2009. With 29 transactions in the first quarter, 2010 is off to a fast start. In terms of value, deals totaled $21.2 billion in the first quarter of 2010 compared with $2.6 billion and $23.7 billion in the first and fourth quarters of 2009, respectively.

There was a strong rebound in mega-deals (transactions of at least $1 billion) during the quarter, with four transactions announced. Conversely, no mega-deals were announced in the first quarter of last year, and there were only seven in all of 2009. The largest transaction during the period was US-based Schlumberger Ltd.'s $11 billion definitive agreement to acquire all of the share capital of US-based Smith International Inc., which provides products and services in all phases of oil and gas exploration and development, in a stock-swap transaction. The Schlumberger transaction is the largest announcement since 2007, when UK-based Lehigh UK Ltd. completed its $15.6 billion acquisition of all of the share capital of Hanson PLC, a UK-based manufacturer of heavy building materials.

Throughout 2009, the absence of the financial buyer had an adverse impact on the M&A environment. Financial buyers faced considerable challenges in fundraising and access to credit because of the global recession, which we believe limited their participation in deal activity. Into 2010, although financial investors remain secondary to strategic buyers in driving overall deal activity, they were the primary drivers of mega-deal activity, which runs counter to historical trends. For first-quarter 2010, 75 percent of mega-deal activity was attributable to financial buyers compared with 14 percent in 2009. This robust turnaround suggests that financial buyers are back in the deal market in force, which would be a boon for deal activity in 2010.

Targets and acquirers in the North America and Asia and Oceania regions were the primary drivers of deal activity in the first quarter. We believe these regions will continue to drive deal activity because each generally benefits from factors conducive to M&A, including favorable regulatory environments that support both foreign investment and domestic consolidation and more efficient capital markets. For the economies of Brazil, Russia, India, and China (BRIC), only four transactions were announced — two local-market transactions in China, one cross-border transaction in Brazil, and one cross-border transaction in India.

Looking ahead, we believe fundamentals are ripe for the deal environment to continue to improve. In many global markets, credit is loosening, equity markets are advancing, and economic growth rates are stabilizing. Renewed economic growth is particularly noteworthy because M&A activity fundamentally correlates to GDP growth. We believe that the surge in first-quarter mega-deal activity indicates that financial and strategic buyers are increasingly optimistic. 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 2009.[2]

Furthermore, US high-yield bond deals set a quarterly record, with $67 billion of issuances in the United States, up from $57 billion in fourth quarter 2009 and $11 billion in the first quarter of 2009.[3] Although many macroeconomic factors have improved, others remain weak, 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 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.

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

[3] Ibid

Commentary

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

	2008				2009				2010
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q
Number of deals	57	68	42	47	15	31	36	49	29
Total deal value ($ bil.)	14.3	18.3	13.5	23.5	2.6	10.3	9.0	23.7	21.2
Average deal value ($ bil.)	0.3	0.3	0.3	0.5	0.2	0.3	0.2	0.5	0.7

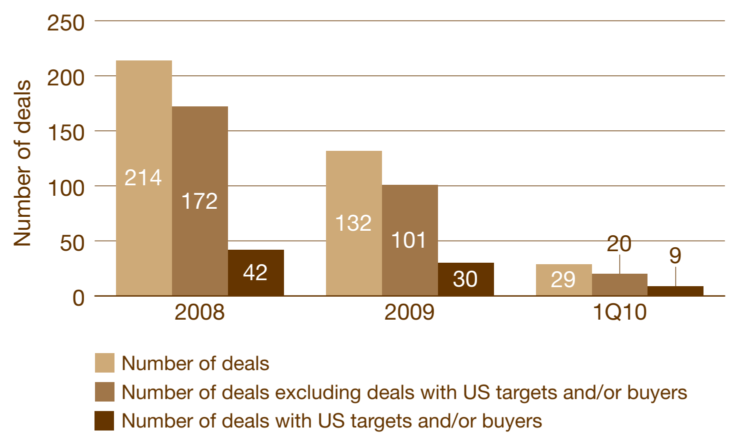
A solid start to 2010

On a year-over-year basis, 2010 is off to a strong start as the volume and value of deals during the first quarter improved substantially. Heading into the first quarter, we believed year-over-year improvement was possible because only 15 deals totaling just $2.6 billion were announced during the first quarter of 2009. Sequentially we expected trends to moderate given the strong results in the fourth quarter of 2009. The impressive year-over-year rebound may suggest that many of the factors that adversely affected deal activity in early 2009, such as the lack of credit availability and weak global demand, have moderated, which bodes well for deal activity in 2010.

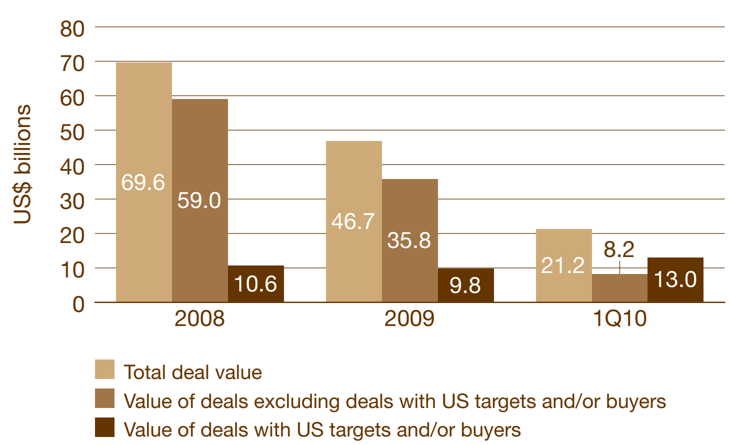
US-affiliated transactions fuel activity

Transactions involving both US targets and buyers were the key drivers of deal activity during the first quarter, particularly in terms of deal value. Of the 29 transactions announced during the period, nine (31 percent) involved a US entity. Of the $21.2 billion in deal value announced during the period, 61 percent was attributable to US-affiliated activity.

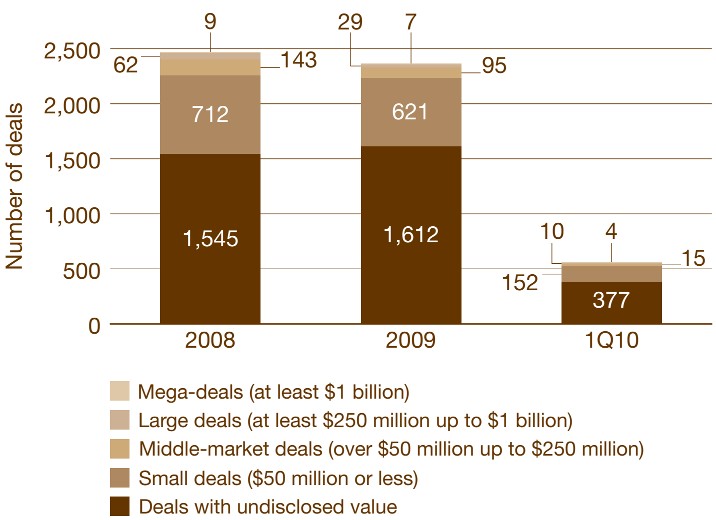
Deal activity by number of deals
Measured by number of announced deals worth $50 million or more



Deal activity by total deal value
Measured by value of announced deals worth $50 million or more



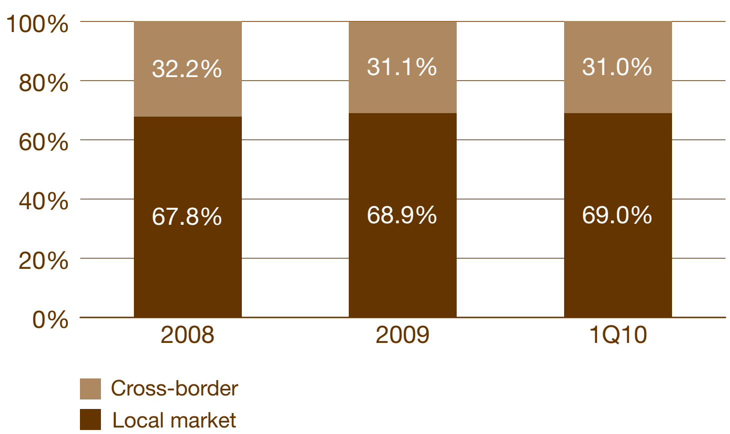
Deal activity by volume and range of deal value (including transactions with undisclosed values)
Measured by value of announced deals



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.

Local-market versus cross-border deals (all nations)
Measured by number of announced deals worth $50 million or more



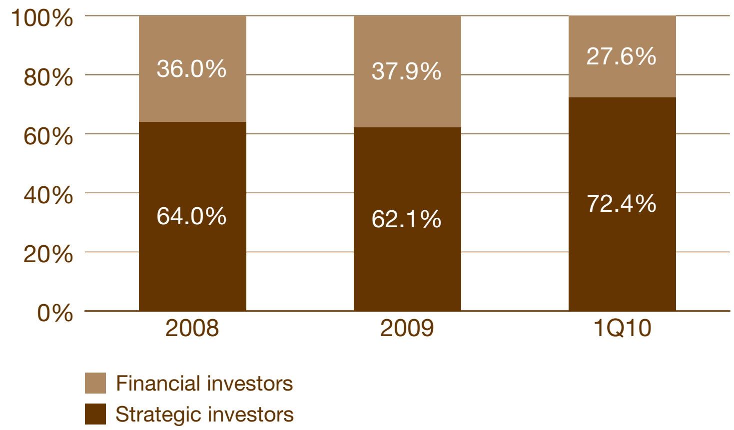
Allocation of cross-border deals unchanged

Cross-border transactions have always been an important part of the M&A story, and although recent trends reveal a somewhat lower concentration of cross-border transactions compared with levels experienced in 2007 (36.6 percent), the contribution of cross-border activity remains an integral driver of transactions.

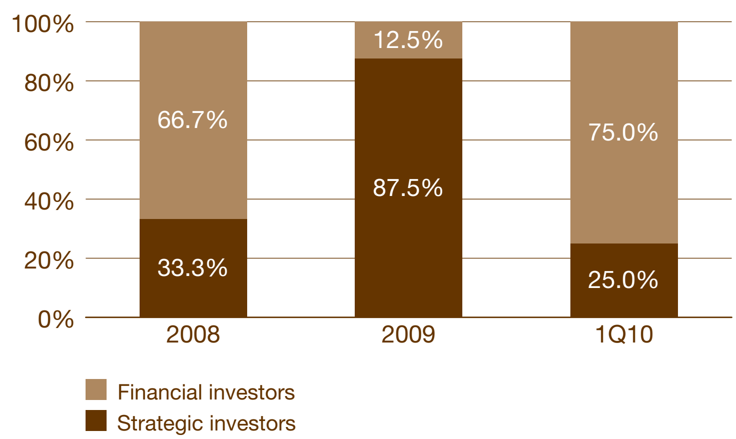
Strategic investors fuel deal activity

Over the past few years, private equity firms have faced considerable fund-raising challenges, which deterred their participation in deals. However, financial investors (i.e., private equity, pension funds, and equity income funds) as a group continue to participate in M&A activity. Financial investors have adapted to the new types of transactions that have evolved in the changed deal environment. For example, the pace of leveraged buyouts has slowed dramatically while distressed transactions (i.e., creditors assuming ownership), asset divestitures, and minority stake and incremental stake investments have all increased. Although strategic interests continued to drive the bulk of transactions, financial buyers were the main catalysts in driving mega-deals during the first quarter.

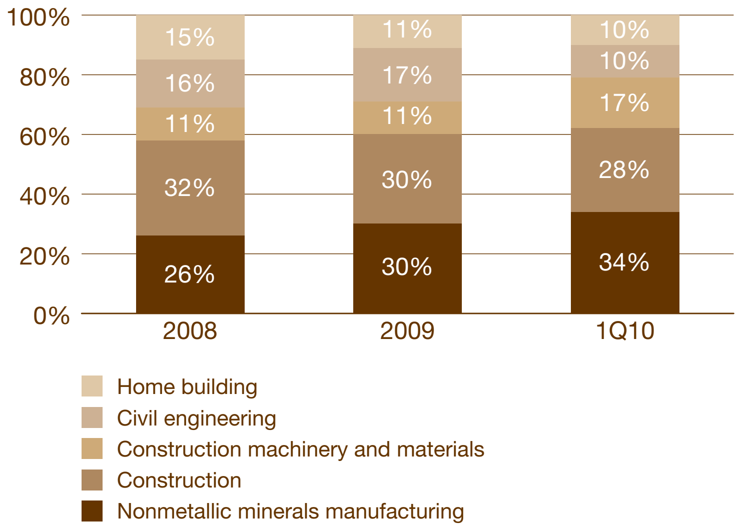
Deal activity by investor group
Measured by number of announced deals worth $50 million or more



Mega-deal (at least $1 billion) activity by investor group
Measured by number of mega-deals



Deals by E&C category
Measured by number of announced deals worth $50 million or more



Note: Percentages may not sum to 100% due to rounding.

Nonmetallic minerals manufacturing category leads deal activity

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

- Civil engineering
- Nonmetallic minerals manufacturing
- Construction machinery and materials
- Home building
- Construction

Based on this methodology, during the first quarter of 2010, targets classified in the nonmetallic minerals manufacturing and construction segments were the primary drivers of deal activity.

Mega-deals show strong year-over-year recovery

During the period, mega-deal (transactions of at least $1 billion) activity experienced a strong recovery, with four transactions compared with none in the first quarter of 2009 and seven for the year. Details of the four transactions announced during the first quarter include:

1. On February 21, 2010, US-based Schlumberger Ltd. agreed to acquire the entire share capital of US-based Smith International Inc., which provides products and services in all phases of oil and gas exploration and development, for a consideration of approximately $11 billion in a stock-swap transaction.

2. On January 9, 2010, United Arab Emirates (UAE)-based Aabar Investments PJSC announced that it planned to acquire a 70 percent interest, or approximately 2.8 billion ordinary shares, in Arabtec Holding PJSC, a UAE-based construction company, for a consideration of $1.7 billion.

3. On January 13, 2010, Portugal-based Camargo Correa Portugal SGPS SA announced that it planned to acquire a 22 percent stake, or 147.8 million ordinary shares, in Cimpor Cimentos de Portugal SGPS SA (Cimpor), a Portugal-based manufacturer and wholesaler of hydraulic cement, for $1.3 billion, in a privately negotiated transaction.

4. On February 4, 2010, Malaysia-based BlueFire Capital Group Ltd. announced that it planned to acquire the entire share capital of KNM Group Bhd, a Malaysia-based manufacturer of industrial equipment and machinery, for a consideration of $1.1 billion.

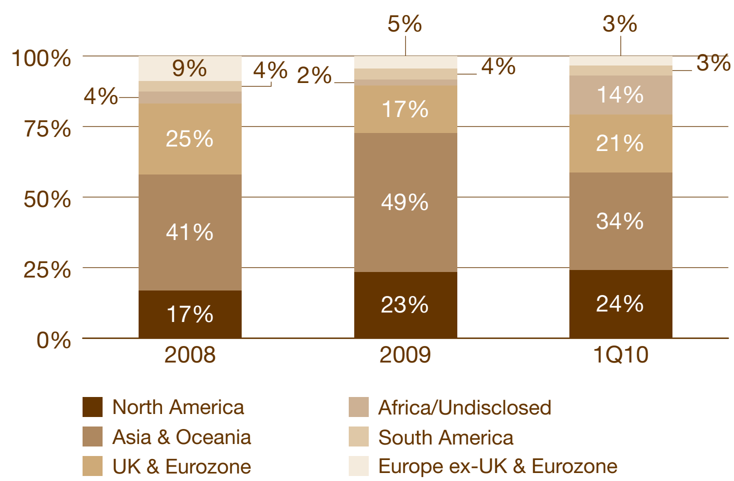
Mega-deals in 1Q 2010

Month announced	Target name	Target nation	Acquirer name	Acquirer nation	Status	Value of transaction in US$ bln	Category
Feb	Smith International Inc	United States	Schlumberger Ltd	United States	Pending	11.04	Construction machinery and materials
Jan	Arabtec Holding PJSC	Utd Arab Em	Aabar Investments PJSC	Utd Arab Em	Pending	1.75	Home building
Jan	Cimpor Cimentos de Portugal SGPS SA	Portugal	Camargo Correa Portugal SGPS SA	Portugal	Pending	1.33	Nonmetallic minerals manufacturing
Feb	KNM Group Bhd	Malaysia	BlueFire Capital Group Ltd	Malaysia	Pending	1.06	Construction machinery and materials

More deals continue to come from Asia & Oceania and North America

During the first quarter, targets and acquirers located in Asia & Oceania and North America were the primary drivers of deal activity. We believe that these regions will continue to lead in deal activity because they benefit from regulatory environments that generally support both foreign investment and domestic consolidation and from more efficient capital-market systems and infrastructure compared with the other regions (South America and Africa), which makes it easier to raise capital (secondary offerings, spin-offs, etc.) for M&A transactions.

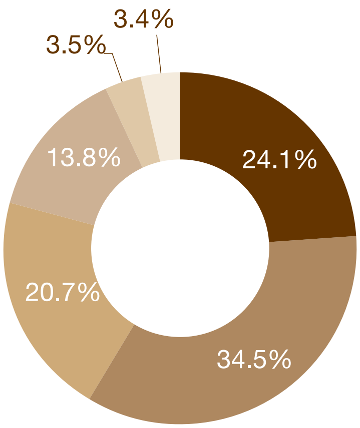
Regional distribution of deals by target region
Measured by number of announced deals worth $50 million or more



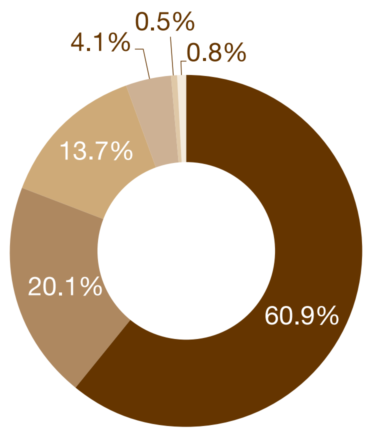
Note: Percentages may not sum to 100% due to rounding.

Regional distribution of 1Q 2010 deals

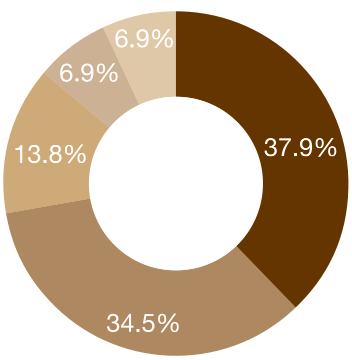
Regional distribution of deals by target region
Measured by number of deals worth $50 million or more



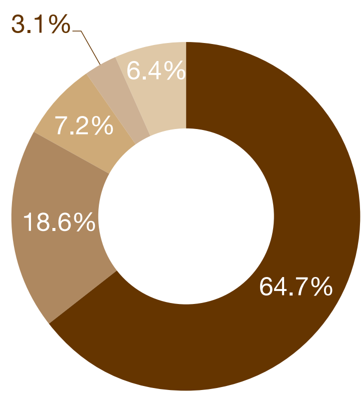
Regional distribution of deals by target region
Measured by value of deals worth $50 million or more



Regional distribution of deals by acquirer region
Measured by number of deals worth $50 million or more

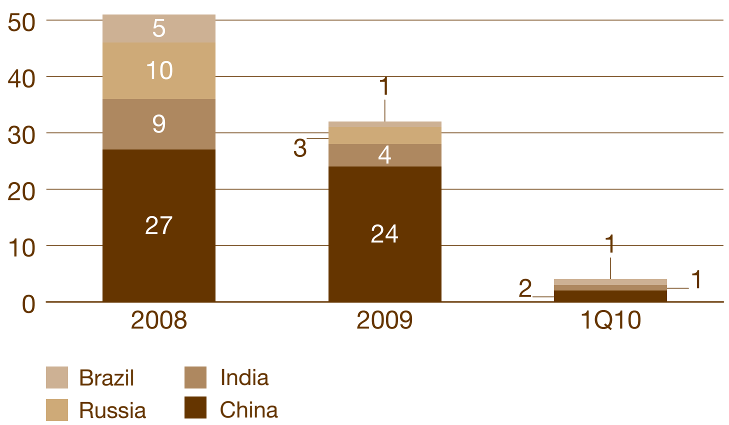


Regional distribution of deals by acquirer region
Measured by value of deals worth $50 million or more

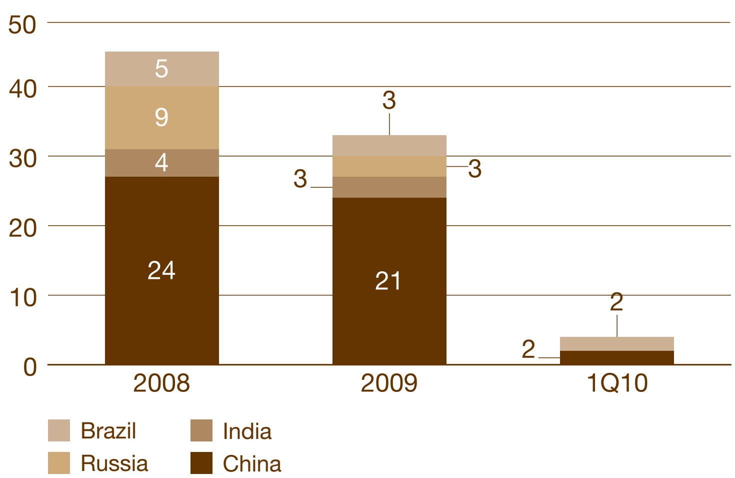


North America | Asia & Oceania | UK & Eurozone | Africa/Undisclosed | South America | Europe ex-UK & Eurozone

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



BRIC transactions

With a global economic recovery under way, we believe BRIC economies present significant opportunities for multinational companies willing to adjust to each regime's political, economic, and strategic idiosyncrasies. Long-term growth in these emerging economies is expected to be higher than in the developed world, due to appreciating currencies, technological progress, and growth in capital stock, among other factors. Details regarding first-quarter 2010 BRIC target transactions:

1. On March 30, 2010, Japan-based Hitachi Construction Machinery Co. Ltd. raised its interest to 60 percent from 40 percent by acquiring a 20 percent stake in Telco Construction Equipment Co. Ltd., an India-based manufacturer of construction equipment, from Tata Motors Ltd. for a consideration of $258.3 million.

2. On February 9, 2010, China-based Luquan Dongfang Dingxin Cement Co. Ltd., a wholly owned unit of BBMG Corp., acquired the cement production assets of Hebei Yanzhao Cement Co. Ltd., a China-based manufacturer and wholesaler of cement, for a consideration of $101.5 million.

3. On January 3, 2010, Australia-based WorleyParsons Ltd. acquired CNEC Engenharia SA, a Brazil-based provider of engineering services, from Camargo Correa SA for a consideration of $97.6 million.

4. On February 24, 2010, China-based BBMG Corp. agreed to acquire 70 percent interest in Beijing Shunfa Lafarge Cement Co. Ltd. for a combined value of $74.2 million, from China-based Lafarge China Offshore Holding Co Ltd.

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 semidistressed 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 E&C companies take a holistic and integrated approach to due diligence. Team members represent a cross section of different functional areas and industry expertise and comprise not only finance experts but also legal, tax, marketing, and operational specialists as well as compliance, regulatory, and business strategy specialists, who all work as one group to identify a broad range of risks as well as chances. 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 business entity.

Steps to take toward better due diligence

To potentially improve a company's due diligence process, E&C companies may consider the following steps:[4]

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

  Strike a balance between making sure the due diligence team members are close to the people doing the deal and yet remain 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?
  - 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?

[4] PricewaterhouseCoopers, Global Best Practices, 2010.

- 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?
- Will there be overlapping sales territories, which can cause turf battles between sales representatives?

- 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 postmerger integration and communicate those goals to the target company's employees so that they will have a clear understanding of how the transaction will impact them, including whether they will retain their jobs and, if so, whether their pay and benefits will change.

Identifying the most common deal killers

Gaining a true picture of a target company requires overcoming deal biases. Successful acquirers must also avoid overconfident synergy estimates by assessing their projections for the current deal against those completed in the past. The more deals they close, the more data they will accumulate to help them develop 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 PwC can help

Determining which acquisitions will create shareholder value depends 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 products liability, insured or not, affect 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.
- **IT and operations due diligence—**identifying systems and processes can affect 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:

Client issue	A large international company involved in the commercial nuclear electric power industry was interested in buying a controlling stake in a related business. It asked PwC to perform a due diligence investigation of the target company to identify potential risks before the acquisition.
Approach	PwC assembled a team that included professionals from our global network to conduct extensive multilevel due diligence, including a forensic accounting analysis of the target's books and records and a background analysis of its key personnel.
Impact	PwC's due diligence investigation identified several risks and helped the company make a more informed decision about the potential acquisition. The company acquired a controlling stake in the target, gaining an advantage over rivals in the competition for new atomic power plants. The company later engaged PwC to help with other aspects of the acquisition, including the conversion to US GAAP and preparation of balance sheets.

PricewaterhouseCoopers' engineering and construction experience

Deep E&C experience

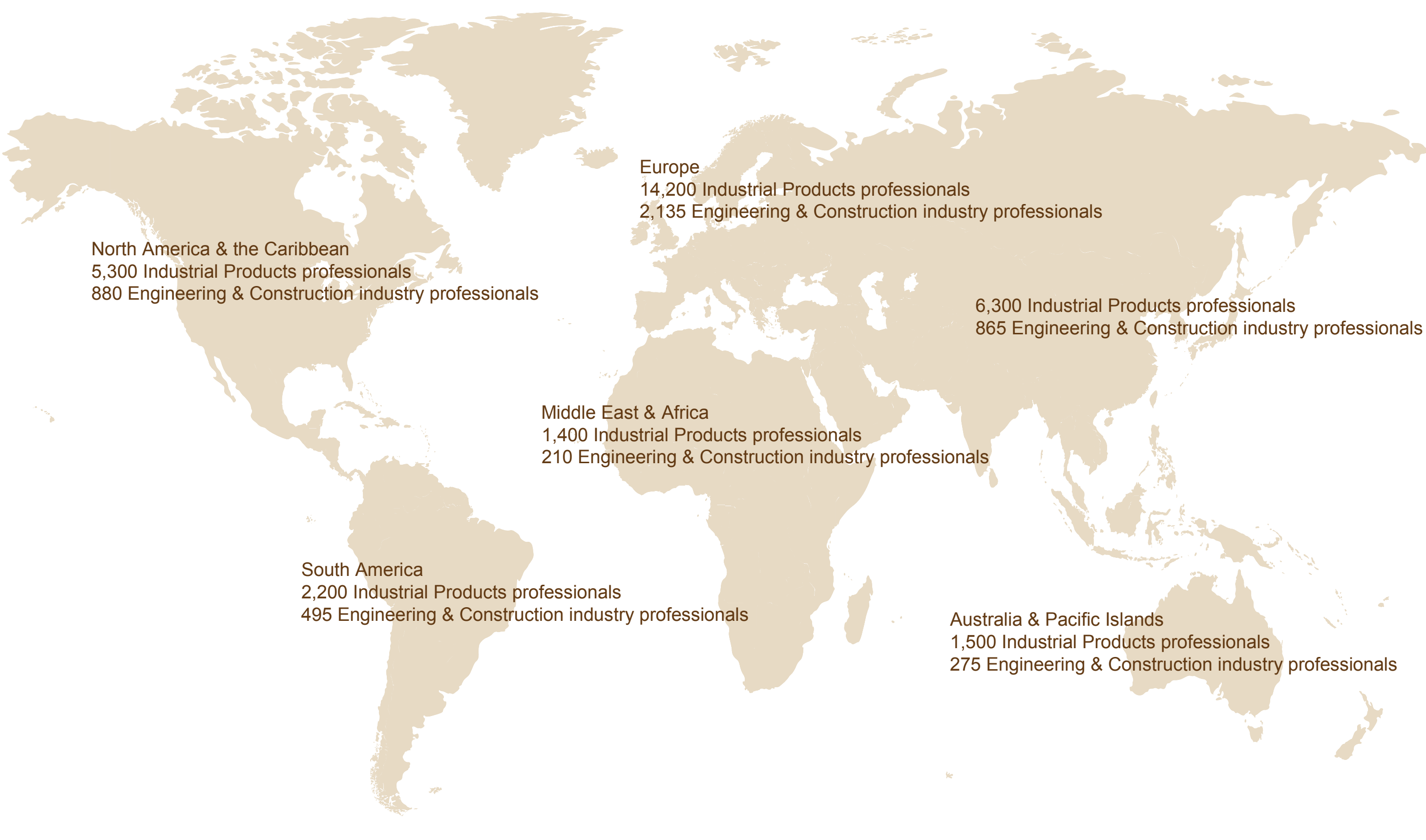
More E&C companies listed on the Fortune 500 use the audit services of PwC than any other accounting firm. Our Engineering and Construction industry practice comprises a global network of industry professionals who serve more than 20,000 E&C companies around the world. We specialize in providing Assurance, Tax, and Advisory services to contractors, house builders, building products companies, professional and support services companies, and governments, as well as private and public sector companies. 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 in solving complex business challenges. Our highly skilled team encourages dialogue on top-of-mind trends and issues through active participation in industry conferences and associations, such as the Construction Financial Management Association, 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 E&C 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 Engineering and Construction practice, our transaction professionals can bring a unique perspective to your deal, addressing it from a technical aspect as well as from an industry point of view.

Local coverage, global connection

In addition to having more than 4,800 professionals who serve the E&C industry, our team is a part of an expansive Industrial Products group that consists of 31,000 professionals, including approximately 15,800 providing Assurance services, 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.



Contacts

PricewaterhouseCoopers Engineering and Construction practice

PwC's Engineering and Construction practice provides industry-focused Assurance, Tax, and Advisory services. Through our global network, we can draw upon the technical and industry experience of specialists in every country in which your company operates.

US Engineering and Construction Industry Leader
H. Kent Goetjen — +1.860.241.7009
h.kent.goetjen@us.pwc.com

Global Engineering and Construction Industry Leader
Jonathan Hook — +44.22.7804.4753
jonathan.hook@uk.pwc.com

US Transaction Services Partner
Engineering and Construction
Michael Collier — +1.713.356.8133
michael.collier@us.pwc.com

US Transaction Services Partner
Engineering and Construction
Gvido Teteris — +1.646.471.3526
gvido.teteris@us.pwc.com

US Industrial Products Leader
Dean Simone — +1.267.330.2070
dean.c.simone@us.pwc.com

US and Global Industrial Products Tax Leader
Michael Burak — +1.973.236.4459
michael.burak@us.pwc.com

US Industrial Products Advisory Leader
Karen Vitale — +1.973.236.5347
vitalek@us.pwc.com

US Industrial Products Director
Neelam Sharma — +1.973.236.4963
neelam.sharma@us.pwc.com

US Industrial Products Marketing Manager
Diana Garsia — +1.973.236.7264
diana.t.garsia@us.pwc.com

US Industrial Products Sector Analyst
Tom Haas — +1.973.236.4302
thomas.a.haas@us.pwc.com

US Research Analyst
Jeffery Williams — +1.813.348.2146
jeffery.williams@us.pwc.com

PricewaterhouseCoopers Global Transaction Services practice

PwC's Transaction Services practice offers a full range of tax, financial, business assurance, and advisory capabilities covering acquisitions, disposals, private equity, strategic M&A advice, advice on listed company transactions, financing, and public-private partnerships.

Global Transaction Services Leader
Colin McKay — +1.646.471.5200
colin.mckay@us.pwc.com

US Transaction Services Leader
John McCaffrey — +1.415.498.6150
john.p.mcaffrey@us.pwc.com

Europe Transaction Services Leader
Phillippe Degonzague — +33.01.5657.1293
phillippe.degonzague@fr.pwc.com

Asia-Pacific Transaction Services Leader
Chao Choon Ong — +65.6236.3018
chao.choon.ong@sg.pwc.com

US Transaction Services, Assurance
Brian Vickrey — +1.312.298.2930
brian.vickrey@us.pwc.com

US Transaction Services, Tax
Michael Kliegman — +1.646.471.8213
michael.kliegman@us.pwc.com

US Transaction Services, Merger Integration
David Limberg — +1.216.875.3506
david.limberg@us.pwc.com

PricewaterhouseCoopers Global Capital Project and Infrastructure practice

PwC's Capital Project & Infrastructure (CP&I) practice focuses on transactions and the building of assets that span both the public and private spaces, with experience in the planning, analysis, execution and governance and reporting of large capital programs, public-private partnership experience on both the public and commercial side, regulatory expertise, fund structuring and deal expertise in synergistic areas such as tax, sustainability, fraud and corruption, utilities, energy, healthcare and government.

Global and US Capital Projects and Infrastructure Leader
Carter Pate — +1.703.918.1111
carter.pate@us.pwc.com

US Capital Projects and Infrastructure Partner
Kristen Vieira Traynor — +1.267.330.2530
kristen.vieira.traynor@us.pwc.com

Capital Projects and Infrastructure Transactions Partner
Michael McHale — +1.646.471.2628
michael.w.mchale@us.pwc.com

Methodology

Engineering growth is an analysis of deals in the global engineering and construction sector. Deal information was gathered from Thomson Financial and includes deals for which targets have primary SIC codes that fall into one of the following SIC industry groups: single-family housing construction; residential construction; operative builders; industrial buildings and warehouses; nonresidential building construction; highway and street construction; bridge, tunnel, and elevated highway construction; water, sewer, pipeline, and utility line construction; heavy construction; plumbing, heating, and air conditioning; electrical work; carpentry work; roofing, siding, and sheet metal work; concrete work; water well drilling; structural steel erection; excavation work; installation or erection of building equipment; special trade contractors; asphalt paving mixtures and blocks; asphalt felts and coatings; flat glass; glass containers; pressed and blown glass and glassware; glass products, made of purchased glass; cement, hydraulic; brick and structural clay tile; ceramic wall and floor tile; clay refractories; vitreous plumbing fixtures and bathroom accessories; fine earthenware (whiteware) kitchen articles; pottery products; concrete block and brick; concrete products, except block and brick; ready-mixed concrete; gypsum products; cut stone and stone products; abrasive products; minerals and earths, ground or otherwise treated; mineral wool; nonclay refractories; nonmetallic mineral products; construction machinery and equipment; mining machinery and equipment, except oil and gas; oil and gas field machinery and equipment; elevators and moving stairways; conveyors and conveying equipment; hoists, cranes, monorail systems; industrial trucks, tractors, trailers, and stackers; lumber, plywood, millwork, and wood panels; brick, stone, and related construction materials; roofing, siding, and insulation materials; construction materials; lumber and other building materials dealers; engineering services; architectural services; surveying services; air and water resource and solid waste management.

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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