

How to Avoid M&A Minefields

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Mark Shayne, ASA, CPA/ABV, MBA
Managing Director

Phone (US): 212-714-0122
Phone (Israel): 050-3058977
E-mail: marks@empireval.com
Website: www.empireval.com

The Take-aways for the Buyer

- ◆ “The best transition and integration plan in the world cannot compensate for overpaying for a target.”
- ◆ Learn from FAS 157 “market participant” concept – what is realistic and achievable for your target company, not what you’re hoping for or the seller (or the Investment Banker) promises
 - “We do a lot of churning here, but we don’t produce a lot of butter.”
 - Have some humility and a “Plan B”
- ◆ For Private Equity investors: you get measured on IRR, which is highly sensitive to the time that you hold an investment; so every extra year means the investee must drive EBITDA forward
 - This is especially important when the “exit door” is barred

Havel Havalim HaCol Havel (Kohelet)

- ◆ Two of three new restaurants in the US close within three years of opening
- ◆ Two of three small businesses in the US fail

“Two outta three ain’t good...”



- ◆ McKinsey & Co.: 70% of acquisitions fail to earn their hurdle rate (cost of capital)
- ◆ Cambridge Associates (1981-1998): 45-50% of early stage VC investments and 35-40% of late stage VC investments return less than 1.0 times capital

How Do You Measure an M&A Deal?

- ◆ ROIC
- ◆ Ego gratification
 - This might be Number 1
- ◆ Building a bigger company
 - The “Shark Theory”
- ◆ Diversification / New market
 - Distraction from core competencies?
 - Waste valuable financial resources?
- ◆ Defensive acquisition to thwart competitor



“Human see,
Human do.”

Worldwide Government Bailouts

- ◆ The Winners: “the strong, the big, the established, the domestic and the safe – the folks who, relatively speaking, don’t need the money.”
- ◆ The Losers: “ the new, the small, the foreign and the risky – emerging markets, entrepreneurs and small businesses not politically connected.” [David Smick, Thomas Friedman]
- ◆ Opportunity for private investors to pick up companies at attractive prices in new markets!

Innovation

- ◆ “Innovation is the only mechanism that can actually change things in substantive ways. Innovation is where creative thinking and practical know-how meet to do new things in new ways, and old things in new ways.”
 - Charles Vest, Former President, MIT
- ◆ “Innovation is now the only path to growth, prosperity, environmental sustainability and national security... [I]t is an incredibly competitive world. Many information industries require that products be improved by 100% every 12 to 36 months, just for the company to stay in business.”
 - Curtis Carlson, CEO, SRI International (Silicon Valley)
- ◆ Develop in-house, acquire or die

Exploitation of Intellectual Capital

- ◆ Intellectual capital interacts with other resources (physical, financial) to create a core competency, which, in turn, helps to deliver the value proposition
- ◆ Acquirer must have detailed plan to integrate and exploit acquired company's Intellectual Property, and protect and sustain its Competitive Advantage
 - Critical to understand acquired company's Value Driver
 - Multi-product opportunities v single product company
 - Leverage customer base across multiple revenue opportunities
 - Supply chain and delivery issues
 - IP protection / infringement
 - ▶ Costs to obtain, maintain and enforce
 - ▶ Scalability

Technology Release Schedule

Release Schedule as of: 20 January 2001		Oct-00	Nov-00	Dec-00	Jan-01	Feb-01	Mar-01	Apr-01	May-01	Jun-01	Jul-01	Aug-01	Sep-01				
Products	v#	Release Notes															
SupplyChain Solution Suite																	
Core - Supply management base system																	
	v6.0	Web-enabled version of SupplyChain Manager										Beta	GA 12/15	Retire 7/15			
	v7.0a	Web-Native version. Shipment processing, selection services, basic alerting and tracking. Not for a GA release.										Build	CC 2/15	Beta			
	v7.0b	Web-Native version. Deeper functionality added to v7.0a release. - validation, audit trail, auto actions, etc. Not for a GA										Build	CC 3/30	Beta			
	v7.1	Web-Native version. Complete order and shipment services, tie to SCM, visibility, reporting, alerting.										Build		Beta	GA 7/15		
	v7.2	Web-Native version. Add depth of functionality for shipment and order processing, visibility, etc.												Build	Beta		
	v7.3	Web-Native version. Add in international and multiple mode capability															
Consolidator - load consolidation																	
	v1.0	Consolidator Standalone version												Retired			
	v1.0	Consolidator Integrated (into Core 6.0)												GA	Retired		
	v2.0	Old Consolidator. Standalone - Inbound and Outbound modules - many to one or one to many, with DC bypass.												Beta at TCAM			
	v2.1	Old Consolidator. Integrated to Core 6.0 - IB and OB modules and build screens for standalone. Bug fixes of existing TCAM code.												Build	Beta	GA	Retired
	v3.0	Phase 1 - Productize ASP deliverable load consolidation, combine the three consolidation products, streamline the process, tie to Consolidator v1												Prototype	Build	Beta	GA
Optimized execution of the routing guide																	
	v?	Existing SCM - only sold in conjunction with Core 6.0. No standalones										GA		Retire 7/15			
	v?+1	Revised solution, considers capacity constraints and dynamic performance factors.										Build	Beta	GA 7/15			
Consolidator II - Exceptions management for surge/distressed routing																	
	Beta	Surge 1.5 - Specific 'distressed routing' tendering and selection.												Beta 10/9			
	v1.0	Productize and combine with tendering built on the Core architecture, uses architecture of Core 7.0. Integrate to Core 6.0. TL & IM ONLY.												Build	CC 12/15	Beta 1/15	GA 2/15

Due Diligence Template for IP Acquisition (Marr, 2008)

◆ Human Capital

- Knowledge & Skills
- Work-related experience
- Competencies
- Vocational qualification
- Employee engagement
- Emotional intelligence
- Entrepreneurial spirit
- Flexibility
- Employee loyalty
- Employee satisfaction
- Education
- Creativity

◆ Relational Capital

- Formal relationships
- Informal relationships
- Social networks
- Partnerships
- Alliances
- Brand image
- Trust
- Corporate reputation
- Customer loyalty
- Customer engagement
- Licensing agreements
- Distribution agreements
- Joint ventures

Due Diligence Template for IP Acquisition (Marr, 2008)

Structural Capital

- ◆ Organizational Culture
 - Corporate values
 - Social capital
 - Management philosophy
- ◆ Processes & Routines
 - Formal processes
 - Tacit/informal routines
 - Management processes
- ◆ Intellectual Property
 - Brand names
 - Data & information
 - Codified knowledge
 - Technology
 - Patents/copyrights
 - Trade secrets

Valuation Analytic Framework (Palepu, et. al.)

- ◆ Step 1: Business Strategy Analysis
 - Identify key profit drivers & business risks
 - Assess subject company’s profit potential at a qualitative & quantitative level
 - Analyze & understand firm’s industry & its strategy to create a sustainable competitive advantage
 - How sustainable are current levels of profitability & growth
- ◆ Step 2: Accounting Analysis
 - Evaluate appropriate accounting treatment & policies
 - Undo accounting distortions by recasting reported results
- ◆ Step 3: Financial Analysis
 - Use financial data & ratio analysis to evaluate past performance, assess its sustainability, elicit trends from the numbers, and compare company results & trends to industry peers
- ◆ Step 4: Prospective Analysis
 - Forecast of firm’s future
 - Extrapolate historical trends
 - Consider impact of new products & markets
 - Reversion to the mean
 - Monte Carlo simulation tools, decision trees, expected values
 - “Tornado” diagrams (expansion of traditional sensitivity analysis)

Empire Corporate Overview

- ◆ One of the largest independent valuation consulting firms in the U.S.
- ◆ Valuation professionals are MBAs; many have other designations (e.g., CFA, ASA, CPA, etc.).
- ◆ Extensive financial reporting valuation background and strong experience with private equity and hedge funds.
- ◆ Empire has strong experience working with both early stage and major corporate and technology clients in the U.S, Israel and Europe. The firm has provided valuation services on behalf of all of the Big Four accounting firms, as well as many regional and local firms worldwide.

Empire Corporate Overview

- ◆ Empire has strong experience in a wide variety of industries, including:
 - software (300+ valuations)
 - life sciences and medical devices (100+ valuations)
 - telecommunications (200+ valuations)
 - semiconductors (30+ valuations)
 - internet (100+ valuations)
 - engineering, environmental consulting and clean-tech companies (200+ valuations).

- ◆ In February 2008, Empire co-chaired the first annual Fair Value Summit in NYC (www.fairvaluesummit.com), with participants from the Big Four, FASB and the SEC.

Empire Valuation Services

- ◆ Financial Reporting, Corporate Planning
 - Mergers & Acquisitions
 - ▶ FAS 141 Purchase Price Allocation (US GAAP)
 - ▶ IFRS Purchase Price Allocation (International Accounting Standards)
 - ▶ Pre-transaction Consulting
 - Financial Compliance
 - ▶ FAS 142 Goodwill Impairment Testing
 - ▶ IFRS 3 Goodwill Impairment Testing
 - ▶ FAS 144 Intangible Asset Impairment Testing
 - Valuations of Share-based Compensation

- ◆ Valuations for Option Grants
 - IRC 409A
 - Pre-IPO/Exit

- ◆ Private Equity, Hedge Funds, Family Offices
 - FAS 157 & 159 Investee Company Valuations

- ◆ Fairness Opinions
 - Fees one-third to one-half of investment banks; work product more robust

Sample Israel Client Base - Corporate

- ◆ Telecom
 - Amdocs
 - Alvarion
 - Big Band Networks
 - IXI
 - Starhome
 - ViryaNet
- ◆ Software
 - NICE Systems
 - Check Point
 - Attunity
 - Jacada
 - Retalix
 - Kontera
- ◆ Pharmaceuticals/Biotech/Life Sciences
 - Quark Pharmaceutical
 - Medingo
 - UltraShape
- ◆ Semiconductors, Optical, Test Equipment
 - DSP Group
 - Orbotech
 - Ophir Optronics
 - Wintegra
 - CEVA
- ◆ Conglomerate, Consumer
 - Elron Electronics
 - Oberon Media
 - AHAVA Dead Sea Laboratories

Sample Client Base – Hedge Funds & Private Equity

◆ Sample Hedge Fund & Private Equity Clients:

DB Zwirn & Co., LP

Baupost Group

JP Morgan Exchange Funds and Option Fund

Lazard Freres

Reservoir Capital

Roswell Capital

Wells Fargo / Foothill Capital

Stairway Capital

Granite Capital

Family Offices with public & private holdings in the US, Israel & Europe