Intersections

First-quarter 2010 global transportation and logistics industry mergers and acquisitions analysis

Making smarter deals in a changing environment: Due diligence

Welcome to the first-quarter 2010 edition of *Intersections*, PricewaterhouseCoopers' quarterly analysis of mergers and acquisitions (M&A) in the global transportation and logistics 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 better due diligence as the transportation and logistics industry recovers from the economic downturn. 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 that transportation and logistics (T&L) 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 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 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, a 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.”

We focus here on strategic buyers, but with the easing of credit restrictions, it seems clear that financial buyers also will soon venture from the sidelines. In fact, there is increasing evidence that this is already happening.

To make the right deal, T&L 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 closer 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, decreased revenue growth, and led to permanent changes in some segments because capacity has increased as demand for transportation services has weakened. 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 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 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 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 the 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 feel pressured to make strategic business decisions about when to purchase additional assets, how to find more working capital, or when to 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 T&L industry. 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 major initiatives that create the kind of uncertainty that demands further diligence.

The emission trading scheme in the European Union, scheduled to be expanded to cover airlines beginning in 2012, adds an entirely new commodity exposure to the airlines (i.e., carbon offsets), and in turn a new dimension of risk to the industry. The potential for a US cap-and-trade scheme may increase the complexity and potential risk.

With a history of offering generous health and pension benefits, many of which have evolved through collective bargaining processes, T&L companies can face complex due diligence around healthcare and benefits. The uncertainty associated with new US healthcare regulations in the context of existing benefit plans may result in additional liabilities that a target may not have recognized yet.

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 and foreign currency fluctuations also present complexities to acquirers, which must understand the impact of price volatility on the target company and its financial statements. It is becoming increasingly apparent that raw materials 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 such factors as whether raises and bonuses were curtailed to cut costs and 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 statements. Pension funds and other post-employment benefit plans (OPEB plans), and how they are funded, are of particular interest to companies in the T&L industry because they often provide these employee benefits.

Additionally, contemplated changes to the Railway Labor Act that could allow local collective bargaining organizing units, instead of the current companywide units, could add significant complexity and cost to managing unionized workforces.

Tax and information technology 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 economic recession. Further, in today's corporate environment, acquisition transactions often are done on an aggressive time schedule, and sometimes 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.

Tax due diligence generally focuses on the tax returns and tax examinations of the acquisition candidate and serves to satisfy 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 should utilize the seller's tax attributes and similar tax opportunities.

In 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.

Buyers also need to thoroughly evaluate the information technology (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 must gain an understanding of the major business systems that support and automate core operating processes. They also should consider the role IT plays in financials 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 begins to look more imminent, Wall Street and 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, T&L companies considering an investment in an emerging country must weigh the risks and the work entailed to manage the integrity of compliance. At issue is falling into line with US regulations, such as the Foreign Corrupt Practices Act, 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.

Beyond perfunctory due diligence

To drive further efficiency and fulfill stakeholder demands for growth, T&L companies are challenged to look to combine similar players to drive scale and enhance productivity. These types of mergers may be a driving force in 2010 as companies look to increase revenue and enhance margins.

Successful acquirers within the T&L 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 resources 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 T&L companies lay the groundwork for more accurate competitive pricing; greater potential synergies; and faster, smoother postmerger 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

Welcome to the first-quarter 2010 edition of *Intersections*, our quarterly analysis of M&A activity in the transportation and logistics sector. The environment continues to exhibit signs of recovery since the post-leverage bubble period, as demonstrated by the general rise in overall deal activity. We qualify this positive observation about the pace of deals by noting the greater use of minority stakes and the increase in local-market deals, both of which indicate that a sense of risk aversion may remain among some sector deal participants.

As predicted in earlier updates, the passenger air mode continues to be highly active. This mode contributed the majority of deal value, driven by the Japanese government-backed acquisition of Japan Airlines (JAL) out of bankruptcy, which was also the only mega deal announcement of the quarter. The JAL transaction was driven out of necessity, and we note that competitive pressures in the airline industry could lead to further mega deal announcements in 2010. For example, UAL Corp., the parent of United Airlines, and Continental recently agreed to a merger that will create the largest global airline by traffic. This announcement followed reports that UAL had recently been in talks with Continental and US Airways.

Acquirers in the Asia and Oceania region and in emerging and developing economies are increasingly making their presence felt in sector M&A activity relative to acquirers outside these areas. This growth has been driven by deals involving Chinese entities, in addition to a concurrent decline in deals by European acquirers. We attribute the changes generally to differences in economic growth expectations for nations in these regions.

On a related point, it appears that concerns over economic output and employment levels may have negatively affected the appetite for privatizations in the sector. However, the overall poor state of national budgets in the developed world is likely to make these transactions more attractive to governments in coming years.

Although this quarter presented something of a conundrum in analyzing sector deal flow, the mixed signals relating to the health of M&A activity should abate over the course of 2010. The positioning of acquirers to engage in deal activity continues to improve, supported by generally higher levels of traffic as well as better liquidity and capital market conditions. In addition, rising expectations for economic growth should encourage those acquirers that have remained on the sideline to reenter the deal market. The result is a relatively sanguine outlook for 2010 sector deal activity.

Commentary

Quarterly transportation and logistics deal activity
Measured by number and value of announced deals worth $50 million or more

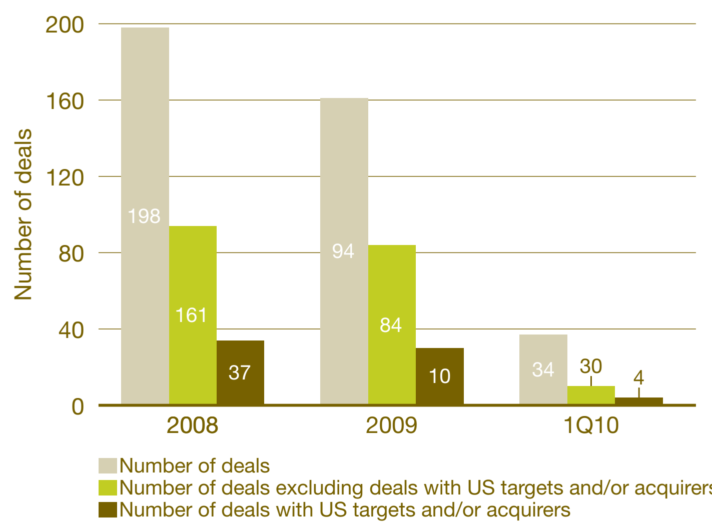
	2007				2008				2009				2010
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q
Number of Deals	41	57	56	62	56	44	49	49	22	13	26	33	34
Total Deal Value ($ bil)	19.8	25.2	24.7	24.7	22.6	35.5	18.8	22.6	5.9	2.5	8.1	48.4	13.4
Average Deal Value ($ bil)	0.5	0.4	0.4	0.4	0.4	0.8	0.4	0.5	0.3	0.2	0.3	1.5	0.4

Number, value of deals continue to climb

The pace of deal announcements in the transportation and logistics sector during the first quarter can generally be considered robust compared with 2009. The number of deals announced in the first quarter exceeds the number announced in each quarter of 2009. In addition, the aggregate deal value announced during the quarter is on pace to approach the level of 2009, even given the inclusion of Berkshire Hathaway's $36.7 billion acquisition of Burlington Northern Santa Fe last year. When excluding this transaction from 2009 totals, 2010 deal value is on pace to far exceed the level of 2009.

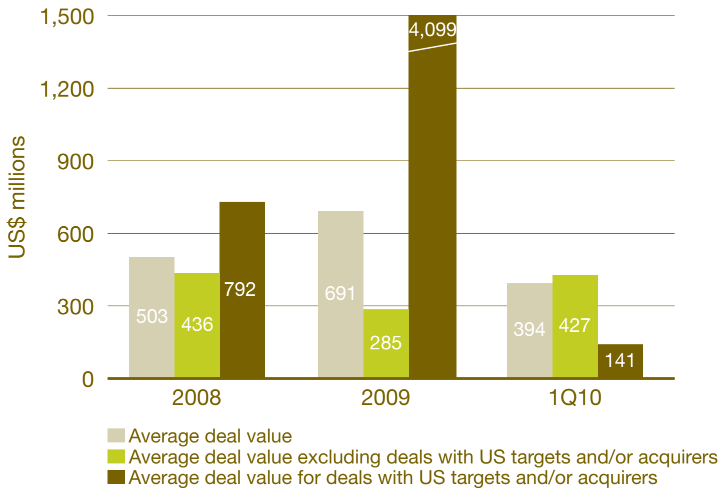
Previous editions of *Intersections* have noted the likelihood that activity involving US entities in this sector would improve as the nation emerges from recession. The pace of announcements involving these acquirers and targets did increase in the first quarter as measured by number of deals. But this activity was limited to smaller deals, which led to a decline in the pace of total deal value announced by US parties this past quarter.

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

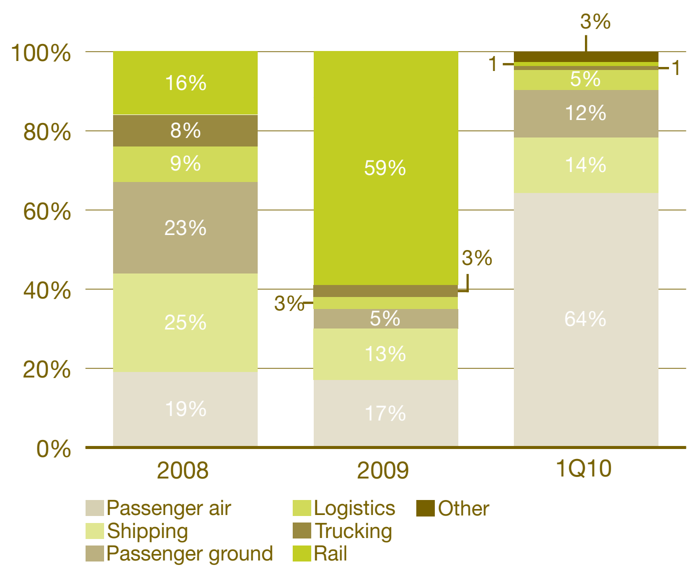


Deal activity by total deal value
Measured by value of announced deals worth $50 million or more

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



Deals by transportation and logistics mode
Measured by value of announced deals worth $50 million or more



Passenger airline deals dominate first quarter as shipping declines

Average deal values declined in the first quarter; however, this shift is obscured by the aforementioned Burlington Northern Santa Fe deal. Absent this transaction, total average deal value in the first quarter increased from the level of 2009 though average value for deals with at least one US entity declined. This improvement in average deal values, without the Burlington deal, indicates that acquirers are gaining more confidence to engage in larger deals. However, it may take some time for US entities to become more engaged in the deal market given the depth of the recent recession and overhang related to the recent leverage bubble.

Interest in the shipping mode has declined on a relative basis since 2008, evidenced by fewer mega deals (worth more than $1 billion) for these targets. Shipping accounted for six mega deals in 2008 and two in 2009, but there were no mega deal announcements in this category during the first quarter of 2010. The largest shipping deal this past quarter was a $672 million offer for Forth Ports PLC by a consortium of infrastructure investors; this offer and a sweetened bid were rejected by the target, which has reportedly asked the UK Takeover Panel to set a deadline for further proposals.

Previous issues of *Intersections* have indicated the expectation that the passenger air mode would become more active on a relative basis. In the first quarter, deal activity shifted toward these targets. This was driven by the $7 billion acquisition of Japan Airlines out of bankruptcy by the Japanese government through the Enterprise Turnaround Initiative Corporation (ETIC). The $7 billion represents the value of cash paid, debt reduction, and assumption of liabilities by the ETIC. This option was chosen in favor of financial support packages from American Airlines and Delta Air Lines, the latter of which would have reportedly involved an alliance change to SkyTeam. The ETIC acquisition is part of a JAL restructuring plan, which includes job and route reductions as well as asset sales.

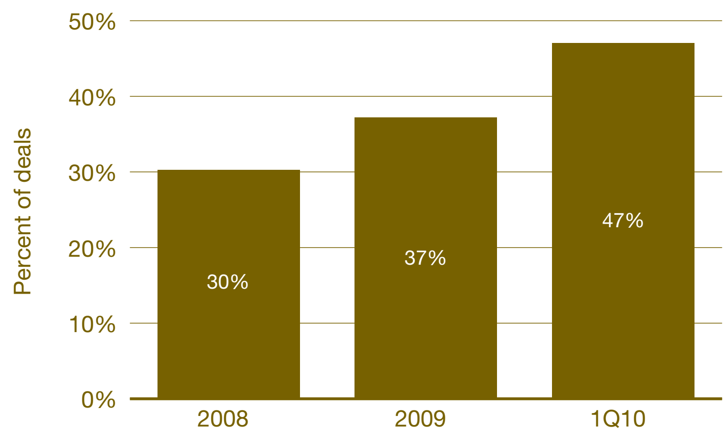
Passenger air is likely to remain an active source of new deals. During the second quarter of 2010, United Airlines (UAL Corp.) announced a mega deal with Continental valued at more than $3 billion. In addition, airline executives in other countries, including those of Air China and Kuwaiti low-cost carrier Jazeera Airways, have indicated interest in potential local and cross-border acquisitions.

Minority stake purchase percentage climbs again; more deals strategic

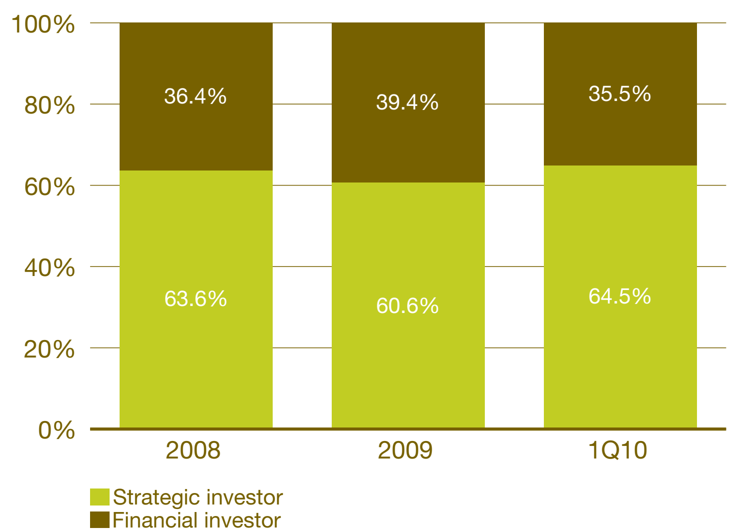
Despite improved conditions for raising capital, minority stake purchases jumped in the first quarter, and deal participation shifted slightly toward strategic investors. While the increase in minority stake purchases continues a trend from the fourth quarter of 2009, the shift toward strategic investment is a reversal from the trend of the previous quarter, in which financial investor participation had improved on a relative basis.

Several of the characteristics of minority stake purchases in the quarter closely resemble those of the broader deal market. These characteristics include involvement by strategic acquirers, entities in the Asia and Oceania region, and targets in the passenger air and shipping modes. In addition, because the decline in financial investor participation during the first quarter is relatively minor, it is difficult to judge whether this is the beginning of a trend of lower financial investment in the sector as was the case immediately after the leverage bubble. Although it appears a recovery in the deal market is under way, the economic environment has not improved enough to encourage sustained interest in controlling-interest transactions and financial investor participation.

Minority stake purchases
Measured by percent of deals worth $50 million or more for < 50% ownership



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



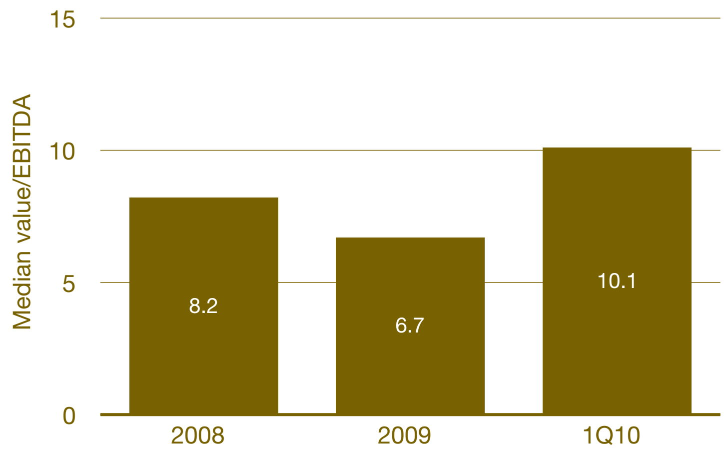
Median value of M&A climbs; privatizations abate

Deal valuations increased in the first quarter, exceeding the recent high of 2008. At first, this trend seems counterintuitive given the significant rise in minority stake purchases. Minority stakes would be expected to contribute to lower valuations because of the lack of transfer of controlling interest, as well as the increase in deals that involved targets in or entering bankruptcy. However, this rise in valuations must be qualified by the relatively small sample of deal valuation data available in the first quarter. Specifically, this data was available for approximately 18 percent of deals announced in the first quarter, compared with 30 percent and 24 percent in 2008 and 2009, respectively. Also, though deals targeting bankrupt entities did rise in the first quarter, the contribution of these deals to overall M&A activity in the sector remained relatively low.

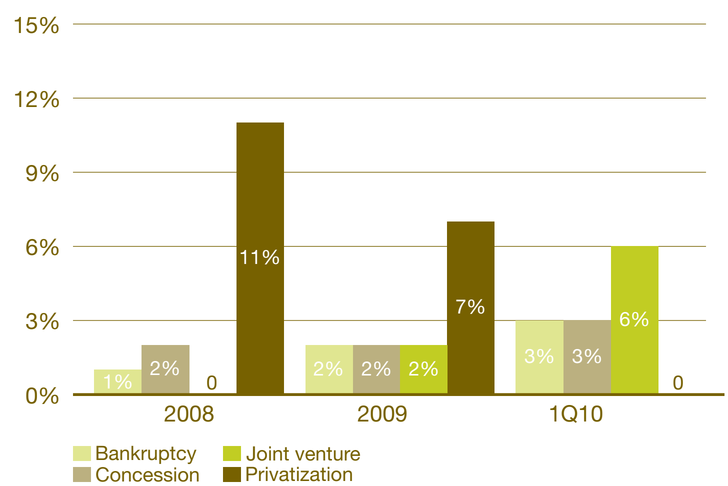
The rapid decline in privatizations, defined as the direct transfer of ownership from government and government-controlled entities to private buyers, is also of interest. This trend is likely the result of recent economic weakness in developed countries, which could lead to concern over the potential loss of jobs following these types of transactions. The rise in the use of joint ventures, which involve the transfer of existing assets by multiple parties, likely reflects the desire of sector constituents to maintain their liquidity because of uncertainty over the strength and tenor of a recovery in key global economies.

Over the balance of 2010, deal valuations are likely to remain above the level of 2009 since capital markets have become more supportive and acquirers have gained more confidence in the recovery. In addition, a resultant improvement in traffic across modes should lead to fewer financially challenged constituents; ergo the sector probably will see a reduction in the purchase of targets out of bankruptcy as well as less apprehension around transactions that involve privatizations. The severity of national and local budget deficits in certain developed economies is another factor that could aggrandize the future level of privatization activity.

Deal valuation by median value/EBITDA
Measured by value/EBITDA for deals worth $50 million or more



Deals by acquisition technique
Measured by percent of deals worth $50 million or more



One distressed target comprises mega deal activity; increase likely

The pace of mega deal activity receded somewhat from the robust level of previous years with only one deal announced for a value of at least $1 billion. This was the Japan Airlines acquisition by the Japanese government-backed ETIC. Though the largest deal this past quarter involved a distressed target, since JAL had already entered into bankruptcy, it is likely that mega deals announced during the remainder of 2010 will be less often driven by need as operating environments across most modes gradually improve.

We must qualify this outlook by noting that the passenger air mode will likely be a source of new mega deals, given the competitive intensity of the industry and the desire to improve financial positioning. For example, even though BAA PLC recently won an appeal against the UK Competition Commission's ruling that it must divest more airports (the BAA divestiture of London Gatwick Airport to Global Infrastructure Partners in 2009 can be found in the nearby table), there are rumors that the UK-based airport operator may decide to move forward with other divestitures to reduce debt. In addition, the United Airlines-Continental merger is expected to create $200 million to $300 million in annual cost synergies as well as improve the ability of the combined carrier to compete against larger rivals.

A limiting factor to future mega deals in the passenger air category is the numerous potential barriers. Specifically, any of these deals would likely face high regulatory hurdles. In addition, there are deal-specific challenges such as British Airways' sizable pension deficit, which could allow Iberia to terminate the merger agreement between these carriers.

Mega deals in 2010 (deals with a disclosed value of at least $1 billion)

Month announced	Target name	Target nation	Acquirer name	Acquirer nation	Status	Value of transaction in US$ bln	Category
Jan	Japan Airlines Corp	Japan	Enterprise Turnaround Initiative Corp of Japan	Japan	Pending	7.00	Passenger air

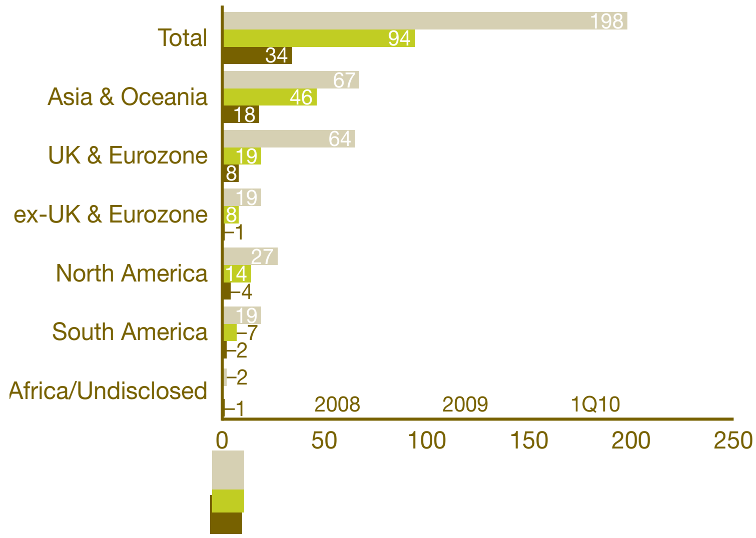
Mega deals in 2009 (deals with a disclosed value of at least $1 billion)

Month announced	Target name	Target nation	Acquirer name	Acquirer nation	Status	Value of transaction in US$ bln	Category
Nov	Burlington Northern Santa Fe Corp	United States	Berkshire Hathaway Inc	United States	Completed	36.72	Rail
Nov	Iberia Lineas Aereas de Espana SA	Spain	British Airways PLC	United Kingdom	Pending	2.90	Passenger air
Oct	London Gatwick Airport Ltd	United Kingdom	Global Infrastructure Partners	United States	Completed	2.47	Passenger air
Mar	Smit Internationale NV	Netherlands	Koninklijke Boskalis Westminster NV	Netherlands	Pending	1.56	Shipping
Sep	Hanjin Shipping Co Ltd -Shipping & Relevant Business	South Korea	Shareholders	South Korea	Completed	1.35	Shipping
Jul	National Express Group PLC	United Kingdom	Investor Group	Spain	Withdrawn	1.24	Passenger ground
Jul	Shanghai Airlines Co Ltd	China	China Eastern Airlines Corp Ltd	China	Completed	1.10	Passenger air

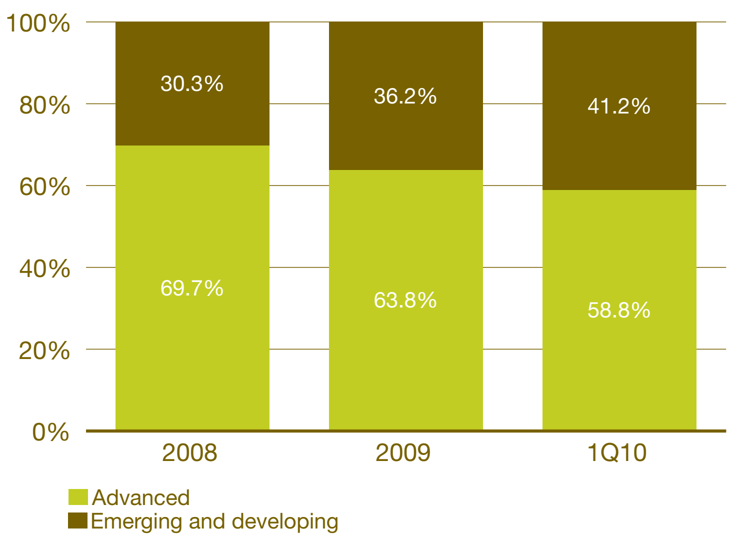
Mega deals in 2008 (deals with a disclosed value of at least $1 billion)

Month announced	Target name	Target nation	Acquirer name	Acquirer nation	Status	Value of transaction in US$ bln	Category
May	Pennsylvania Turnpike	United States	Investor Group	Spain	Withdrawn	12.80	Passenger ground
Jun	Angel Trains Ltd	United Kingdom	Investor Group	Australia	Completed	7.01	Rail
Oct	Hapag-Lloyd AG	Germany	Albert Ballin GmbH & Co KG	Germany	Completed	4.70	Shipping
Jan	Korea Express Co Ltd	South Korea	Investor Group	South Korea	Completed	4.33	Trucking
Oct	Porterbrook Leasing Co Ltd	United Kingdom	Investor Group	Germany	Completed	3.11	Rail
Apr	Northwest Airlines Corp	United States	Delta Air Lines Inc	United States	Completed	2.96	Passenger air
Aug	Asciano Group	Australia	Asciano Group SPV	United States	Withdrawn	2.68	Rail
Sep	Midway International Airport	United States	Investor Group	United States	Withdrawn	2.52	Passenger air
Apr	Prosafe SE-FPSO Business	Cyprus	Shareholders	Cyprus	Completed	1.66	Shipping
Jan	Quintana Maritime Ltd	Greece	Excel Maritime Carriers Ltd	Bermuda	Completed	1.63	Shipping
Sep	Smit Internationale NV	Netherlands	Koninklijke Boskalis Westminster NV	Netherlands	Withdrawn	1.55	Shipping
Feb	Japan Airlines Corp	Japan	Investor Group	Japan	Completed	1.48	Passenger air
Jan	Cia de Distribucion Integral Logista SA	Spain	Imperial Tobacco Group PLC	United Kingdom	Completed	1.40	Logistics
May	Cia Logistica de Hidrocarburos CLH SA	Spain	Investor Group	Australia	Completed	1.36	Logistics
Sep	Alitalia Linee Aeree Italiane SpA-Passenger Assets	Italy	Cia Aerea Italian Srl {CAI}	Italy	Completed	1.31	Passenger air
Aug	Brussels Airport Co SA	Belgium	Macquarie European Infrastructure Fund III	United Kingdom	Completed	1.22	Passenger ground
Mar	Rodoanel Oeste	Brazil	Integracao Oeste	Brazil	Completed	1.18	Logistics
Jun	XB Luxembourg Holdings 1 SA	Luxembourg	DSV Air & Sea Holding A/S	Denmark	Completed	1.17	Trucking
Oct	Dom Pedro I Highway	Brazil	Integracao Dom Pedro I	Brazil	Pending	1.14	Logistics
Jan	LLX Logistica SA	Brazil	Shareholders	Brazil	Completed	1.12	Trucking
Nov	Qatar Navigation Co QSC	Qatar	Qatar Shipping Co QSC	Qatar	Pending	1.10	Shipping
Dec	Los Lagos	Chile	Atlantia SpA	Italy	Pending	1.06	Passenger ground
Mar	Global Ship Lease Inc	United Kingdom	Marathon Acquisition Corp	United States	Completed	1.03	Shipping
Mar	Groupe Eurotunnel SA{GET SA}	France	Goldman Sachs Group Inc	United States	Pending	1.02	Rail

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



Acquirers from advanced versus emerging and developing economies
Measured by number of deals worth $50 million or more



Asian, Chinese companies most active in M&A

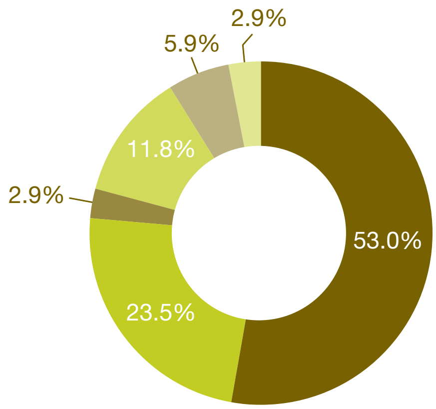
The relative level of activity for Asia and Oceania targets has increased, accounting for approximately half of all announcements in 2009 and the first quarter of this year as compared with approximately 35 percent in 2008. In addition, the inclusion of the $7 billion Japan Airlines mega deal in first-quarter deal totals led Asia and Oceania acquirers and targets to account for the majority of deal value announced in the first quarter. An increase in deals involving Chinese entities also contributed to the importance of Asia and Oceania involvement in deal totals this past quarter.

Emerging and developing market economy acquirers continue to flex their financial muscle, led by local-market announcements in many nations as well as firms from China. Also noteworthy was the decline in deals for targets in Europe.

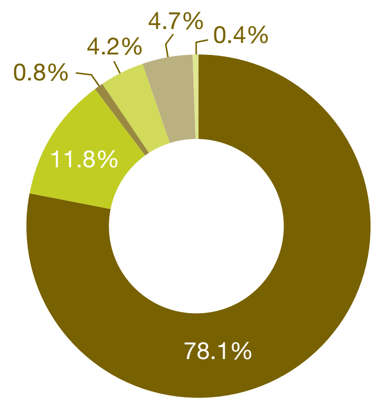
Previous editions of *Intersections* have noted the generally higher growth expectations for economies in the Asia and Oceania region. This economic growth should contribute to a relatively high level of participation among companies in the region in the future.

Regional distribution of 1Q 2010 deals

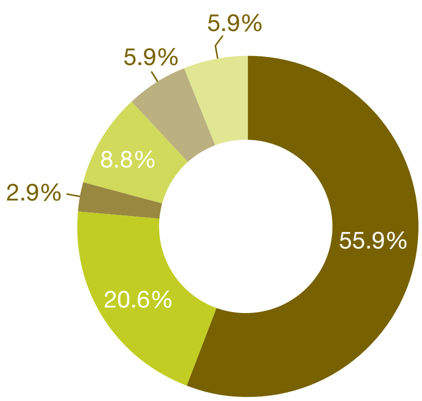
Regional distribution of deals by target region
Measured by number of deals worth $50 million or more



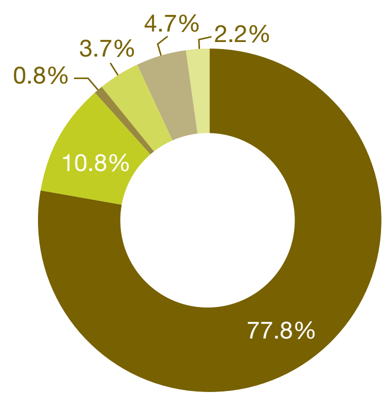
Regional distribution of deals by target region
Measured by value of deals worth $50 million or more



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

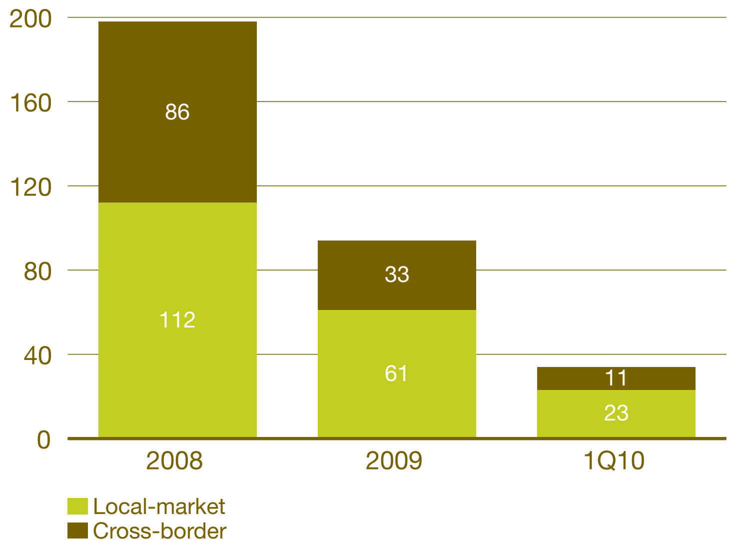


Regional distribution of deals by acquirer region
Measured by value of deals worth $50 million or more



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

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



More companies favor nearby targets

The proportion of local-market deals continued to edge higher in the first quarter, a somewhat surprising trend. It may indicate risk aversion as well as a potentially greater desire for deals that benefit growth through cost reduction instead of network expansion. In fact, eight of the 10 largest deals announced this past quarter involved entities within nations.

Should the economic recovery continue to gain strength, contributing to a decline in protectionist sentiments and increased comfort among sector constituents in the expansion into foreign markets, this trend may reverse.

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, we predict the 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 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 T&L 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, operational, compliance, regulatory and business strategy specialists, who all work as one group to identify a broad range of risks and opportunities. This team conducts financial due diligence as well as 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 these various analyses to the forefront, companies lay the groundwork for more accurate competitive pricing, potential synergies, and faster, smoother postmerger integration.

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 the advice of external specialists. They know that even the most well-intentioned due diligence specialists may occasionally, perhaps even unconsciously, become partisan in their thinking.

Steps to take toward better due diligence

To potentially improve their due diligence process, T&L companies may consider the following steps:[1]

- 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 a good corporate steward, 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 registration statements, tax returns, and management letters. Although this review typically includes a reading of all annual and quarterly reports, financial statements prepared 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?

[1] PricewaterhouseCoopers, *Global Best Practices*, 2010.

- 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?

• 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, the company should 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.

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 postdeal 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 is 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—**assessing how insurable risks such as workers' compensation and product 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 affects the price of the business.

Specialty case study:
Performing due diligence on many fronts

Client issue	A global logistics and trucking company needed transaction services support for several active and potential deals requiring action within a short period.
Approach	PwC's M&A practice provided financial due diligence and lease accounting support in the active deals, while also providing financial, tax, and other ad hoc due diligence in connection with the contemplated acquisitions. Specific services included: • Highlighting customer retention and pricing considerations through lease contract analyses • Evaluating the target company's accounting for rebate and depreciation procedures • Identifying one-time and nonrecurring items, including gains and losses on equipment dispositions • Identifying significant adjustments required to determine normal working capital for purposes of the post-closing adjustment
Impact	PwC's work helped to mitigate transaction risks in several ways, including: • Accurately evaluating the appropriateness of net acquired assets • Identifying certain inconsistencies in the application of FAS 13 that potentially carried financial statement implications • Determining the sustainable earnings of the target companies

PricewaterhouseCoopers' transportation and logistics experience

Deep transportation and logistics experience

PwC continues to have the leading Fortune Global 500 market share in the industry. Our Transportation and Logistics practice is composed of a global network of more than 4,400 industry professionals who provide assurance, tax, and advisory services to public and private transportation and logistics 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 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 American Trucking Association, the Air Transport Association, the American Railroad Association, and the European Logistics Association. To address your industry needs wherever they arise, our professionals are concentrated in areas where the transportation and logistics 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, information technology, and supply chain considerations. Teamed with our Transportation and Logistics industry practice, our deal professionals can bring a unique perspective to your transaction, addressing it from a technical as well as industry point of view.

Local coverage, global connection

In addition to having more than 4,400 professionals who serve the transportation and logistics industry, our team is part of an expansive Industrial Products group that consists of nearly 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.

Methodology

Intersections is an analysis of mergers and acquisitions in the global transportation and logistics industry. Information was sourced from Thomson Reuters and includes deals for which targets have primary NAICS codes that fall into one of the following NAICS industry groups, NAICS industries, or national industries: scheduled air transportation; nonscheduled air transportation; rail transportation; deep-sea, coastal, and Great Lakes water transportation; inland water transportation; general freight trucking; specialized freight trucking; urban transit systems; interurban and rural bus transportation; taxi and limousine service; school and employee bus transportation; charter bus industry; other transit and ground passenger transportation; support activities for air transportation; support activities for rail transportation; support activities for water transportation; other support activities for road transportation; freight transportation arrangement; other support activities for transportation; postal service; local messengers and local delivery; general warehousing and storage; refrigerated warehousing and storage; other warehousing and storage; and process, physical distribution, and logistics consulting.

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, 2007, 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 acquirer have been met but deal has not been completed), withdrawn, seeking buyer, or seeking buyer withdrawn. The term *deal*, when referenced herein, refers to transactions with a disclosed value of at least $50 million unless otherwise noted.

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 North America and Latin and Caribbean UN groups), the Asia and Oceania region (includes Asia and Oceania UN groups), and Europe (divided into United Kingdom, plus Eurozone and Europe ex-UK and Eurozone regions). The Eurozone includes Austria, Belgium, Cyprus, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Malta, Netherlands, Portugal, Slovakia, 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. International Monetary Fund classifications were used to categorize economies as advanced or developing and emerging.

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PwC's Transportation and Logistics practice provides industry-focused assurance, tax, and advisory services. Through our global network, we can draw upon the in-depth industry experience of professionals in every country in which your company operates. Our people can help you deal with the challenges of today, and they understand the implications for tomorrow.

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