



Corporate transactions: opportunities abound, but proceed cautiously

Global transaction markets are gathering steam. In the aftermath of a financial crisis, attractively priced assets and opportunities can be found in nearly every sector. But today's marketplace also features an array of unique challenges and in many cases heightened risks. Mindful of the need to optimize the deployment of capital, audit committees should see that their transaction teams balance optimism and a growth-oriented agenda with situational awareness and caution.

Transaction climate

Current markets present many reasons to pursue transactions. Numerous industries have been shaken up. In many cases, leading or influential players have been hobbled by over-leverage or any of a variety of strategic missteps. Historically, some of the most successful capital deployments have taken place under similar circumstances. Meanwhile, a now nearly two-year downturn in M&A markets has created, among portfolio investors, a need for new buyers to provide exit financing. In short, opportunities are all around.

A transitioning marketplace, though, also presents a range of challenges. Consider valuation. The same collapse in asset values that may make today's pricing seem so attractive can also frustrate efforts to reliably value any acquisition. Add to this lingering volatility—market indices in Europe, the US and Asia are currently exhibiting wide short-term swings—and valuation becomes a moving target.

Another issue in the present marketplace is the potential for hidden liabilities. For some time now, many companies have been operating under considerable financial and operational duress. As such, buyers need to devote added effort in examining acquisition targets for flaws such as delayed or deferred operating expenses, underfunded pension liabilities or breach of contract claims.

Today's deal structures may also offer an opportunity to optimize capital deployment through added leverage. New lending may be returning, but it is still relatively limited. By contrast, many acquisition targets are already carrying heavy debt loads. Buyers can take advantage of this pre-leveraging by negotiating with banks and other creditors for rollovers and extensions.

Audit committees should also be ready to examine potentially complex or arcane deal structures or components. As challenging deal environments often call for creative solutions, the number of alternative structures is on the rise. And while there is nothing wrong with pursuing a complex transaction such as a tax-free spinoff, due diligence must ensure that all tests for such status are well satisfied.

Finally, across the globe, the current business climate includes higher-than-average government participation in industry. Many nations are making major changes to rules for competition, healthcare, energy, taxation and ownership. Companies need to view their capital deployment in light of both current and likely potential future government actions.

The voice of reason

There are many cases where the transaction environment might be viewed as an opportunity to seize significant competitive advantage. But side by side are a range of complex and fast-evolving commercial, financial, regulatory and related risks. Indeed, there may be compelling reasons to transact in this environment. Nonetheless, the audit committee must infuse any urge to transact with a dose of capital reality.

Questions for the audit committee

- ▶ Is this transaction essential? Is this the optimal use of our investment capital at this time?
- ▶ What is the basis for our bid on this transaction? How do we know this is a fair price? How will investors and analysts evaluate our pricing?
- ▶ What happens if our fragile economic recovery slips into a double-dip recession? What if inflation accelerates? How rigorously have we stress tested the effects of this investment on our overall capital structure and performance?
- ▶ What changes can we expect in the regulatory and tax climate? Have we assessed how these changes will affect this transaction's performance?

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EYG No. CEO658
1006-1166307NY

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