WHITE & CASE

Innovation drives dealmaking: Outlook for M&A in Israel

Competition for technological expertise has transformed Israel's M&A landscape as dealmakers strive to stay ahead of the curve

MERGERMARKET

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Israel M&A scales new heights

Investors continue to flock to Israel, as innovation and technological advancements create fertile ground for M&A. The country's leading expertise in cybersecurity is proving a key draw for dealmakers

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Dubbed the "startup nation," Israel is an epicenter of innovation. It boasts more venture capital firms and startups on a per capita basis than any other country in the world. In tech terms, it is second only to Silicon Valley.

Much of this is borne of necessity, with a large portion of government R&D spending dedicated to technology relating to defense and national security. But many of these technologies have been adapted for the commercial sector, opening the door for ample M&A opportunities.

Yet many Israeli startups struggle to gain scale. Few unicorns (private companies with US$1 billion-plus valuations) originate from Israel, and only one of the 500 largest global companies, Teva Pharmaceutical, is Israeli. Will this continue to be the case? And does M&A offer a way for Israeli innovators to achieve greater scale?

To get a clearer sense of the forces shaping M&A in Israel, White & Case worked with Mergermarket to survey 66 senior-level executives at Israeli companies and PE firms. That provided a qualitative and quantitative basis for assessing dealmaker sentiment, which we analyzed along with data on current M&A activity. This report offers a perspective on Israel M&A, including views on which sectors are likely to be in demand, how deal activity may evolve and where investment opportunities may emerge in the future.

Key takeaways include:

- **Deal values remain high**
  Inbound and domestic dealmaking combined achieved record values in 2016 with 99 deals worth US$20 billion, and 2017 is already on course to be another strong year—there were 19 deals worth US$15.3 billion in the first quarter alone.

- **Executives are optimistic about the future of dealmaking**
  The vast majority of respondents (86 percent) expect 2017 deal activity to remain high or even increase compared to 2016. Deal stats for Q1 2017 support this view.

- **Tech tops the charts**
  Technology remains the most active sector for M&A in Israel, with the country's expertise in cybersecurity drawing particular interest. Life sciences and financial services are also attracting investors.

- **Regulation offers both opportunities and challenges**
  While respondents say regulation remains a challenge in Israel, particularly antitrust enforcement, the country's Anti-Concentration Law has created opportunities for private equity, as many of Israel's largest holding companies and conglomerates are set to be broken up.

Disruption fuels deals

HEADLINES

■ The 19 deals worth US$15.3 billion with Israeli targets recorded in Q1 2017 have already reached the second-highest annual value on record (following 2016), with three quarters left to run ■ TMT is the most active sector, notching up 45 deals worth US$7 billion in 2016 and the first quarter of 2017 combined ■ The US was the top bidder in Israel through 2016 and in the first quarter of 2017, with 37 deals worth US$17.1 billion. China was second, with 10 deals worth US$10.9 billion ■ The US was also the top outbound market in 2016 and the first quarter of 2017, with 17 deals worth US$2.1 billion. The UK was second, with five deals worth US$1.1 billion

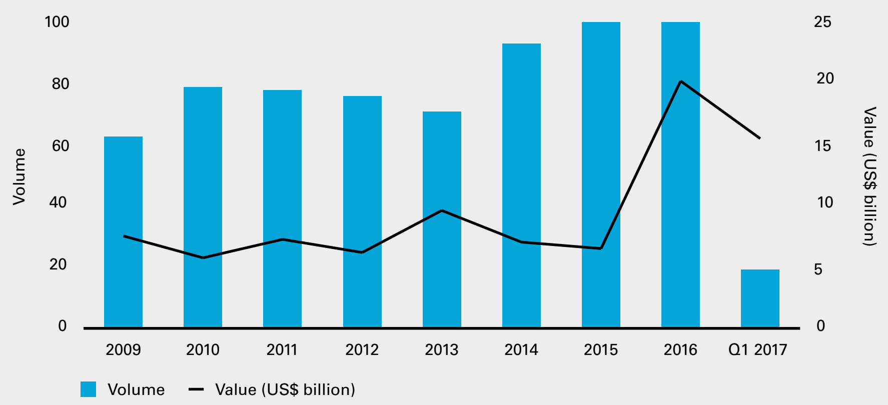
While Israel's technological prowess has attracted inbound interest for years, domestic limitations are now prompting some Israeli firms to search for scale abroad.

Israel's rich entrepreneurial ecosystem makes it a prime target for M&A. In 2016, there were 99 M&A deals with an Israeli target, worth a total of US$20 billion, a record in value terms and a joint-record by volume, tying with 2015. Indeed, total annual inbound deal values in 2016 were more than double those of any previous year going back to 2007.

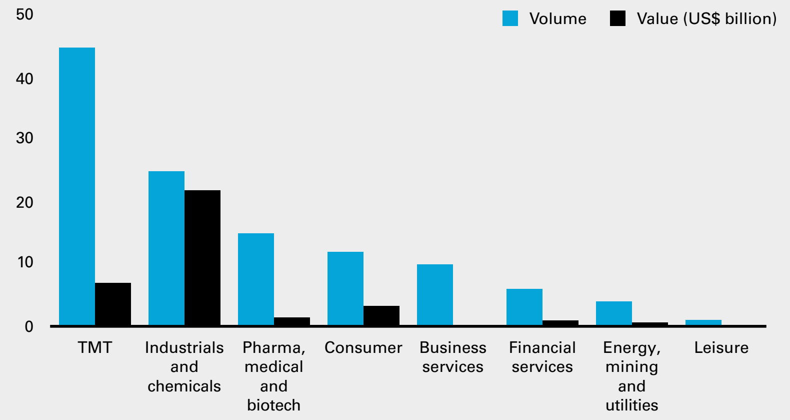
This momentum continued into 2017, with 19 deals worth a total of US$15.3 billion in Q1. Most of this value can be attributed to the largest deal of the period: Intel's US$14.7 billion acquisition of Mobileye, a developer of advanced driver assistance systems and autonomous driving. This means that, in one quarter, the market already reached the second-highest annual value on record (following 2016), with three quarters left to run.

The Mobileye deal, which falls under the industrials and chemicals category of deal activity, pushed that sector to the top of the value charts, with 25 deals worth US$21.9 billion through 2016 and the first quarter of 2017. But in terms of volume, TMT was the clear winner: The sector notched 45 deals worth US$7 billion during that same period.

Israel M&A 2009—Q1 2017



Top sectors 2016—Q1 2017



It's worth noting that the Mobileye deal could quite easily have qualified for the TMT category, as emerging technologies and the solutions they provide are adopted by adjacent industries.

This trend toward convergence is particularly evident in the automotive sector served by Mobileye, where manufacturers rely heavily on technology to enable autonomous vehicles, connectivity, advanced safety systems and high efficiency. We expect to see more cross-sector deals underpinned by technology in Israel in the future.

As the head of business development at one company says, while fintech, foodtech and automotive are attracting the most attention at the moment, "automotive is the most appealing because the industry is in transition worldwide. Manufacturers are looking to add technological innovation to their vehicles, with many companies in Israel pursuing this strategy aggressively."

On the inbound side, the top bidder through 2016 and the first quarter of 2017 was the US, with 37 deals worth US$17.1 billion.

US$15.3 billion

The value of 19 deals with Israeli targets in Q1 2017 (surpassing annual totals between 2006 and 2015)

45

Total number of TMT deals in 2016 and Q1 2017 combined

In second place was China, with 10 deals worth US$10.9 billion.

The US and Israel, in particular, have strong ties, with the former showing robust diplomatic and economic support for the latter, but savvy Chinese and American investors know that, in terms of technology, Israel remains one of the best markets in the world for innovative thinking.

Searching for growth

Israel may boast more startups per capita than any other nation, but with a population of only 8.4 million, about the same as New York City, the scope for domestic growth, through M&A or otherwise, is relatively narrow. Outbound acquisitions offer inroads to foreign markets and opportunities for scalability.

In 2016, there were 25 outbound M&A deals with an Israeli bidder, worth a total of US$2.2 billion, down from 42 deals worth US$47.8 billion in 2015. However, 2015 was an outlier, with values inflated by Teva Pharmaceutical Industries' US$39.6 billion acquisition of the US generics business of Allergan.

The eight-year mean average of outbound M&A by Israeli firms between 2009 and 2016 (excluding Teva-Allergan) was 27 deals worth US$3.8 billion. This suggests that 2016 volume was average, although value was low. Global markets were highly volatile at the beginning of 2016, which is likely to have hampered activity.

Through 2016 and into the first quarter of 2017, the top outbound market was the US, with 17 deals worth US$2.1 billion, followed by the UK, with five deals worth US$1.1 billion. The latter claimed the largest deal of the period—the US$1.1 billion purchase of Ithaca Energy by Delek Group in February 2017, which saw the firm secure a foothold in the North Sea.

In terms of industry, the majority of the largest 10 deals were accounted for by the software sector, including the second-largest deal of the 15-month period, the US$940 million acquisition of US-based on-demand contact-handling application services firm InContact by NICE.

Activity has also been strong in the lower end of the market, as Israeli companies pursue scale through acquisitions. In a bid to expand its product offerings, for

Top 10 Israel M&A deals 2016—Q1 2017

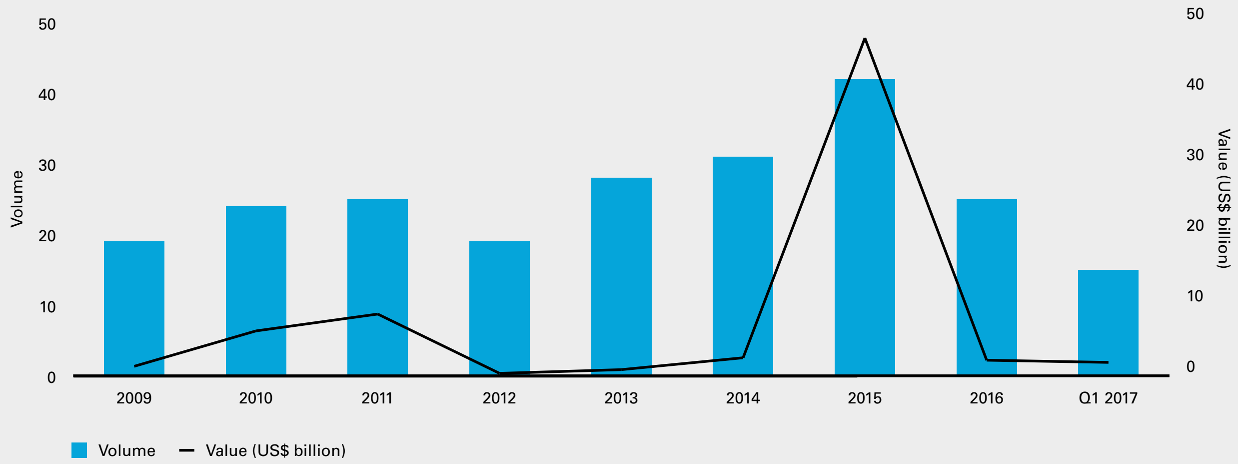
Announced date	Target company	Sector	Target country	Bidder company	Bidder country	Deal value (US$ million)
13/03/2017	Mobileye N.V.	Automotive	Israel	Intel Corporation	USA	14,670
30/07/2016	Playtika Ltd	Computer software	Israel	Chongqing New Century Cruise Co., Ltd	China	4,477
14/09/2016	ADAMA Agricultural Solutions Ltd	Chemicals and materials	Israel	Hubei Sanonda Co Ltd	China	3,936
17/07/2016	ADAMA Agricultural Solutions Ltd (40% Stake)	Chemicals and materials	Israel	China National Chemical Corporation	China	1,400
28/07/2016	Keter Plastics Ltd	Manufacturing (other)	Israel	BC Partners Limited; Public Sector Pension Investment Board	United Kingdom	1,300
29/01/2016	Alon Holdings Blue Square Israel Ltd (72.71% Stake)	Consumer: Retail	Israel	Gindi Israel 2010 Ltd	Israel	1,163
04/02/2016	Osem Investment Ltd (36.3% Stake)	Consumer: Foods	Israel	Nestlé S.A.	Switzerland	837
31/08/2016	Alon Holdings Blue Square Israel Ltd	Consumer: Retail	Israel	Moti Ben-Moshe (Private Investor)	Israel	741
22/08/2016	The Phoenix Holdings Ltd (52.3% Stake)	Insurance related	Israel	Yangon Investment Pte Ltd	China	518
19/04/2016	SintecMedia Ltd	Computer software	Israel	Francisco Partners, L.P.	USA	400

example, CyberArk purchased US-based Conjur for US$42 million in May 2017. Flavor and fragrance company Frutarom has been highly acquisitive over the past five years, with multiple small and mid-market outbound deals each year, purchasing French flavor producer René Laurent and South Africa based Unique Flavors in Q1 2017 alone.

Despite a relatively subdued year in 2016, the outlook for outbound deals in 2017 holds promise. In Q1 2017, there were 15 outbound transactions worth US$1.9 billion, closing in on the previous year's stats with nine months still to go.

> **Through 2016 and into the first quarter of 2017, the top outbound market was the US, with 17 deals worth US$2.1 billion.**

Israel outbound M&A 2009—Q1 2017



Top 10 outbound deals 2016—Q1 2017

Announced date	Target company	Sector	Target country	Bidder company	Bidder country	Deal value (US$ million)
06/02/2017	Ithaca Energy Inc (80.3% Stake)	Oil and gas	United Kingdom	Delek Group Ltd	Israel	1,074
18/05/2016	InContact Inc.	Computer software	USA	NICE Ltd	Israel	940
03/08/2016	Anda, Inc.	Medical: Pharmaceuticals	USA	Teva Pharmaceutical Industries Ltd	Israel	500
28/03/2017	Strauss Coffee B.V. (25.1% Stake)	Consumer: Foods	Netherlands	The Strauss Group	Israel	279
09/02/2017	Centro Canalejas Madrid, S.L. (50% Stake)	Real estate	Spain	Mohari Limited	Israel	240
29/11/2016	Operative Media, Inc.	Computer software	USA	SintecMedia Ltd	Israel	200
11/01/2016	Nexidia, Inc.	Computer software	USA	NICE Ltd	Israel	135
30/06/2016	VF Corporation (Contemporary Brands businesses)	Consumer: Other	USA	Delta Galil Industries Ltd	Israel	120
15/02/2017	StoneRiver, Inc.	Computer software	USA	Sapiens International Corporation N.V.	Israel	102
06/03/2017	Sentido Cypria Bay; Cypria Maris Beach Hotel & Spa; Laura Beach & Splash Resort	Leisure	Cyprus	Fattal Hotels Company Ltd; ISSTA Lines Ltd	Israel	85

Tech leads the way

HEADLINES

■ More than two-thirds of respondents (69%) say technology and media is the most appealing sector for acquirers of Israeli companies (96% rank it in their top three) ■ Cybersecurity is rated as the hottest tech sub-sector, with 67% ranking it in their top three

Demand for tech assets are driving Israel's M&A market, with cybersecurity firms gathering pace.

According to Israel's National Cyber Bureau, the country accounted for approximately 20 percent of the world's new investment in cybersecurity in 2015, making it second only to the US. Israel owes most of its cybersecurity expertise to its advanced military: Its computing division, Unit 8200, releases thousands of veterans equipped with world-class hacking skills every year, many of whom launch startup ventures or join existing companies.

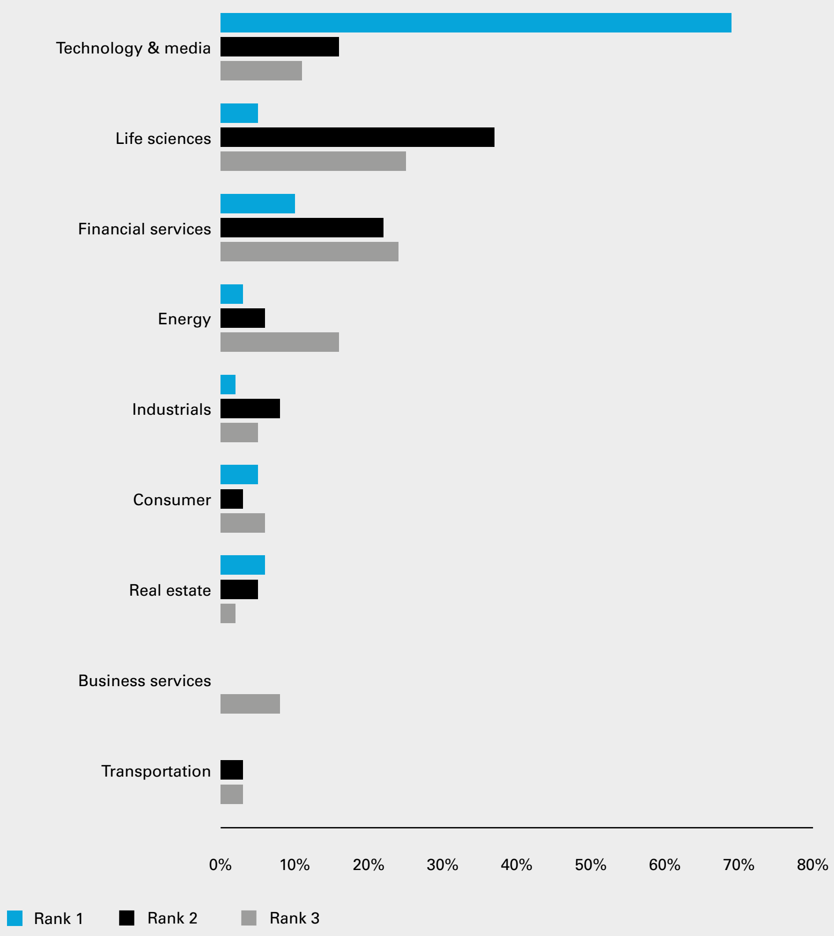
"Cybersecurity has become a major concern, and many new companies are coming to market to address it. The pace at which these companies are developing shows a lot of promise for growth," says the chief corporate strategy and development officer of a media company.

This mirrors respondent views: While 69 percent cite tech and media as the most appealing sector for acquirers of Israeli companies, cybersecurity is rated as the hottest tech sub-sector, with 67 percent ranking it in their top three.

Israel's deep talent pool in data science enables it to excel in a range of rapidly growing fields—including fintech, a sub-sector that was ranked as the most attractive in tech by 46 percent of respondents.

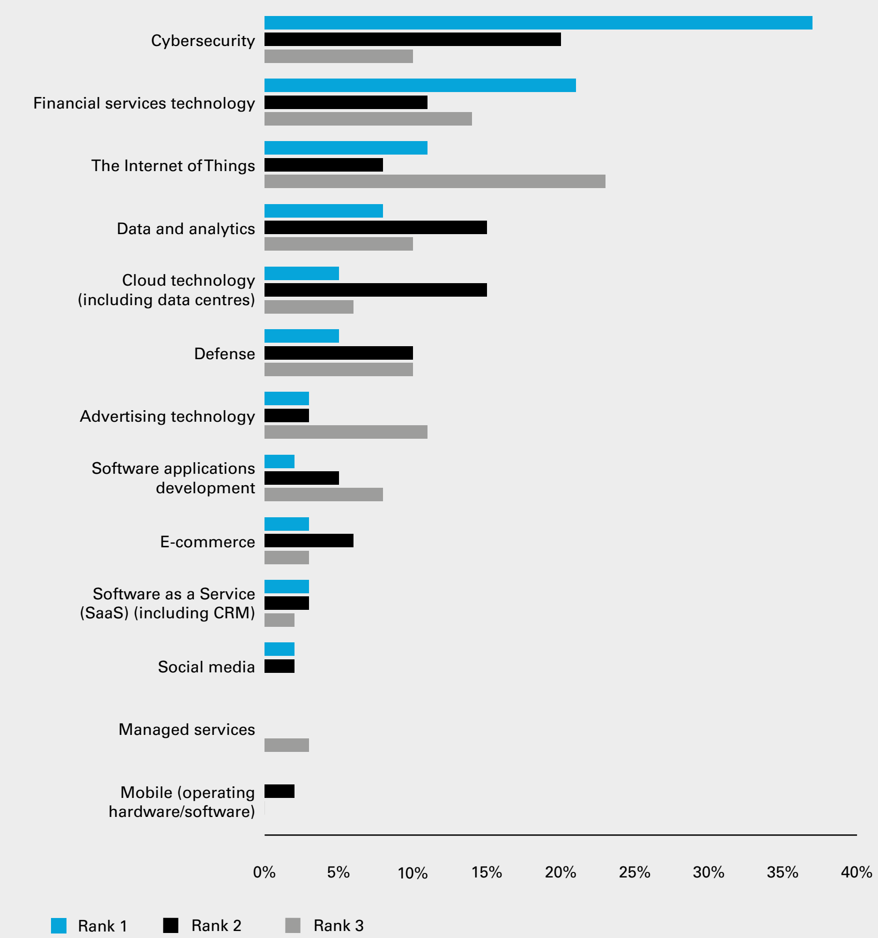
According to The Floor, a startup hub in Tel Aviv, at least 430 Israeli fintech companies are developing

Which sector do you think will be most appealing to acquirers of Israeli companies over the next 12 months? (Please rank top 3, where 1 = most appealing)



Virtual combat aircraft in a flight simulator at Cybertech 2017, Tel Aviv

Within the technology sector, which sub-sectors will be the most appealing to acquirers of Israeli companies over the next 12 months? (Please rank top 3, where 1 = most appealing)



products for needs ranging from digital banking to fundraising. This includes cross-border payments company Payoneer, which completed a US$180 million equity financing round in October 2016; online crowd-investing platform OurCrowd; and Lemonade, an online mobile platform that uses machine learning to deliver homeowners' and renters' insurance to New Yorkers, and which raised US$34 million in December 2016.

"Israeli technology companies are known to have superior innovation capabilities due to the significant intelligence they possess in this field. There are significant opportunities to invest in startups, while established players are looking to expand and diversify their product and service offerings," says the CEO of an industrial company.

"Israel's deep talent pool in data science enables it to excel in a range of rapidly growing fields.

A positive outlook

HEADLINES

■ Over the next 12 months, 36 percent of respondents expect to be involved in more M&A deals compared to the previous 12 months ■ More than half of respondents expect an increase in competition for Israeli assets over the next 12 months, suggesting investor appetite for deals is strong ■ More than 80 percent anticipate an increase in the number of Chinese entities bidding for Israeli companies

Companies in Israel are enthusiastic about the future of dealmaking in the country, supported by government initiatives and strong interest from global investors.

The outlook for the Israeli M&A market remains resolutely positive. Over the next 12 months, more than a third of respondents expect to be involved in more M&A deals than they have been in the previous 12 months. Half of respondents expect activity to remain constant.

More than half (53 percent) of respondents expect to see an increase in competition for Israeli assets over the next year, and only 6 percent anticipate a decrease, with activity fueled by demand for tech and tech-related targets. This reflects wider trends: Computer and software stocks have increased to more than one-fifth (23.2 percent) of the S&P 500 index's value, with half of the top 10 highest valued companies today being tech stocks.

The government is doing its part to encourage and support this activity. For example, the Israel Innovation Authority launched an Innovation Visa program at the end of 2016. This will allow entrepreneurs to reside in Israel for 24 months while receiving help from the Authority's Tnufa program, which supports entrepreneurs at the pre-seed stage. The initiative is a strong signal that Israel is open for business.

"Companies are demanding Israeli assets like never before, with the government making the region stable and companies growing at a fast pace," says the partner of a private equity firm.

East meets Middle East

China has taken a particular interest in Israel. Examples of significant deals include the acquisition of Israeli games company Playtika by a Chinese consortium for US$4.5 billion, announced in July 2016; ChemChina's US$1.4 billion takeover of Adama, a manufacturer of crop protection products, announced in the same month; and the purchase of Israel's largest dairy, Tnuva, by China's Bright Food for US$2.1 billion, announced in July 2015.

Chinese buyers are often interested in accelerating promising technology that is developed by Israeli firms, who benefit from gaining access to China's vast market. The Tnuva deal is a prime example of this dynamic. China's Bright Foods gains access to foodtech that significantly increases the volume of milk produced per cow, and Tnuva gains access to the rapidly growing consumer milk market in China. Eighty-one percent of respondents say they expect an increase in the number of Chinese entities bidding on Israeli companies in the future; just 8 percent expect a decrease.

"In their bid to acquire new technologies and business opportunities, Chinese companies will continue expanding into the Israeli market," says one corporate director of mergers and acquisitions.

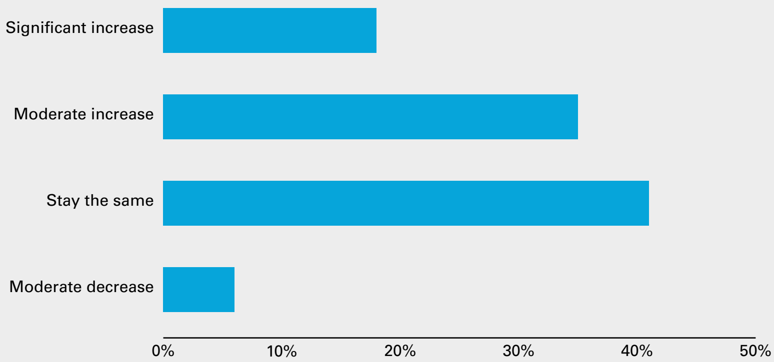
36%

Percentage of respondents who expect to be involved in more M&A deals over the next 12 months

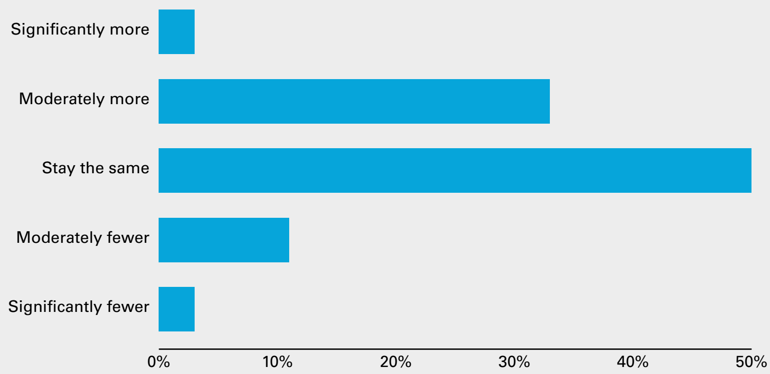
81%

Percentage of respondents who anticipate an increase in the number of Chinese entities bidding for Israeli companies

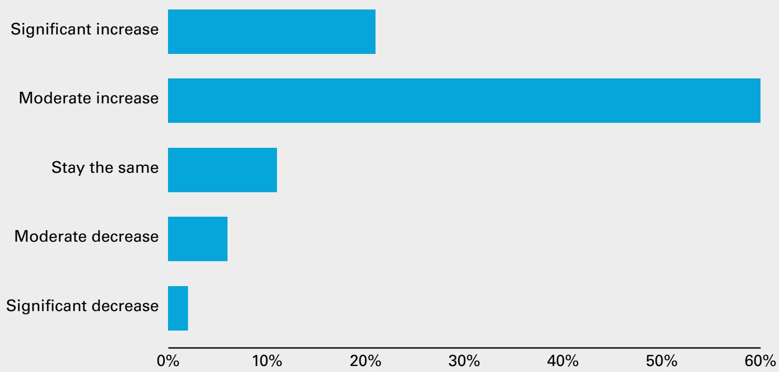
Over the next 12 months, do you expect your organization to be involved in more or fewer M&A deals in Israel compared to the previous 12 months?



Over the next 12 months, do you expect competition for assets in Israel to change compared to the previous 12 months?



Do you expect the number of Chinese bidders targeting Israeli companies to change over the next 12 months compared to the previous 12 months?



Regulation: Where challenge meets opportunity

HEADLINES

- Nearly half of respondents (47 percent) believe that the regulatory environment in Israel is more difficult to navigate than other developed economies
- 24 percent rate regulatory and legal obstacles as the main obstacle to dealmaking in the next 12 months
- Global economic volatility is a major concern for respondents, with 76 percent citing it as one of their top-three challenges facing dealmaking over the next 12 months

Israel may be a hive of M&A opportunity, but investors recognize that the country still presents challenges for dealmakers. The country's regulatory landscape is complex and can be a hindrance to foreign buyers unfamiliar with the terrain. But within that complexity lies the potential for growth.

Government measures are expected to add to deal flow in Israel, despite the fact that 47 percent of respondents believe the regulatory environment in Israel is more difficult to navigate than in other developed economies; only 13 percent believe it is easier to navigate.

In the late 2000s, about 20 major business groups controlled approximately half of the market capitalization traded on the Tel Aviv Stock Exchange. These businesses tended to be family-controlled and highly diversified.

Obser vers began to worry that the high levels of concentration in the Israeli market presented potential system risk for the country. Concern erupted into protests in 2011, prompting the government to analyze concentration levels, which resulted in the Law for the Promotion of Competition and Reduction of Concentration being passed in 2013.

The implementation of the "Concentration Law" will turn many Israeli holding companies into sellers. It will restrict the use of multi-tiered corporate holdings structures—so-called "pyramids", where a control group owns multiple layers of publicly traded companies.

Existing structures will have four years to divest to three levels of public companies, and six years to divest to two levels. These anticipated divestitures could be a golden opportunity for private equity buyers.

In addition, the Competition Law will prevent joint ownership of financial and non-financial businesses. Current joint owners will be given six years to divert one type of asset.

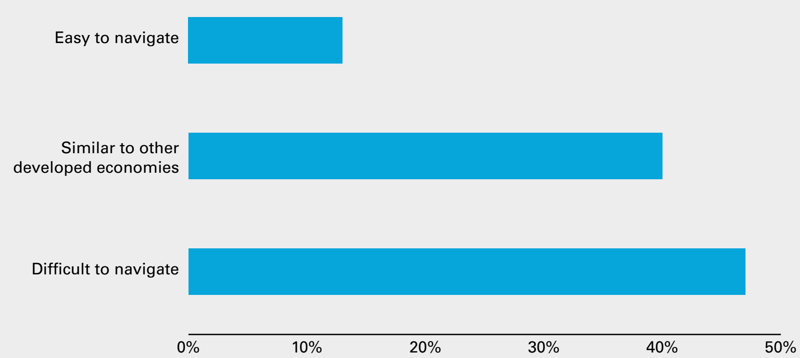
In early 2017, the Israeli parliament passed the "Strum Law", requiring Israel's two largest banks, Bank Leumi and Bank Hapoalim, to divest their credit card businesses, Leumi Card and Isracard, respectively. Under the law, other Israeli financial institutions will be prevented from acquiring them. This will leave the field open for other buyers.

But challenges still remain: The Israel Antitrust Authority has been imposing increasingly larger fines on companies that do not comply with its rulings. In at least one case, the Authority ordered a custodial sentence for officers that violated its rulings.

47%

Percentage of respondents who believe that the regulatory environment in Israel is more difficult to navigate than other developed economies

Compared to other developed economies, is the regulatory environment in Israel…?



"Legal problems are growing," says a partner at a PE firm. "The government has changed a few regulations that have made the market stricter. Antitrust enforcement activities have also increased and a few regulations have restricted the growth of companies to avoid market monopolies. Securing finance will also be problematic and this will have an impact on growth."

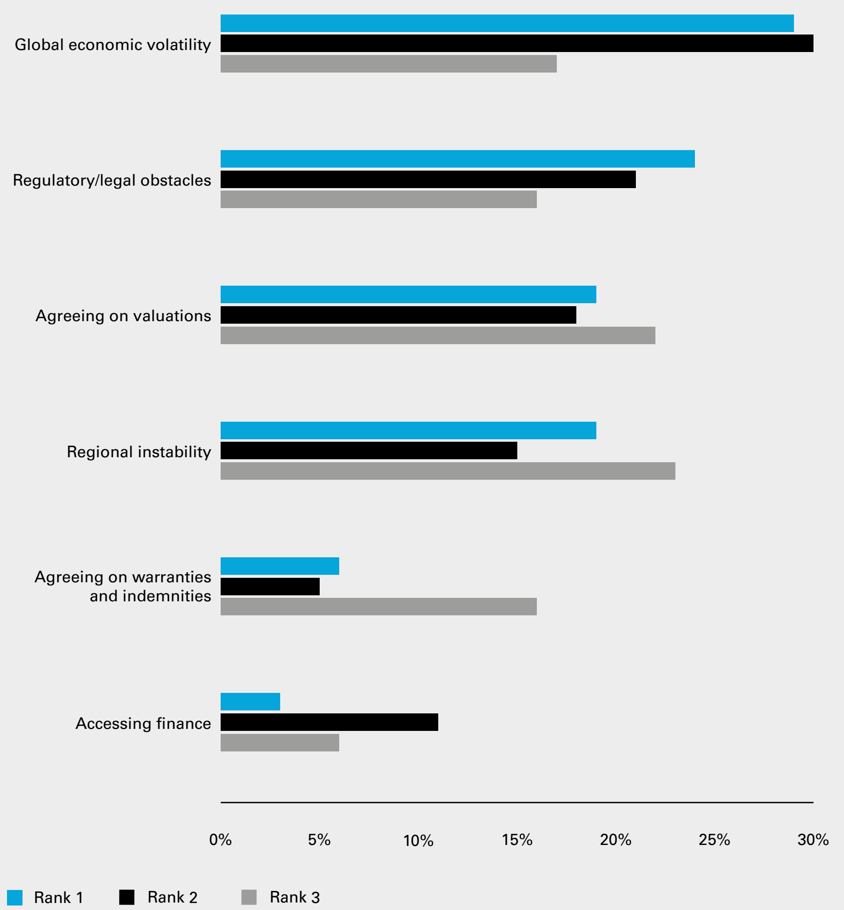
Outside obstacles

Global economic volatility is seen as the biggest challenge to dealmaking over the next 12 months, with 76 percent of respondents citing it as one of their top-three challenges. The CEO of one company notes that it is not just economic turbulence but policy trends in the two biggest inbound acquirers, the US and China, which may dampen dealmaking.

Other major challenges that rank highly include agreeing on valuations and regional instability. As a partner at one PE firm points out: "Regional instability has deterred investors in the past. If this persists or escalates, companies will not invest in the market. Reaching agreements and carrying them out can be difficult. Due diligence processes have suffered in the past and this has affected dealmaking activity."

> **Global economic volatility is seen as the biggest challenge to dealmaking over the next 12 months, with 76 percent of respondents citing it as one of their top-three challenges.**

What will be the top-three challenges to Israeli M&A dealmaking over the next 12 months? (Please rank top 3, where 1 = most challenging)



Conclusion: Looking ahead

Israel's innovative drive will continue to create ample M&A opportunities for investors looking for growth opportunities within the country. To profit from these opportunities, investors must learn to navigate challenges within the country's complex regulatory environment

Based on our survey, we have identified three trends that are set to influence M&A activity over the next 12 months:

1. Cybersecurity demand will continue to create opportunities
Israel has established itself as a world-class tech hub, and investors from all corners of the globe are seeking opportunities to access innovation through acquisitions. In light of the proliferation of cybersecurity attacks experienced globally, the need for cutting-edge technology in this field in particular will become increasingly vital.

2. Government initiatives will encourage activity
In recent years, the government has enacted laws with the overarching purpose of stimulating competition by reducing concentration. In the main, these anti-concentration rules are expected to contribute to deal flow by forcing concentrated groups to divest assets, particularly in the case of single entities with significant holdings in both financial services businesses and industrial companies.

3. Antitrust regulation may hamper top-end deals
A greater emphasis on increasing competition could risk putting the brakes on larger deals and buy-and-build consolidation plays. In addition, stricter enforcement of antitrust rules poses a significant risk. Any investor sizing up the opportunities on offer in Israel should seek advice and local expertise before diving headlong into the market.

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