Analysis of transaction deal breakers across several European countries and Quebec

carried out in collaboration with Transeo Member Ernst & Young - Financial Accounting Advisory Services

REPORT – September 2011

TranSeo AISBL
European Association for SME Transfer

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European Association for SME Transfer

Transeo is the first association in the SME transfer sector (SME transfer refers to the sale or acquisition of small and medium-sized enterprises in a broad meaning (MBO, MBI, EBO, family succession, etc.).

Transeo encourages and promotes the exchange of good practices between experts to stimulate the European SME transfer market. Transeo increases awareness of the business transfer issue at regional, national and European level and works on solutions and projects to improve business transfer at European scale.

Transeo connects:

-Private experts (M&A practices, matching platforms, lawyers, business auditors, accountants, chartered accountants, tax consultants, M&A consultants, intermediaries in business transfers, business transfer agencies, banks, private equity firms, …),

-Public institutions (chambers of commerce, economic development agencies, public financing organizations, public matching programmes, …),

-Academic researchers (universities, business schools, research centres, …).

Transeo gathers 33 members from 12 countries (Belgium, France, The Netherlands, Italy, Luxembourg, Switzerland, Germany, Latvia, Finland, Denmark, Norway, Canada).

For more information, visit the Transeo website: www.transeo-association.eu

Executive summary (1/3)

Purpose, scope and methodology of the study

- Business transfer is generally a lasting and emotionally testing process that could be cancelled or postponed at every moment by both vendors or acquirers. The purpose of the study consists of identifying and analysing the deal breakers in twelve M&A markets.
- The study scope covers a limited number of countries (where Transeo members are active) and only regards transaction on small target companies (see table besides).
- The study has been carried out according to a three-axes approach:
  (1) a compilation of documents dealing with the topic;
  (2) the quantitative analysis of the transaction markets; and
  (3) interviews with local market experts, members of the Transeo network.
- Six major categories of deal breakers have been identified (see table besides).

Deal breaker definition

A factor that hampers a transaction between a seller and an acquirer to take place.

Study scope

Small companies (according to the EU)

- Target operating revenue: maximum € 10 million ;
- Target staff: maximum 50 full-time equivalent; or
- Target total assets: maximum € 10 million

Countries under study

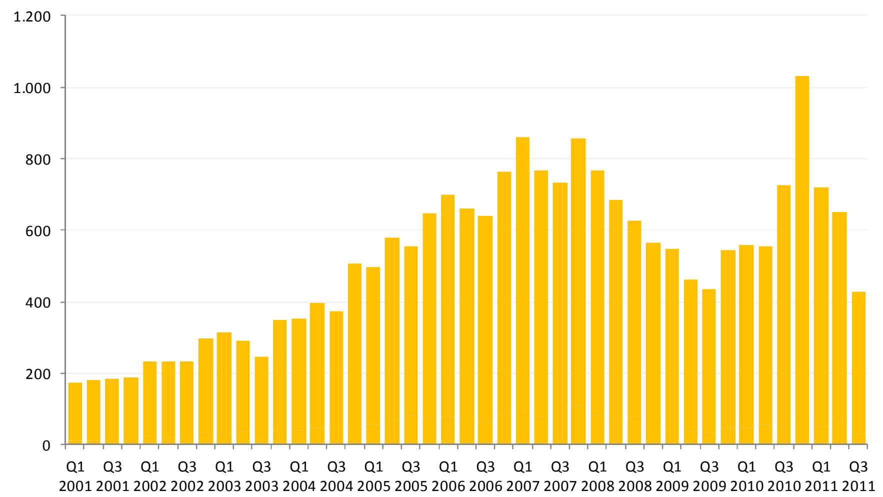
Belgium	Finland	Luxembourg
Quebec	France	the Netherlands
Denmark	Italy	Norway
Germany	Latvia	Switzerland

Deal breakers identified

Several deal breakers have been identified, prior to the study, via preliminary interviews with M&A experts and document analysis.

Regulatory factors
Regulation complexities
Restrictive labour regulation
Capital gain taxes
Economic factors
Weak economic fundamentals
Small market size
Political factors
Political stability
Financial factors
Role of the banks
Role of buy-out funds
Transarency
Socio-cultural factors
Secrecy culture
M&A knowledge / Professionalism
Business practices
Reluctance to complex contractual clauses
Shadow practices

Whole Europe (number of transactions)



Source: Zephyr & Mergermarket, Ernst & Young analysis

General transaction market trends in Europe

- The European transaction markets have been heavily impacted by the financial and economic crisis. After a steady growth from 2001 until 2007, the number of transactions has declined in 2008 and 2009.
- Similarly to equity markets, transaction markets have somehow recovered in 2010 and declined again in 2011. The abnormally high number of deals during the last quarter of 2010 is mainly due to a regulatory change related to the holding structure in the Netherlands.
- Transactions roughly concern all the industries of the economy (excepted non profit sectors). Some industries are however characterised by a more intense deal activity, such as mining, manufacture of machines and equipment, energy, ICT and media. To the contrary construction and service industries appear to be relatively less concerned by transactions. The trends is common to most European countries although local specificities may appear.
- Most of the investors involved in a transaction are local investors. They are indeed usually confronted to much less deal breakers than foreigners as they are familiar with local regulations and practices. Moreover, small deal making is featured by proximity – not only geographic but also cultural and linguistic. Small transactions are however evolving towards a greater share of cross-border deals, especially when it comes to smaller countries.
- Most of the investors are industrial acquirers amongst whom about 50 per cent are active in the same business as the target company. Certain countries are characterised by a higher proportion of financial acquirers; private equity funds (United Kingdom and France) or financial institutions (Denmark, Germany or France).

Analysis of transaction deal breakers across several European countries and Quebec

Executive summary （2/3）

Study result overview

▶The deal breakers can be classified according to two dimensions :

（1） Brakes preventing buyers and sellers to meet; economic climate, regulatory constraints, poor availability of information and transparency, political instability, financial constraints, lacking attractiveness of a market to foreign investors;

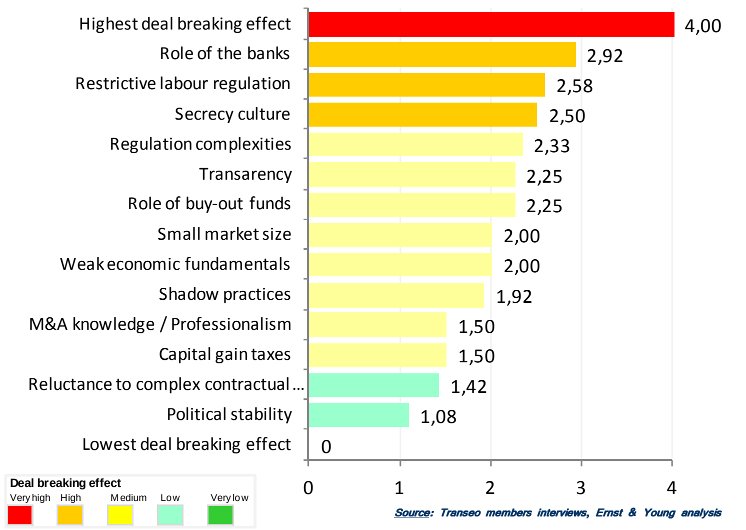
（2） Factors that can cause a deal process to be stopped or postponed; price expectation mismatch, lacking financing （from banks, or buy-out funds）, illegal business practices, entrepreneur's reluctance to covenants and delayed payments and overall professionalism of the market players.

Main deal breakers observed across the twelve countries under study

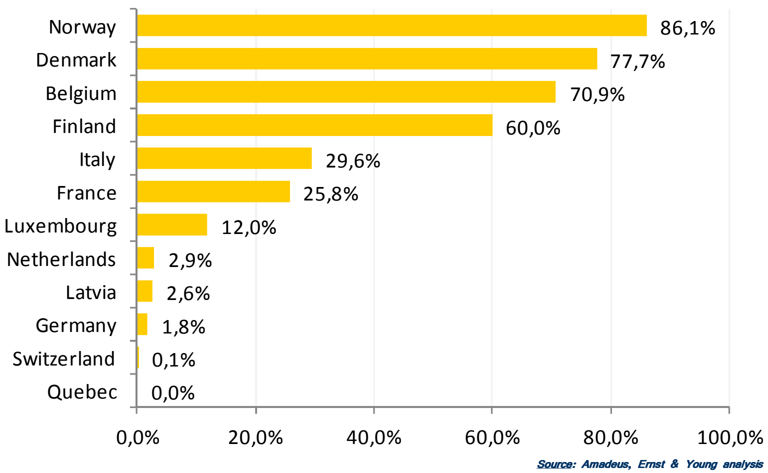
▶Disagreement on price between the acquirer and the seller is undeniably the ultimate deal breaking factor. However, price gap is the consequence rather than the cause of divergent perceptions, reflecting risk, surroundings and prospects.

▶All the deal breakers identified beforehand have been considered significant by the interviewed experts. most of the deal breakers that have been observed are common to the scrutinised markets, only their intensity may vary in some case. However their average intensity varies. Across the twelve countries under study, the role of the banks （restricting loans provided to the acquirers）, the complex regulations （diminishing the market attractiveness） and the culture of secrecy spread amongst most of the small enterprise owners are perceived as being the most important obstacles to deal making （see table beside）.

Average deal breaking effects in the 12 countries under study



Percentage of companies disclosing an income statement



Disclosure and public availability of financial information

▶Publicly available financial information on target companies （see table besides） has a substantial impact on deal–making, particularly at the first stage of the market, when investors and entrepreneurs should meet.

▶Potential acquirers make use of public information for three main reasons: （1） screening target companies （on the basis activities, size or financial soundness）, （2） conducting a preliminary analysis of the target's financials and （3） benchmarking target companies to their to peers.

▶The sellers or their advisers may resort to public information to select potential acquirers.

▶Information restriction on non listed companies hampers the fluidity and the efficiency of the transaction market.

▶The interviewees indicated that the unavailability of qualitative financial information is not a high deal breaker for the local players but certainly for foreign investors. The lack of public information results in additional cost and time requirements for them （sometimes just refraining them from initiating a deal）.

▶Financial information on small companies is generally made available to a large extent in Scandinavian countries and Belgium. Smaller companies are allowed not to file accounts in Italy, France and the Netherlands. German and Luxemburgish companies usually do not comply with filing requirements. There is no obligation for SME to file accounts in Quebec and Switzerland.

Executive summary (3/3)

Transaction market maturity and financial acquirers

► Local transaction markets can be scaled according to their level of maturity. Although not being the only indicator, the degree of involvement of financial players in the market – especially that of buy-out funds supporting individual acquirers - provides a fairly good indication of market maturity.

► Financial acquirers have a substantial impact on the M&A market because:

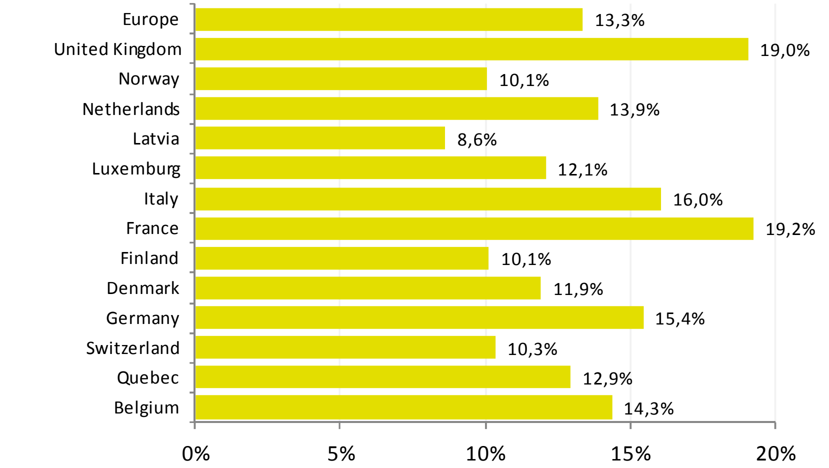
(1) they increase the number of acquirers – by acting themselves or by financially supporting investors who otherwise could not acquire a company – and multiply the chance for companies to be sold to get taken over;

(2) as serial acquirers, they tend to adopt and disseminate the best market practices, making transactions more professional.

► For its intensity and attractiveness, the British market is considered the most mature in Europe and incidentally, the one where financial acquirers, especially private equity, are operating on a very large scale.

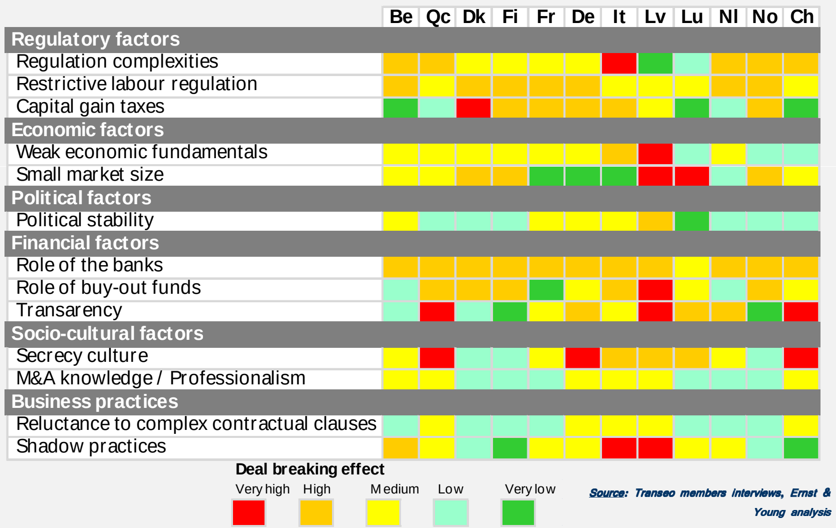
► The graph besides illustrates the implication level of financial investors in each market (as a percentage of the total number of deals).

Proportion of deals involving a financial acquirer



Source: Zephyr & Mergermarket, Ernst & Young analysis

Deal breaking effects as perceived across countries under study



Source: Transeo members interviews, Ernst & Young analysis

Deal breakers intensity in the countries under study

► If most deal breakers are similar across the twelve countries under study, the perceived intensity (deal breaking effect) might reflects local specificities (see table besides). The list below summarizes the major deal breakers observed in the countries analysed (role of the banks excluded):

► **Belgium:** High labour cost – Complex regulations – Black payment practices

► **Quebec:** Entrepreneurs' mistrust and widespread culture of secrecy – No company data made public

► **Denmark:** Restrictive labour regulations - High tax levels – Small market size - Specific language

► **Finland:** Small and remote market – Specific language

► **France:** Stringent and inflexible labour regulations and market

► **Germany:** Restrictive labour regulations – Entrepreneurial culture of secrecy and opacity

► **Italy:** Complex regulations – Lasting approvals and payments – Black payment practices

► **Latvia:** Small, remote and declining market (heavily hit by the financial crisis) – Lack of information disclosure – Specific language – Shadow payment practices – Lacking entrepreneurial culture

► **Luxembourg:** Small market size – Networking culture

► **The Netherlands:** Constraining labour regulations – Poor quality of public information on SMEs

► **Norway:** Stringent environmental and labour regulations – Small and remote market – Specific language

► **Switzerland:** Entrepreneurial culture of secrecy and opacity – Complex regulations

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