Outlook for M&A in Israel: Execs expect the bull run to continue

Our third annual survey finds that a bullish outlook and the ascendance of domestic and Asian buyers could make 2019 a standout year

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Foreword

Israel had a stellar year for M&A in 2018. The country set a new record for value, logging US$26.5 billion over 103 deals

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Such strong M&A activity may have come as no surprise to readers of last year's issue of *Outlook for M&A in Israel*. Indeed, 79 percent of executives we surveyed for last year's report said that they expected to be involved in more deals in the year ahead than in the previous year.

Can Israel continue its M&A streak in 2019? That would be impressive, given that the country has set new records for value in every year since 2016. Both domestic and international politics are uncertain. And the global economy may be heading for a downturn—indeed, a number of economies are already slowing.

For the third year in a row, we conducted a survey to gain insight into the future of Israel M&A. In the first quarter of 2019, Mergermarket surveyed 51 senior-level executives at Israeli companies and private equity firms on their outlook for M&A. The survey included a combination of qualitative and quantitative questions, and all interviews were conducted over the telephone, by appointment.

Our research suggests that M&A will continue apace or even accelerate in 2019, as Israeli dealmakers enthuse about the current market.

Key takeaways from the study include:

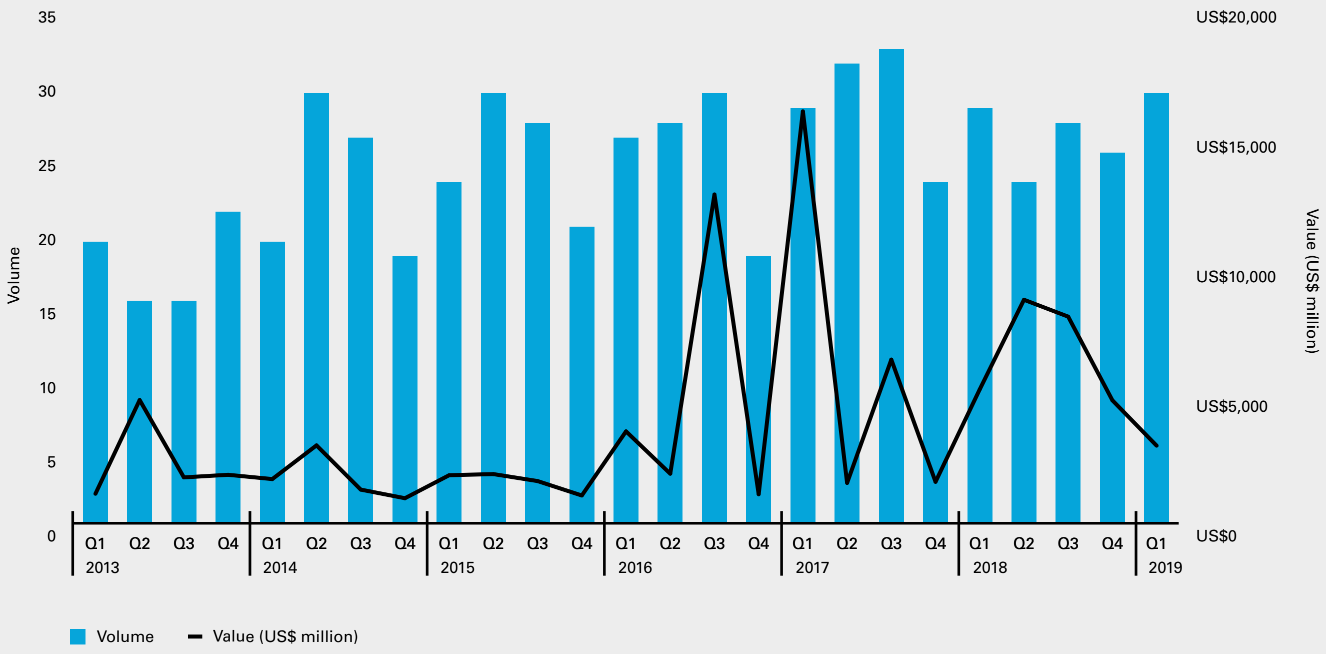
- **Optimism about future dealmaking is stronger than ever**
  More than three-quarters of survey respondents (76 percent) expect to complete more M&A transactions over the next 12 months than they did in 2018, with optimism about the level of deal activity remaining about the same as it was last year. Anxieties about the availability of financing have not affected confidence regarding dealmaking.

- **Global economic headwinds do not worry dealmakers**
  More than three-quarters of respondents (76 percent) say a global economic slowdown would not make them less likely to engage in M&A. Some 37 percent say a slowdown would actually increase the chances of them doing a deal.

- **Expect domestic acquirers to dominate, Asian investment to rise**
  In recent times, international dealmakers have dominated Israel's M&A market, but respondents expect domestic acquirers to step up activity in the year ahead. More than two-thirds (69 percent) anticipate that Israeli private companies will be most active over the next 12 months. Respondents also anticipate an increase in the number of Asian acquirers as a proportion of the international dealmakers active in the country.

Israel M&A, by the numbers

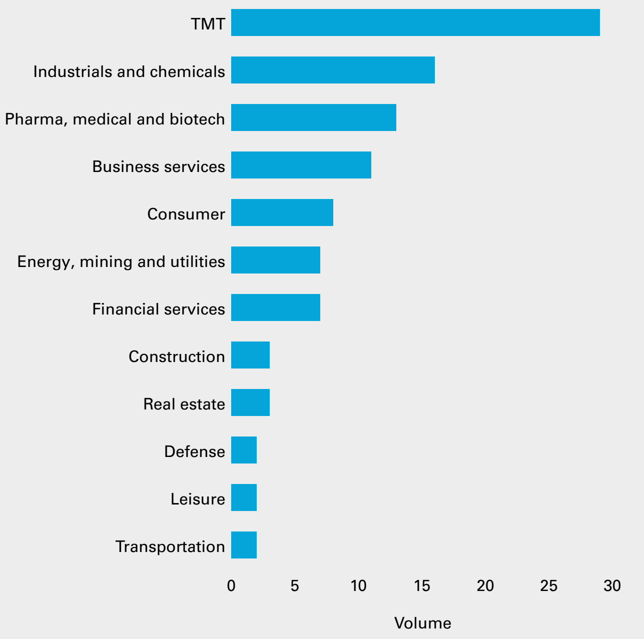
Total Israel M&A 2013 – 2019 YTD



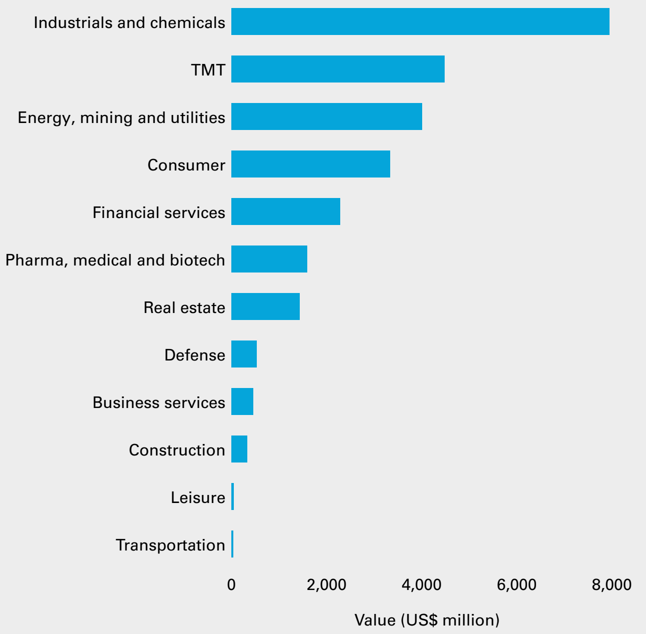
Top-ten Israel M&A deals 2018

Announced date	Target company	Target sector	Bidder company	Bidder country	Deal value (US$ million)
07/05/2018	Frutarom Industries, Ltd.	Industrials and chemicals	International Flavors & Fragrances Inc.	USA	7,036
20/08/2018	SodaStream International Ltd.	Consumer	PepsiCo, Inc.	USA	3,174
19/03/2018	Orbotech Ltd	TMT	KLA-Tencor Corporation	USA	3,101
01/11/2018	J.O.E.L. Jerusalem Oil Exploration Ltd. (62.93% Stake)	Energy, mining and utilities	Equital LTD	Israel	2,663
20/09/2018	Mazor Robotics Ltd. (88.69% stake)	Pharma, medical and biotech	Medtronic plc	USA	1,340
02/09/2018	Africa Israel Investments Ltd.	Real estate	Moti Ben-Moshe (Private investor)	Israel	1,300
29/01/2018	Tamar field (7.5% stake); Dalit field (7.5% stake)	Energy, mining and utilities	Tamar Petroleum Ltd.	Israel	798
08/11/2018	Mizrahi Tefahot Bank (18.99% stake)	Financial services	Eyal Ofer (Private investor)	Israel	766
28/07/2018	Leumi Card Ltd.	Financial services	Warburg Pincus LLC	USA	684
05/09/2018	Bank Leumi le-Israel BM (5.32% stake)	Financial services	Citi	USA	524

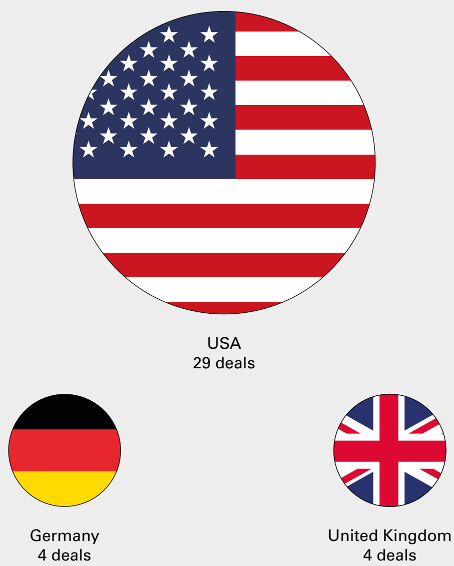
Israel M&A 2018 – sectors by volume



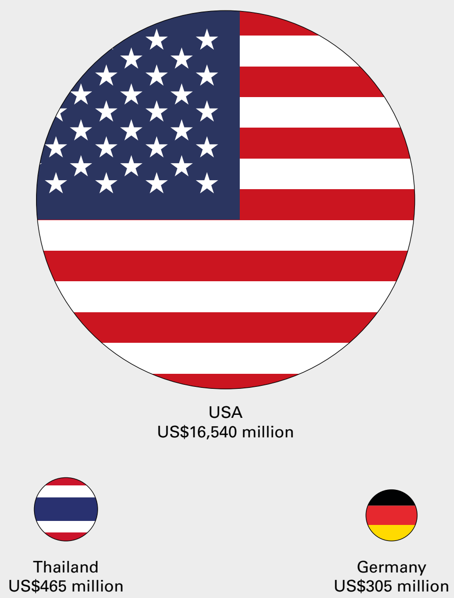
Israel M&A 2018 – sectors by value (US$ million)



Israel M&A 2018 – top bidders by volume



Israel M&A 2018 – top bidders by value (US$ million)



Source: Mergermarket


200
2018

Dealmaking set to flourish in 2019 as optimism abounds

Confident companies, the re-emergence of domestic dealmakers, interest from Asia and a cutting-edge technology sector look likely to drive dealmaking in Israel to new heights in 2019—perhaps even surpassing a record-breaking 2018

By Colin Diamond and Daniel Turgel

Deals targeting Israeli companies hit an all-time high of US$26.5 billion in 2018, from 103 deals—an increase of 4.5 percent in terms of value compared to 2017. Much of this increase was due to a jump in domestic dealmaking, which increased 178 percent over 2018 to almost US$8.1 billion as deal flow from foreign buyers fell 18 percent to US$18.4 billion. Additionally, outbound activity also dropped 39 percent to US$2 billion.

These totals include a number of headline-grabbing deals. Inbound M&A was headed by Frutarom Industries' US$7 billion acquisition by US-based chemicals and materials firm International Flavors & Fragrances. The next biggest deal was in the consumer sector, when US giant PepsiCo announced it would pay US$3.2 billion for SodaStream International.

And, according to our survey of 51 senior Israeli executives, the 2019 outlook could be even stronger, with domestic dealmakers increasingly optimistic about the M&A environment, ready to continue acquiring in the face of any global downturn, and challenging foreign investors for prize assets at home while also welcoming new entrants from Asia.

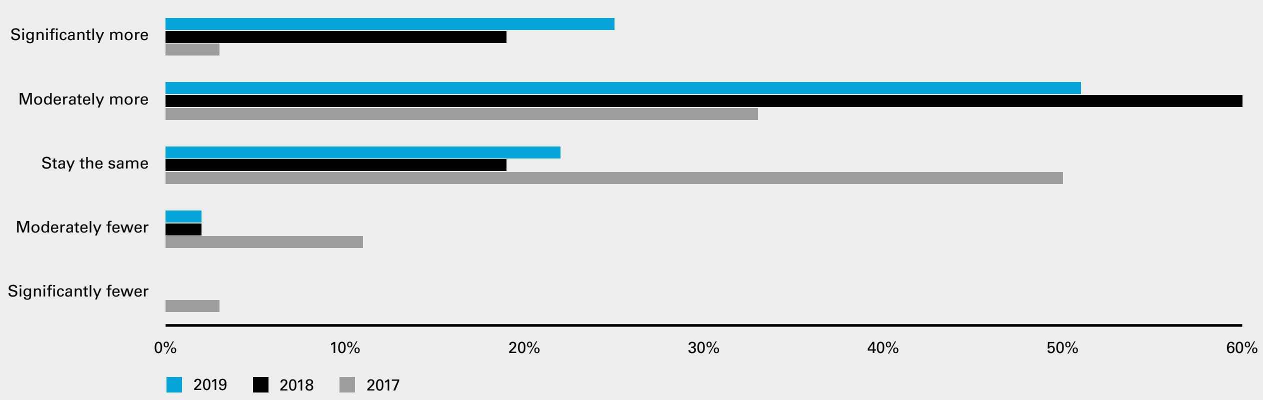
US $26.5 billion

Value of deals in 2018 targeting Israeli companies—an increase of 4.5 percent compared to 2017 and an all-time-high total

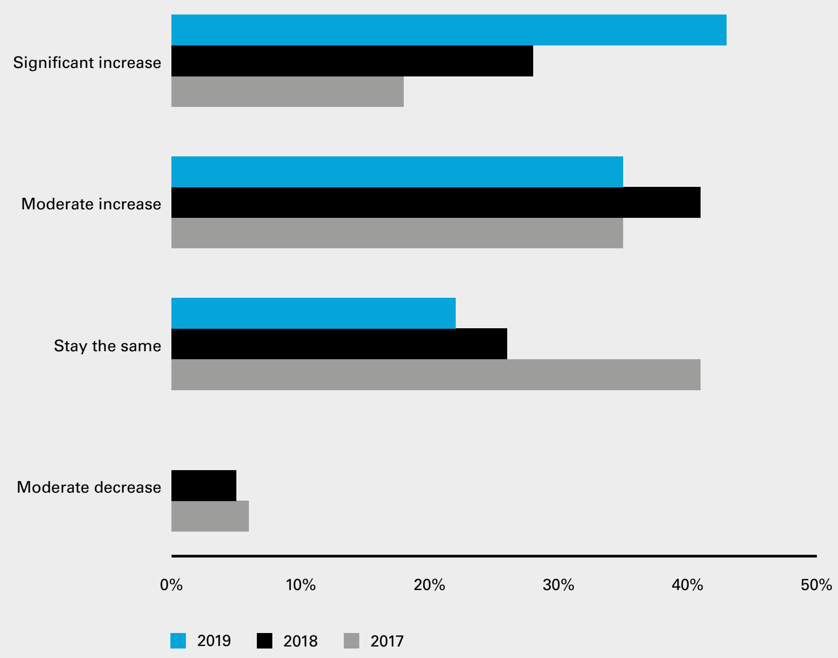
Optimism about M&A is stronger than ever

After two exceptionally busy years for M&A activity in Israel, our survey respondents seem unconcerned that the market may pause for breath, and remain upbeat about 2019. Indeed, 25 percent of respondents expect their organization to do significantly more deals over the next 12 months than in 2018—ahead of the 19 percent who predicted a much busier period a year ago. A further 51 percent anticipate doing moderately more deals, while just 2 percent think M&A activity will decline.

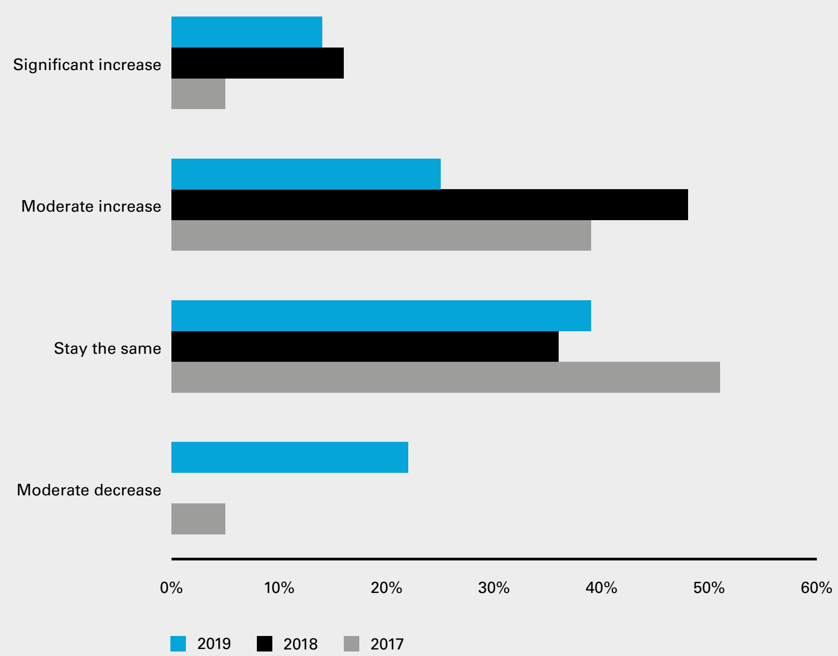
Over the next 12 months, do you expect your organization to be involved in more or fewer M&A deals in Israel compared to the previous 12 months?



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



Over the next 12 months, do you expect the availability of financing for M&A transactions in Israel to change compared to the previous 12 months?



There are several explanations for this positive outlook. One is certainly the continuing strength of Israel's technology sector, with startup and scale-up businesses often found at the center of M&A, both domestically and internationally (see "Technology still on top", page 11, for more).

And, even early in 2019, the burgeoning tech market is once again proving irresistible to foreign buyers—eight of the top-ten deals are in the sector. Major transactions include UK private equity firm Novalpina Capital's purchase of cyber intelligence business NSO Group for US$850 million.

Another factor is the growing maturity of Israeli businesses and their determination to diversify. "Entrepreneurs in Israel are seeking out multiple trading routes to support their domestic business," explains the managing partner of one private equity firm. "Bidding on non-Israeli companies means venturing into newer markets and settling into the next phase of operations for the organization."

Competition drives value

With startups requiring funding to grow and innovative technology a key driver for global M&A, the best Israeli assets are in ever-higher demand, with survey respondents expecting competition for targets to intensify over the next 12 months. Some 43 percent foresee a significant increase in competition for Israeli assets, well ahead of the 28 percent who expected the same a year ago as well as the 18 percent who held this view in 2017. A further 35 percent expect a moderate rise in competition during 2019.

This competition looks likely to be buoyed by growing interest in Israeli businesses from both domestic acquirers and an influx of Asian suitors who are set to join US companies with a long track record of bidding on the country's assets. And with so many bidders doing battle for the best companies, deal values should rise higher even if volume does not increase.

Funding under pressure?

Such competition might seem counterintuitive given the global economic backdrop, with growing trade tensions between the US and China and ongoing uncertainty around Brexit. Moreover, there is no guarantee that the availability of financing will remain at current levels. While 39 percent of survey respondents predict an increase over the next 12 months, the same number predict no change, while 22 percent expect funding levels to decline. Indeed, on funding at least, respondents are markedly less optimistic than in recent years.

Nevertheless, there has been no corresponding drop-off in optimism. Israeli businesses' record of innovation is proving impressive enough to attract increasing numbers of buyers even during a tougher economic period, while also underpinning a rise in the number of domestic companies that are willing and able to engage in M&A.

Global economic headwinds are not worrying dealmakers

Many survey respondents are so confident about the prospects for M&A activity in the next 12 months that they do not view a possible global economic slowdown as an obstacle. More than three-quarters of respondents (76 percent) say a slowdown would not diminish the likelihood of their engaging in M&A. Of that number, almost half (37 percent) say a slowdown would actually increase the chances they would do a deal.

Amid a slowing global M&A market—driven not least by rising political and economic uncertainty—this might be considered complacency rather than confidence. But survey respondents insist their optimism is not misplaced. "The slowdown has been rather gradual," points out the director of M&A and corporate development at one Israeli corporate. "We have made plans to continue our activities while finalizing existing talks with companies."

Again, Israel's technology sector is one factor inspiring confidence. Businesses around the world are scouring the country for assets that might boost their own innovation. US giant Walmart's recent purchase of the artificial intelligence and natural language processing startup Aspectiva is just one example of this phenomenon. While this was the retail business's first startup acquisition in Israel, it has a number of other ventures in the country including investments in technology think tanks and accelerators.

A safe haven

As for the 37 percent who feel a global slowdown could swell Israel's M&A numbers, the country's recent healthy performance may have persuaded some that it represents a safe haven. While the Israeli economy is not immune to external risks, the country's unemployment statistics (currently at an all-time low), supportive monetary policy and rising wages are underpinning consumer spending and investment.

Meanwhile, growing tensions between the US and a number of regions (including Mexico and China) are unlikely to affect Israel, a key ally in the Middle East. It is notable that so far this year US companies have made five of the top-ten acquisitions in the country.

39%
of respondents predict an increase in funding levels over the next 12 months

76%
of respondents say a global economic slowdown would not diminish the likelihood of their engaging in M&A

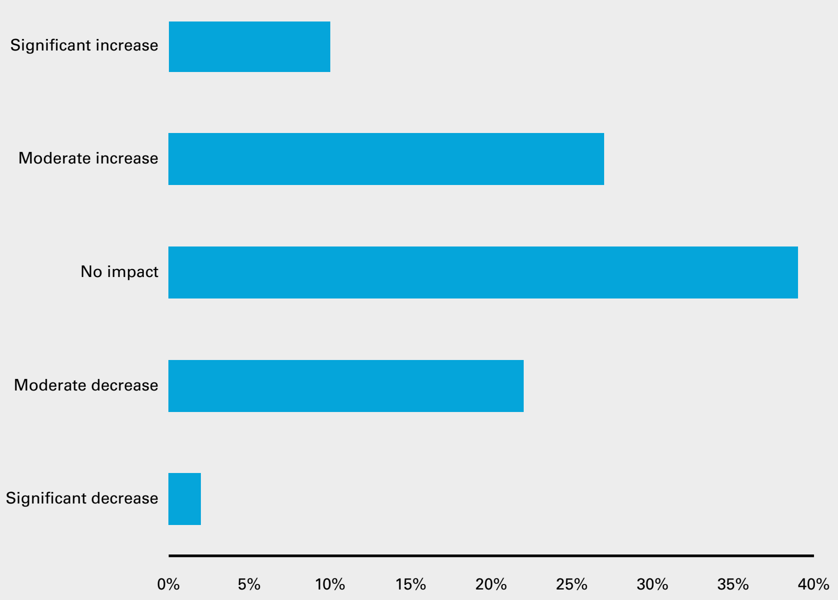
The CFO of an Israeli corporate says of the global picture: "We've seen how well Israeli companies have coped with difficult situations in the past, so while I think the economic conditions do play a certain role in the growth dynamics, they will not deter us from engaging in M&A in the next 12 months."

Local concerns and global issues

This is not to suggest Israeli M&A faces no headwinds at all. However, survey respondents are just as likely to be concerned that regional instability affecting M&A prospects reflects global economic volatility. The former is closer to home and tougher to insulate against. However, the CFO of one Israeli private equity firm says local issues have been eased by the "establishment of security conditions, leading to a degree of normalization, with only slight disruptions now and again."

Nor do respondents consider themselves completely unaffected by the political problems confronting

How much does the possibility of a global economic slowdown affect your likelihood of engaging in M&A in Israel in the next 12 months?



the global economy. More than half (51 percent) think the rise of protectionism and trade disputes are the most significant threat to M&A activity; by contrast, just 20 percent are more concerned about political instability in Israel itself. With cross-border M&A activity having represented such a significant proportion of deal values and volumes in recent years, this is not surprising.

Nevertheless, confidence is robust. More than two-thirds (69 percent) of respondents point out that Israel's regulatory environment is similar to that of other countries, or easier to navigate, which should encourage both domestic and international bidders.

51%

of respondents think the rise of protectionism and trade disputes are the most significant threat to M&A activity in Israel

Expect domestic acquirers to dominate and Asian investment to rise

Last year's cross-border inbound and outbound deal value total of US$20.4 billion was more than three times the domestic-only figure of US$8.1 billion. However, many expect a reversal in 2019.

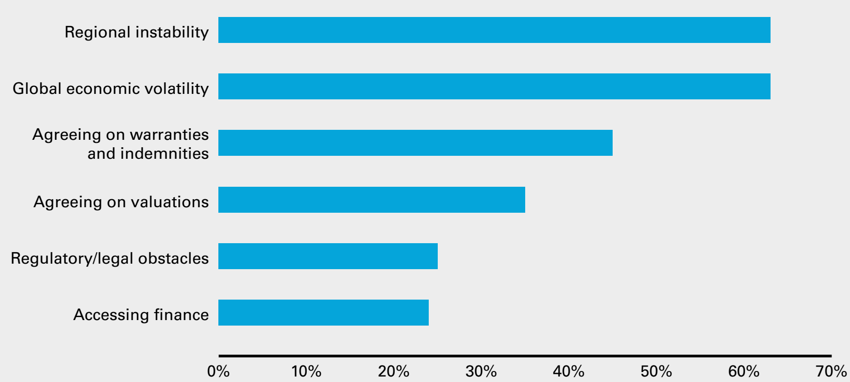
The shift could be dramatic. Last year, just 23 percent of respondents predicted that Israeli private companies would be one of the two most active types of acquirers in the country during 2018. Just 12 months later, 69 percent forecast this group will lead the M&A charge during 2019. Similarly, 51 percent pick domestic publicly owned companies as M&A rainmakers for 2019, up from 22 percent a year ago. Israeli private equity firms are also expected to be busier. And this is borne out by the rising percentage of domestic deal volume in the past two years: In 2017, 40 percent of deals targeting Israeli companies were domestic, while in 2018 domestic deal volume hit 44 percent.

Respondents are much less likely to predict heightened activity from overseas companies, whether public or private—and just 4 percent think foreign private equity will be a major player in the Israeli M&A market during the coming year.

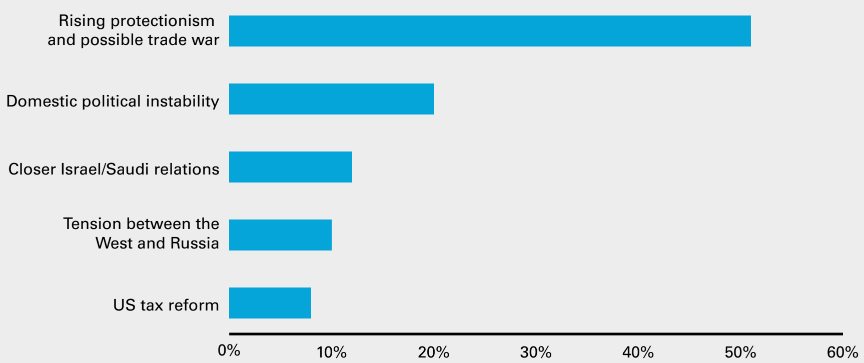
In part, this represents the growing strength of Israel's home-grown companies, which are ready to play a bigger part in the M&A markets. "We've seen over the past few years that Israeli private corporates now have an established technological advantage," says the CFO of one Israeli company. "Also, we've seen a boom in exports, with competitive technological sectors and communities growing rapidly."

Expectations of a shift from cross-border to domestic dealmaking are also likely to reflect concerns about the global market backdrop. If the global economy does slow, some investors may retreat from overseas expansion. If respondents are right about Israel's ability to manage such a setback with only minimal domestic impact, their propensity to engage in M&A should suffer far less.

What will be the top-three challenges to Israeli M&A dealmaking over the next 12 months? (Select top three)

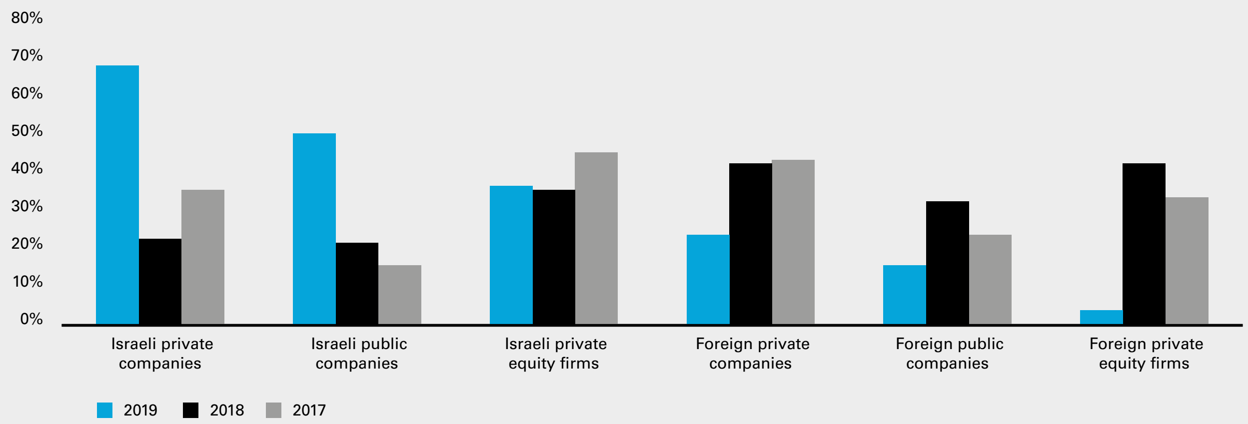


Which of the following political issues do you think will have the most significant impact on M&A in Israel within the next 12 months?



> **Last year's cross-border inbound and outbound deal value total of US$20.4 billion was more than three times the domestic-only figure of US$8.1 billion. However, many expect a reversal in 2019.**

Which type of acquirer do you expect to be most active in Israel over the next 12 months? (Select top two)



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As the US makes it more difficult for Chinese companies to invest in its technology sector, they are seeking alternative targets. Israel's strong tech industry is an obvious candidate.

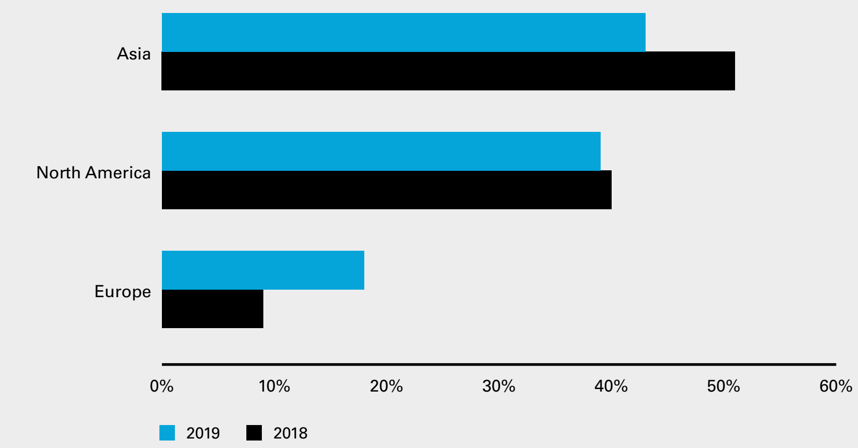
Chinese up investment in Israel
Meanwhile, although cross-border transactions will not dry up, our survey suggests the nationality of bidders for Israeli companies may be set to change markedly. Some 43 percent of respondents think Asian acquirers are most likely to increase their dealmaking in Israel over the next 12 months, ahead of both North America and Europe.

Moreover, 59 percent of respondents predict the number of Asian bidders targeting Israeli companies will increase significantly over the next 12 months; a further 37 percent predict a moderate increase.

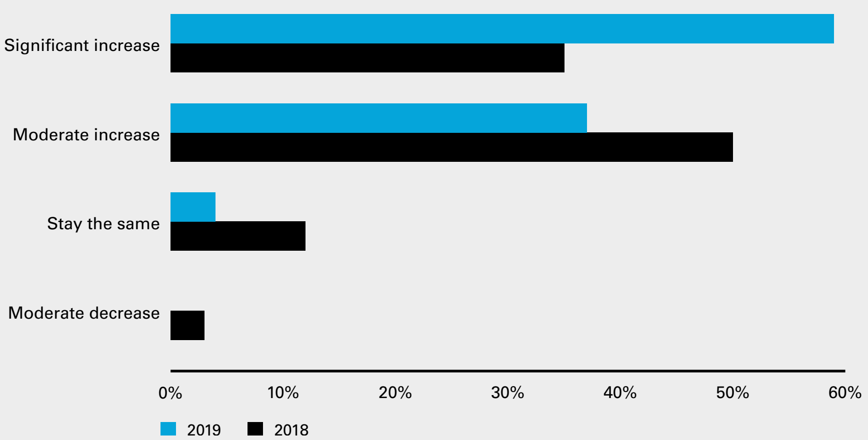
China will likely be the most significant player in this trend. According to the IVC Research Centre, Chinese investors were involved in 12 percent of all deals in Israel's high-tech industry in the first nine months of 2018. And in terms of value, the sums are increasing year on year—US$325 million was invested in 2018, up from US$308 million in 2017 and US$274 million in 2016. As the US makes it more difficult for Chinese companies to invest in its technology sector—as well as in other industries—they are seeking alternative targets. Israel's strong tech industry is an obvious candidate, particularly given the country's strategic location along the "Belt and Road" route to the West that China is pursuing.

"China is searching for advanced technology options and looking to invest in and acquire startups, for both their technology and talent," says the CFO of one Israeli company. "Now is a good time to take a look at Israeli companies."

From which region will the number of foreign acquirers of Israeli companies increase the most over the next 12 months compared to the previous 12 months? (Select one)



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



Technology still on top

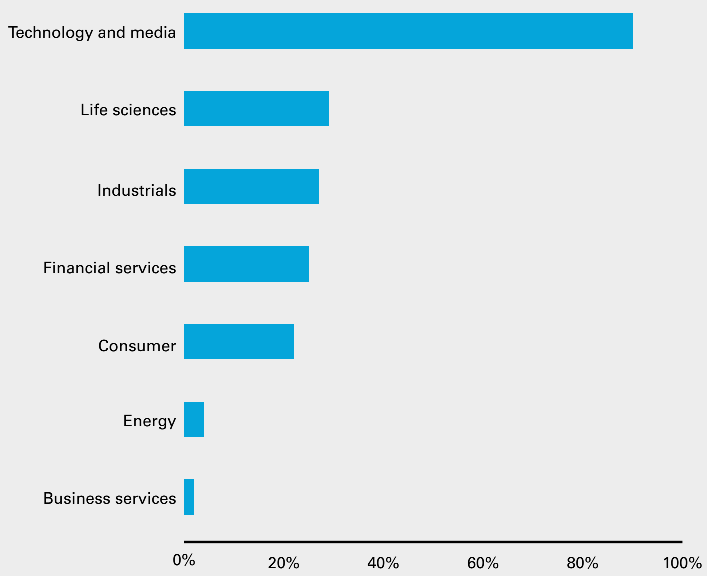
With Israel now second only to the US on a per capita basis in the launch of innovative technology-based companies, the country's high-tech sectors are a natural target for M&A. In our survey, 90 percent of respondents picked the technology and media industry as likely to be among the top-two most appealing sectors to acquirers of Israeli companies this year. The next most cited sector, life sciences, scored just 29 percent.

That would be a continuation of recent trends. There were 42 M&A deals in the TMT sector between the beginning of 2018 and the end of Q1 2019, more than twice as many as in any other sector. Deal values were higher only in the industrials and chemicals industry, where a single transaction, the US$7 billion purchase of Frutarom, accounted for most of the US$8.3 billion total deal value.

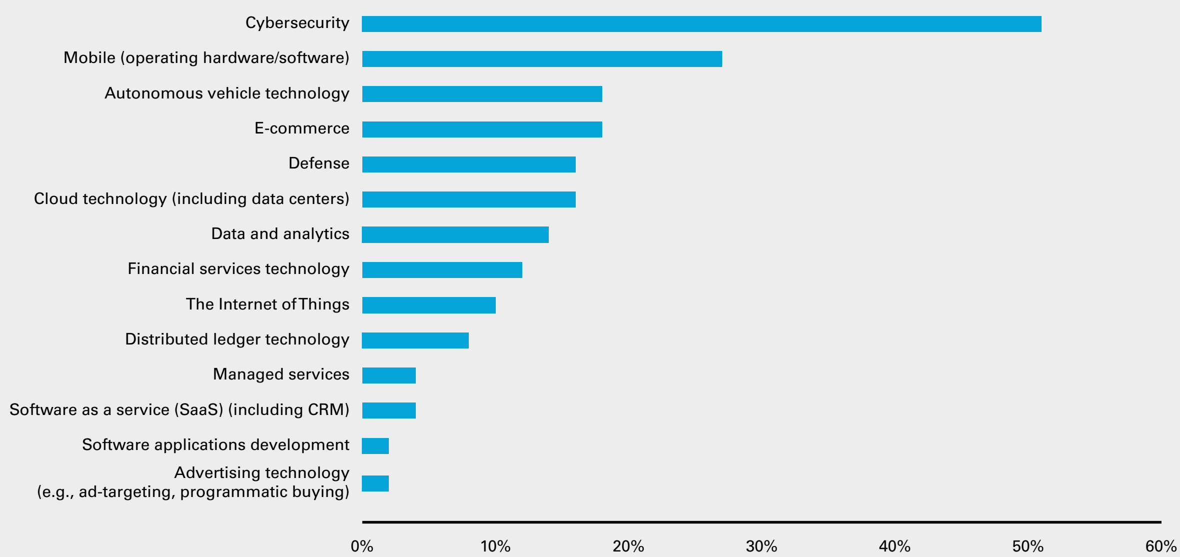
Several technology sub-sectors remain white hot. More than half of survey respondents (51 percent) think cybersecurity firms will be in particular demand with acquirers this year, while mobile technology specialists, cited by 27 percent, are also expected to be widely coveted.

And while Israel's small startup tech businesses are much admired, its more established companies continue to sell too. The US$3.1 billion acquisition of semiconductor specialist Orbotech by US company KLA-Tencor was the third-biggest Israeli M&A deal of 2018.

Which sector do you think will be most appealing to acquirers of Israeli companies over the next 12 months? (Select top two)



Within the technology sector, which sub-sectors will be the most appealing to acquirers of Israeli companies over the next 12 months? (Select top two)



Four trends set to define 2019 and beyond

Our research suggests that M&A activity involving Israeli companies is set to remain strong during 2019 and beyond, despite potential challenges from slower global growth and both regional and international political volatility

This consistency will not necessarily be underpinned by the same factors that drove such high deal volumes and values in 2017 and 2018. Indeed, several new defining trends in Israel M&A are emerging:

1. Domestic dealmakers are setting the pace

The relative strength of the Israeli economy, its ability to withstand external pressures from both political and economic volatility, and the growing maturity of many Israeli companies make for a powerful combination. Domestic bidders are set to seize a much greater share of Israel's M&A market.

2. Valuations are rising

Renewed interest from domestic players, highly prized innovative companies, record private equity dry powder, and Asia's hunt for new IP mean that competition for prized assets will be fierce—78 percent of respondents expect competition to rise this year, and it is likely valuations will rise with it.

3. China is on a shopping spree

Whether through acquisition or venture investment, China continues to scour the world for opportunities to invest in new IP and the top talent. With the US increasingly reluctant to welcome Chinese acquirers, Israel's impressive technology sector is a highly attractive alternative. However, it is worth noting that the US is beginning to look unfavorably on these investments, which could leave Israel in a difficult position.

4. Technology continues to dominate

While Israel's economy is well diversified, the country's technology sector looks set to drive M&A activity in the immediate future, whether the acquirer is domestic or international. Four of the top-ten deals in 2019 so far have been in the TMT sector. Its disproportionate representation in deal volume figures in particular is only likely to increase.

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