

BDO KNOWS INTERNATIONAL PRIVATE EQUITY: **SPOTLIGHT ON ISRAEL**



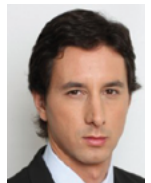
Private equity is still a fairly young industry in Israel, but one that is already gaining international attention. Our own **Lee Duran** and **Scott Hendon** sat down with **Ron Wolman**, an M&A Advisor for BDO Israel, to discuss his observations and predictions for private equity investment in Israel. Here are some insights from their conversation.



Lee Duran



Scott Hendon



Ron Wolman

What is the investment environment for private equity funds in Israel?

While private equity here is still relatively young compared to other countries, at this point almost all of the global private equity players have some local presence in Israel and are clearly enthusiastic about finding investment opportunities here. Israel experienced record deal flows in 2015, with the number of private equity deals increasing by 13 percent according to research firm IVC and law firm Shibolet. In 2015, there was a total of \$3.4 billion in PE investment in Israeli companies, a 3 percent increase from the previous year. Foreign funds accounted for the majority of Israeli PE activity, including the two largest deals of the year: China's XIO Group's buyout of aesthetics company Lumenis for \$510 million, and American firm Francisco Partners' buyout of ClickSoftware for \$438 million.

Private equity has steadily gained popularity in Israel over the last few years but is still overall a fairly small subset of investment activity. Do you expect that private equity will continue to increase its importance in the coming years?

I think the major global players will definitely increase their presence in the country as long as there continue to be good deals and investment opportunities available to them. Because Israel is a young country—turning only 68 years old this year—there's a glut of companies whose founders are beginning to consider divestments as the natural next phase of their business. There are also several companies owned by kibbutzim, and many are currently considering selling their assets, or will be in the next several years. These organizations have many shareholders, and the movement toward pursuing buyouts, including those by private equity, is certainly gaining in popularity.

What are PE investors generally nervous about at the moment?

I don't see private equity funds being particularly nervous about investing in Israel. Israel has relatively high GDP growth, as well as consistently low unemployment levels and interest rates, making it a prime target for investment activity of all kinds. Unlike some other more volatile economies, Israel is widely appealing given its stability.

If anything, nervousness related to private equity investment is global in nature. While the country is likely to be impacted by several factors at play in the international investment landscape, including an economic slowdown in China, I believe top-tier firms will continue to consider Israel a promising target for private equity activity. Taking into account ongoing capital markets' peak prices and the continued stability of low interest rates, we expect PE firms are likely to continue deploying dry powder in Israel.

Which industries are particularly attractive to foreign investors and why?

A majority of the private equity activity in Israel occurs within the broad category of the technology sector. Many Israeli citizens, as a part of their mandatory service in the IDF, train in specialized technology services, and many of these former soldiers go on to found startups within the tech space, which can be ripe for private equity investment once they've matured. Other popular sectors include life sciences, energy, agriculture and consumer goods.

What would you tell a private equity client looking to invest in Israel?

Israel really is a land of opportunity when it comes to investments of all kinds, but can be especially attractive for PE companies. We're making huge leaps in very dynamic industries, including technology and defense, and many companies are either currently looking for capital sources, or will be in the coming years. Israel is also very open to international private equity investment. Companies aren't required to have a local sponsor fund to get involved in the deal landscape here. Money is free flowing into and out of Israel, and international companies can easily pursue private equity investments without experiencing some of the red tape and bureaucracy they face in other countries.

Why do you think Israel is so open to having foreign investment within its borders, especially relative to other countries? Are there particular regulations in place that make the country attractive from a deal flow perspective?

Israel holds top scores on global indexes of economic competitiveness, a striking concentration of innovative people, a culture that promotes experimentation and innovation, and governmental eagerness to create supportive conditions for investors. These factors combine to make Israel a leading site of investment far beyond what its small size and short history might suggest.

Israel is an attractive investment target for a variety of reasons. The country embraces innovation and an entrepreneurial spirit, boasts a highly skilled workforce with significant scientific and technological expertise, welcomes and facilitates flourishing venture capital activity, and possesses a resilient economy and diverse population. As a result, Israel is a hotbed of pioneering technologies, profitable business opportunities and high investment returns. That's why the world's leading multinational companies—over 200 to date—have all made the choice to invest here.

How does Israel handle the taxation of carried interest?

In general, the Israeli tax ordinance doesn't have any specific limitations regarding the deductibility of management fees. The specific taxation rules depend heavily on the exact conditions of the transaction, but assuming the recipient is an Israeli corporate entity, carried interest is considered regular management income, and is thus subject to the standard corporate tax rate, which is 25 percent for 2016. If the income is not business income, but for example capital gains, then the expense should be capitalized to the assets that are sold for tax purposes.

Anything else?

In an effort to increase the competitive nature of the Israeli marketplace, the government of Israel passed the "Concentration Law," a set of regulations enacted in December 2014 to reduce the concentration of multi-layered holding structures in financial and non-financial institutions. The law forces large Israeli groups to divest substantial financial holdings in the coming years, and this process is expected to create M&A opportunities for highly profitable companies with revenues north of \$1 billion. The law sets a timeline of December 2019 to complete the divestiture process, and is already piquing foreign investors' interest in these assets. There are potentially over a dozen transactions in

the \$300 million to \$2 billion range with insurance firms, commercial banks and asset management firms needing to find buyers within the next three years.

We expect this structural and environmental change to the Israeli economy to draw continuous interest from international PE firms and other investors in the Israeli financial sector.

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