How to gain value from M&A
Mikkel Boe
Grab and Go - 2nd October 2019
Agenda

1. Winds of change
2. Setting the scene
3. Creating the M&A value case
4. Think end-to-end M&A
5. Post Merger Integration
6. Q&A
Winds of change
Why are we all here?
M&A activity continues to rise

Global M&A volumes 2002-18

Percentage of organizations expecting an increase in the average number of deals over the next 12 months

Winds of Change

We see headwinds as well as tailwinds – however, outlook remains positive

**Economic and Political Uncertainty**

341 bps

The economic policy uncertainty index hit at record highs towards late last year and continues into 2019.

**Easy access to financing**

$436 bn

A record level of M&A financing was raised from the bond markets in 2018.

**Regulatory pressures**

$300 bn

Worth of mega-deals were withdrawn due to regulatory or political pressure, the highest since 2016.

**Global Investments**

46%

Of the campaigns launched in the last 12 months were global, up from 31% in 2014, with significant growth in UK, Canada and Japan.

**High Private Equity Activity**

$765 bn

Worth of deals were done by private equity in 2018, the highest levels since 2007.

**Disruptive M&A**

$217 bn

Was spent by corporates in 2018 to acquire disruptive technologies, the highest on record and up by 28% from the previous year.

69% of corporate respondents report more cash reserves.

#1 primary intended use of that cash is to fund M&A deals.
Setting the scene
Most M&A transactions fail to deliver the expected results
Almost two-thirds of all M&A transactions globally fail to deliver the synergies and value envisioned, and one in four transactions result in diminished value

Failure to create shareholder value (market view)
- 60%

Failure to reach integration targets (company view)
- 62%

Expected value
- What we paid

True value
- The maximum we should have paid

Actual value
- What we actually achieved

Transaction Gap
We paid too much
- 30%

Integration Gap
The benefits weren't delivered!
- 70%

• Management bias
• Lack of accurate information
• Weak analysis of potential targets
• Incomplete due diligence process
• Failure to take account of changes in the external environment
• Lack of negotiation expertise
• Failure to consider integration complexity and costs in time

• Inadequate integration planning (i.e. not scaling the integration appropriately)
• Lack of programme leadership
• Lack of a formal and fast decision-making process
• Lack of executive alignment on merger rationale
• Too much time spent on organisation politics
• Loss of focus on everyday operations
• Merger synergies not driven through quickly enough
• Customers get forgotten

Source: Deloitte, Merrill
What makes a deal successful?
We have asked 1,000 executives...
Creating the M&A value case
M&A is a lever for growth, innovation and improving the core business
Growth options and strategic elements should be reviewed to understand and define the strategic rationale for M&A transactions

<table>
<thead>
<tr>
<th>Growth matrix</th>
<th>Business model</th>
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</thead>
<tbody>
<tr>
<td>New to industry</td>
<td>Predominantly assimilation</td>
</tr>
<tr>
<td>Identify new uses or users (products, services, solutions, or technologies)</td>
<td>60% of investments</td>
</tr>
<tr>
<td>New to you</td>
<td>Leverage capabilities of Target; some “reverse integration”</td>
</tr>
<tr>
<td>Extend to new geographies, markets, segments</td>
<td>30% of investments</td>
</tr>
<tr>
<td>Business model</td>
<td>Mix of capabilities; sometimes kept autonomous for focus</td>
</tr>
<tr>
<td>Core</td>
<td>New to you</td>
</tr>
<tr>
<td>Adjacent</td>
<td>New</td>
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<tr>
<td>New</td>
<td>New to industry</td>
</tr>
<tr>
<td>Business model</td>
<td>New to you</td>
</tr>
</tbody>
</table>

- Identify new uses or users (products, services, solutions, or technologies)
- Create new markets
- Extend to new geographies, markets, segments
- Expand the value chain
- Change the basis of competition
- Improve Core Operations
- Extend products and services
- New to industry
The role of M&A in realizing the corporate strategy

M&A transactions are a strategic way to disrupt and transform companies to strengthen their product portfolio, gain the benefits from economies of scale or simply get ahead in the digital game.

**IMPROVE THE CORE**
- **Increase scale & efficiency**
  - Buy a business within your existing market to derive economies of scale and decrease cost-to-serve.
- **Acquire a new product**
  - Buy a business that enhances your product offering.
- **Acquire a new capability**
  - Acquire new capabilities such as analytics, digital etc. that will significantly enhance your core business.
- **Acquire the disruptor**
  - A new player is disrupting the market but is not yet at scale.

**MOVE INTO ADJACENT MARKET**
- **Disrupt the adjacent market**
  - Buy a business that will give you entry into an established adjacency or category.

**CREATE AN ENTIRELY NEW BUSINESS**
- **Convergence opportunity across sectors**
  - Buy a business that allows you to take advantage of the convergence opportunities across sectors.
- **Become the disruptor**
  - Buy a disruptive business that could in future transform your industry and you become the disruptor.
Creating the M&A value case

It starts with a clear and validated picture of where the value that the deal should bring comes from.

### Merger Value Creation Logic

#### Traditional Economic Synergies

- **Revenue Synergies**
  - (e.g., economies of scope, geographic expansion)

- **Cost Synergies**
  - (e.g., economies of scale in market access)

#### Forward-Looking Competitive Synergies

- **Risk Mitigation via Diversification**
  - (e.g., business cycle risk)

- **Knowledge Generation**
  - (e.g., access to capabilities and talent)

### Rationale

- Will the gross margin increase as a result of economies of scale?
- Will infrastructure costs decrease (e.g., HQ/SG&A)?
- Can employee costs be reduced?
- Can procurement spend be streamlined?
- Can assets be made more productive?

### Example questions to consider

- Will the merger enable a premium price point (e.g., through valuable brands or higher quality)?
- Will the combined product offering increase cross-sell to existing customers?
- Will the combined firm have access to new customers?

- To what extent are the geographies/product offerings/target customers/R&D pipelines of the two organizations complementary vs. redundant?
- To what degree are the sales of the two organizations correlated to the economic climate?

- Do the companies possess proprietary processes/intellectual property/technology that have value?
- Are there valuable personnel acquisitions to be made? - Will they stay post-merger?
- Does complementary knowledge and expertise exist in the two organizations?
Think end-to-end M&A

How it all needs to be connected across the deal cycle
The high-level end-to-end M&A process (buy-side)
An end-to-end perspective is needed to derive value from M&A

<table>
<thead>
<tr>
<th>M&amp;A Strategy Development</th>
<th>Target Screening &amp; Identification</th>
<th>Transaction Execution</th>
<th>Post Merger Integration</th>
</tr>
</thead>
<tbody>
<tr>
<td>M&amp;A Strategy</td>
<td>Business Case</td>
<td>Due Diligence</td>
<td>Integration Planning incl. Day 1 readiness implementation</td>
</tr>
<tr>
<td>Development</td>
<td>Tax structuring</td>
<td>Confirmatory Due Diligence</td>
<td>Post Merger Integration &amp; Functional integration</td>
</tr>
<tr>
<td>Target Screening &amp; Identification</td>
<td>Preliminary Due Diligence</td>
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<tr>
<td>Identification</td>
<td>Synergy and Value Driver Analysis</td>
<td></td>
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<tr>
<td></td>
<td>Prepare initial offer &amp; negotiate Letter of Intent</td>
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<td></td>
<td>Financial Modelling</td>
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<td></td>
<td>Negotiate Final Transaction</td>
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<td></td>
<td>Transitional Service Agreements (TSA)</td>
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<td></td>
<td>Purchase Price Allocation</td>
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<td></td>
<td>Value Realization</td>
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</table>

**Day 0**
- Final Purchase Agreement (SPA/ATA)

**Day 1**
- Closing / Transfer of Ownership

**Day 2**
- Integration Completed
Post Merger Integration
Key integration challenges
Challenges should be addressed in the integration programme

- Ineffective or weak leadership programme
- Transaction- and integration teams don’t talk to each other
- Deal rationale and future operating model not clear and shared
- Merger synergies not fully identified and value left on the table
- Business as usual gets forgotten and performance in both businesses suffers
- Weak communications and people engagement leads to drop in morale

Need to mitigate these risks to ensure a successful integration and value realization

- Integration governance not set up in time or inefficiently
- Exodus of key talent (from both acquirer and target) before and after Day 1
- Integration planning approach is too complex
- Poorly executed Day 1 sets the wrong tone for the integration
- Slow IT and systems integration puts brakes on the programme
- Decisions are taken too slowly (or not at all!)
Key levers for success
Our experience shows that early and effective planning and discipline in managing any integration is a key lever for success.

1. **CONTINUITY**
   - Gain effective control of the businesses and stabilize the merged entity

2. **DELIVER**
   - Identify, quantify and deliver the synergies

3. **GO BEYOND**
   - Position for transformation beyond the deal
Key success factors for integrations
Our experiences have taught us to keep focus throughout a complex process.

- Alignment on the target picture and integration strategy
- Top management anchoring and dedicated resources
- Focus on culture, employee transition and retention
- Focus on value realization
- Do transformation afterwards
Integration strategy to realize the value case
M&A transactions have potentially one of four different integration approaches or deal types

<table>
<thead>
<tr>
<th>Assimilation</th>
<th>Transformation</th>
</tr>
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<tbody>
<tr>
<td>Calls for rapid and efficient conversion of one organization to the strategy, structure, processes and systems of the parent</td>
<td>Entails synthesizing disparate organizational and technology pieces into a new whole</td>
</tr>
<tr>
<td>Process/systems adopted from parent company</td>
<td>Significant people, process and technology impact</td>
</tr>
<tr>
<td>Significant resources dedicated to integrating operations</td>
<td>Significant planning</td>
</tr>
<tr>
<td>Easiest path towards achieving aggressive synergy targets</td>
<td>More deliberate focus on execution</td>
</tr>
<tr>
<td>Parent’s compliance standards will dominate the acquired entity</td>
<td>Extensive use of internal and external resources</td>
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<tr>
<td></td>
<td>Complex change management characteristics</td>
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<table>
<thead>
<tr>
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<td>Acquiring Company</td>
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<table>
<thead>
<tr>
<th>Metamorphosis</th>
<th>Retention</th>
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<tbody>
<tr>
<td>Means selecting “best” processes, structures and systems from each company to form an optimized operating model</td>
<td>Supports individual companies or business units in retaining their unique capabilities and cultures</td>
</tr>
<tr>
<td>Processes and tools are fine-tuned and optimized using best practice from either company</td>
<td>Minimal standardization outside of contracts consolidation and financial reporting roll up</td>
</tr>
<tr>
<td>Hybrid approach used in governance structure</td>
<td>Holding company controls the operating companies using a “portfolio” model</td>
</tr>
<tr>
<td>Significant resources dedicated to integrating operations</td>
<td>Governance limited to management control, performance targets and expectations</td>
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Integration is typically executed in three high-level phases

<table>
<thead>
<tr>
<th>Operating Model &amp; Organisation Design</th>
<th>Phase 2 Day 1 Planning &amp; Execution</th>
<th>Phase 3 Integration Value Capture</th>
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<tbody>
<tr>
<td>PHASE 1 Mobilisation, Blueprinting &amp; Design</td>
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<tr>
<td>1 Blueprint development</td>
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<tr>
<td>2a Interim target operating model</td>
<td></td>
<td>2b End state target operating model</td>
</tr>
<tr>
<td>3 Synergy case development and validation (Clean room)</td>
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<td></td>
</tr>
<tr>
<td>4 Programme design &amp; governance</td>
<td></td>
<td></td>
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<tr>
<td>5 Integration director appointment</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Day 1 planning &amp; delivery</td>
<td></td>
<td></td>
</tr>
<tr>
<td>6 Day 1 planning &amp; delivery</td>
<td></td>
<td></td>
</tr>
<tr>
<td>7 Integration planning &amp; delivery</td>
<td></td>
<td></td>
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<tr>
<td>8 Accelerator workshops</td>
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<tr>
<td>9 Programme reporting and tracking</td>
<td></td>
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<tr>
<td>10 Managing talent and cultural change</td>
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Begin with the integration blueprint
The most successful integration programmes have developed a blueprint, which answers the key questions before day 1

**VISION AND DEAL RATIONALE**
- What is the strategic rationale for the acquisition, and what must be achieved to be successful?
- What is our deal story, and how do we communicate that externally and internally?

**RISKS AND ISSUES**
- What are the major risks to integration success? Is effective mitigation in place?
- What major decisions must be made now?
- What decisions are we avoiding?

**KEY MILESTONES**
- What are the key programme milestones to be achieved in the first 12 months?
- What interdependencies may impact the critical path for integration?
- How could the programme be accelerated?
- What has to be in place for day 1/day 100?

**GUIDING INTEGRATION PRINCIPLES**
- How does the integration model/depth look?
- How will integration success be measured?
- Style and frequency of communication?

**VALUE DRIVERS AND SYNERGY TARGETS**
- To what level have identified sources of synergy (cost and revenue) been defined and planned?
- What further work is needed on the benefits case before day 1?
- What quick wins can be achieved in the first 12 months?
- Is there clear accountability for synergy delivery?

**DEGREE AND SPEED OF INTEGRATION**
- To what degree will the two organisations be fully or partially integrated?
  - Will any parts of the acquired business be left alone or divested?
  - How quickly should the integration happen?

**GOVERNANCE STRUCTURE**
- What will the integration governance be, and is there a need for joint governance?
- How will the programme be structured and resourced?
- Who are the key managers from both sides?
- What are the decision-making and issue resolution process?

**OPERATING MODEL DESIGN**
- What operating model and structure will be adopted – A, B or a new model?
- Is there a clear organisation structure for the business on day 1? After 12-24 months?

**OPERATING MODEL GAPS**
- What questions remain open for day-1 and end-state operating model?

**PROGRAMME CADENCE**
- What is the schedule for engagements with programme stakeholders?

**KEY MILESTONES**
- At the heart of the integration blueprint is an agreed view of the intended degree of integration and the organisational implications.
Operationalize the synergies

Synergy development

- Definable and quantifiable
- Have clear ownership and accountability
- Linked to lead KPIs and operational milestones
- Baselined against previous performance
- Prioritised and agreed: 5-10 key projects
- Integrated into performance measurement processes

Quick-wins (0-6 months)

- Financing and insurance savings
- Immediate procurement synergies
- Immediate working capital improvements
- Day 1 organisation synergies

Value driving projects (6-24 months)

- Day 2 organisation and real estate synergies
- Shared services and outsourcing
- Production network and capacity optimisation
- Supply chain optimisation
- Tax efficient operations
- Sales channel optimisation
- Cross-selling synergies
- New products and services
- IT system and infrastructure synergies
Example of how to organize an integration programme
Illustrative

Key decisions to be made
1. Appointment of Programme Sponsor and Integration Director
2. Steering Committee members and frequency of meetings
3. Confirmation of workstreams
4. Appointment of experienced leads for each workstream
5. Identification of potential workstream contacts in the target organisation
6. Are there any workstreams best led by a person from the target?
7. Can the integration be driven from the centre or does it require a geographical dimension?
8. What are the key geographies/BU that need to be represented in the structure?
9. Who will take the lead and accountability in each geography/BU?
10. Interface between central functions and geographies – how will this be managed?
Integration costs are typically at the level of yearly synergies
Integration cost estimates as a percentage of cost synergies, for the middle 50% of deals, ranged from 0.6X to 1.5X with a median of 1.1X

Source: Public and Deloitte Proprietary Information
Functional break-down of integration costs

HR and IT are typically the two largest functional expense categories that on average account for 40% of the total one-time integration costs.

Integration one-time cost functional break-down

- HR
  - Severance
  - Retention Bonus
  - Relocation
  - Option Acceleration

- IT
  - Infrastructure
  - Applications
  - IT Consulting

- Finance and Tax
  - Refinancing
  - Tax liabilities
  - Liquidation costs

- PMO
  - Consulting and advisory fees

- Real Estate
  - Facility Closure
  - Retrofitting
  - New facility expenses

- Other Costs
  - Banker Fees
  - Supply Chain
  - Procurement
  - Legal Entity Restructuring
  - Other expenses

Source: Public and Deloitte Proprietary Information
Case example of a successful integration project

Integration costs were estimated at 3.1% of combined expenses, driven by professional services fees and significant implementation costs.

### Deal background

<table>
<thead>
<tr>
<th>Industry</th>
<th>Consumer Products</th>
</tr>
</thead>
<tbody>
<tr>
<td>Acquirer Revenue</td>
<td>$4.0B</td>
</tr>
<tr>
<td>Target Revenue</td>
<td>$1.1B</td>
</tr>
<tr>
<td>Consolidated Costs</td>
<td>$4.2B</td>
</tr>
<tr>
<td>Deal Size</td>
<td>$1.8B</td>
</tr>
<tr>
<td>Integration Costs</td>
<td>$132M</td>
</tr>
</tbody>
</table>

### Integration cost timing

<table>
<thead>
<tr>
<th>Timings</th>
<th>Percent of total integration costs</th>
</tr>
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<tbody>
<tr>
<td>Pre Day 1</td>
<td>34%</td>
</tr>
<tr>
<td>Post Day 1</td>
<td>31%</td>
</tr>
<tr>
<td>Total</td>
<td>63%</td>
</tr>
</tbody>
</table>

Source: Deloitte Proprietary Information.

Professional fees include consulting and advisory fees related to integration execution. Implementation costs include registration fees for canceled and new products, and potential supplemental distributor fees and IT implementation costs. Employee Related costs include cost for severance, retention and relocation. Tax cost are costs set aside to address historical liabilities. Deal costs include Investment banker fees.
Thank you!

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