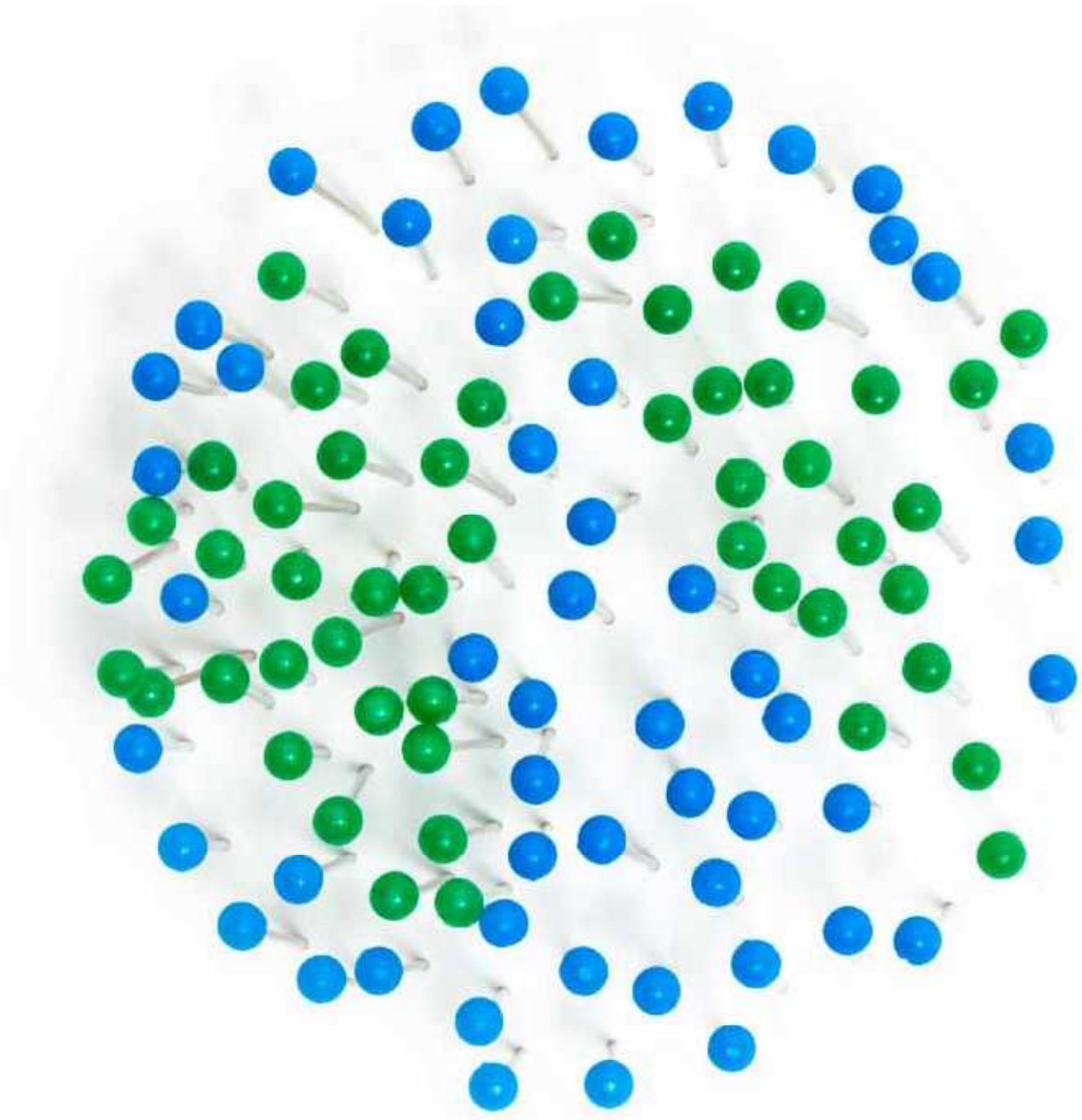
Deloitte.

Devising a blueprint for delivering deal success around the globe



May 2013

Contents

Foreword

Mergers and acquisitions (M&A) have never been more competitive or complicated. As deal makers return to the table with renewed force and as increasing cross-border activity presents new cultural challenges to the deal process, M&A practitioners must develop a repertoire of best practices to ensure that their transactions yield the intended value.

While this is true of all buyers and sellers, acquisitive Japanese companies executing ever more complex transactions within and outside their borders should place particular emphasis on arming themselves with these best practices to make the most of the investments being made. This is especially true as they engage in aggressive, high-value M&A into more mature and sophisticated markets: Japanese corporates saw outbound deal volume increase by 23% and deal value by 52% between 2011 and 2012, according to Mergermarket data. This trend is likely to continue as challenges on the home front – shifting demographics and economic uncertainties – force Japanese companies to venture abroad in search of new growth points, enforcing the need to develop a blueprint of what works best in M&A.

From the boardroom to the negotiating table and through to integration, deal makers, regardless of jurisdiction, must be aware of the tactics and tools needed to not only sign the deal, but merge operations with the acquired business. This includes involving the appropriate leadership in the process, knowing when to consult outside advisers or establish special teams, and conducting thorough due diligence. Best practices and general M&A acumen are absolutely crucial in the post-merger integration (PMI) phase, that critical step where the deal's value is most vulnerable to erosion.

To be most effective both buyers and sellers must find common ground, a goal best accomplished through candor and open communication. Indeed, cultural gaps that inevitably arise when engaging in cross-border M&A can be bridged by ensuring the overall message is received and shared among stakeholders.

To discover best practices in M&A, Deloitte has teamed up with Mergermarket, surveying a pool of M&A practitioners from Japan, the United States and Europe. Respondent insights have helped create a picture of what is needed to see a deal across the finish line, what tactics were effective throughout the process, and where improvements are needed for future M&A.

Methodology

From December 2012 to January 2013, Remark, the publishing division of Mergermarket, canvassed the opinions of 15 M&A practitioners from Japan, 15 from the United States, and 30 from Europe. Respondents in Europe came from the United Kingdom, Germany, France, the Netherlands and Switzerland.

Within graphed survey results, where figures add up to more than 100%, respondents were allowed to choose more than one answer.

Historical data includes all Mergermarket recorded transactions for the period **1 January 2008** to **31 March 2013**.

Transactions with a deal value greater than US$5m are included. If the consideration is undisclosed, Mergermarket will include deals on the basis of a reported or estimated value of over US$5m. If the value is not disclosed, Mergermarket will record a transaction if the target's turnover is greater than US$10m.

Only completed and pending merger and acquisition deals are collated. Transactions to be included will usually involve a controlling stake in a company being transferred between two unrelated parties. In a case where the stake acquired is less than 30% (10% in Asia-Pacific), the deal will only be included if its value is greater than US$100m.

All US$ symbols refer to US dollars unless otherwise stated. All ¥ symbols refer to Japanese Yen unless otherwise stated.

All data quoted is proprietary Mergermarket or Deloitte data unless otherwise stated.

To be most effective both buyers and sellers must find common ground, a goal best accomplished through candor and open communication.

Executive summary

Differences in deal experience

Among survey respondents, those from the United States (US) had the most experience with domestic M&A in the past two years, averaging 5.7 deals each. Their European and Japanese counterparts had completed 2.6 and 1.5 deals each, respectively. For cross-border activity, European respondents had a mean 3.6 deals, with US respondents completing 4.1 transactions and Japanese respondents 1.5 transactions. These figures aligned with macro trends that showed the US leading domestic deal activity, with Europe completing more cross-border transactions.

Building relationships is a necessity

Respondents from each region agreed that building rapport and finding common ground between buyer and seller was critical to completing a successful deal. In most cases, senior executives were involved in the M&A process to lead negotiations and ensure that deals remained on track. European respondents accounted for the largest percent in terms of sending junior staff to take part in the deal process.

Due diligence challenges vary across regions

Respondents agreed that legal compliance issues were the most pressing when it came to due diligence. In most cases, the lack of a comprehensive understanding of the target country's legal and regulatory frameworks came into play, a speed bump that was often overcome with the help of external advisers. Availability of accurate financial and operating data ranked highly among European respondents, with those from the US citing tax exposure as a key challenge. Japanese respondents said managing related party transactions was a recurring problem during their transactions.

Utilizing specialized task forces

Specialized teams were used in varying ways by respondents, although 67% of respondents from the US said these teams were used compared to 33% in Europe and 40% in Japan. Respondents agreed that these teams were essential when conducting cross-border acquisitions and involved input and action from executives and managers from various fields of expertise.

Planning for post-deal

Japanese and US respondents (47% each) said planning for PMI began earlier in the deal process than their European counterparts (40%). This allowed for an easier transition of ownership once the deal was signed. The same percentage of Japanese respondents said that planning began only after the deal was signed. As a result, many of those respondents stated that delayed planning resulted in a slowed PMI and had a negative impact on their transaction.

Diverse challenges to PMI

The largest challenges to PMI among respondents varied across geographies. In the United States, 73% of respondents said cultural and management differences posed the largest stumbling block to the deal, while in Japan, 80% chose internal control issues. European respondents cited both as equally challenging. Regulatory issues also ranked highly among 53% of US respondents, 40% in Japan, and 37% in Europe.

No need to rush

When completing PMI, respondents overwhelmingly chose to take a neutral pace: 87% in the US, 60% in Japan, and 77% in Europe. Many cited the need to strike a balance, or that a hasty or a slow and calculated approach could have a negative impact on the deal. A quick and aggressive approach was taken by a number of respondents, with those from Japan (33%) choosing this method most often, compared to 13% of respondents for both the US and Europe.

Key to success: Communication

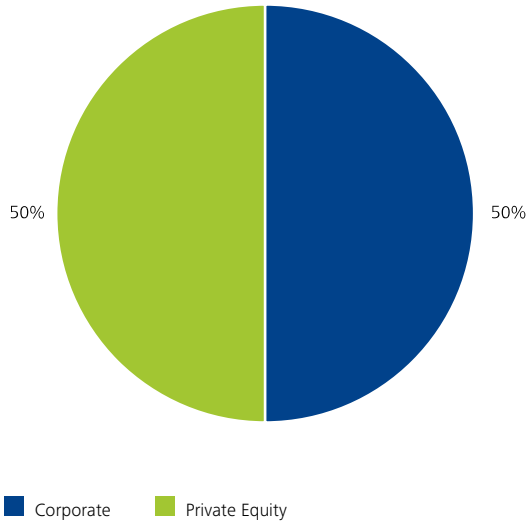
Communicating effectively was the top factor that resulted in M&A success, according to 93% of US respondents, 87% in Japan, and 80% in Europe. Particularly in cross-border deals, respondents noted that open lines of communication helped solidify trust between parties. Communication also helped bring issues to light, ensuring that the deal ran smoothly and on time. Selecting appropriate people for leadership positions also placed highly among respondent answers: 67% in the US, 53% in Japan, and 70% in Europe.

Next time around, focus on due diligence

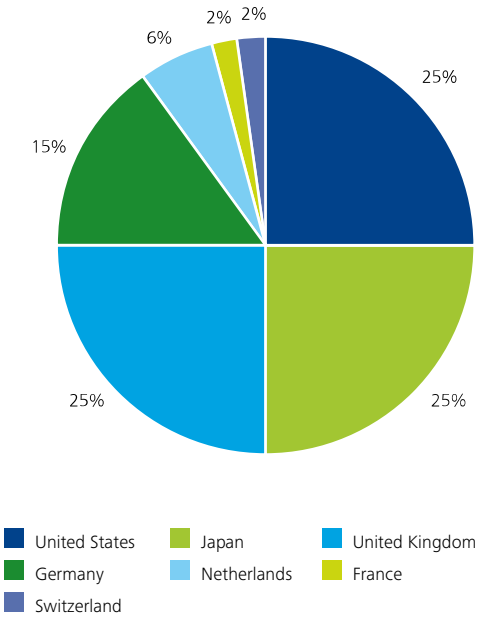
In each geography, respondents said more emphasis should be placed on due diligence in their next deal, according to 40% in the US and Japan and 53% in Europe. A more comprehensive, investigative due diligence could help maintain the deal's value and ensure that all rights were obtained and obligations understood. Respondents also recognized that due diligence was perhaps the most important part of the M&A process and therefore deserved the most attention.

Respondent information

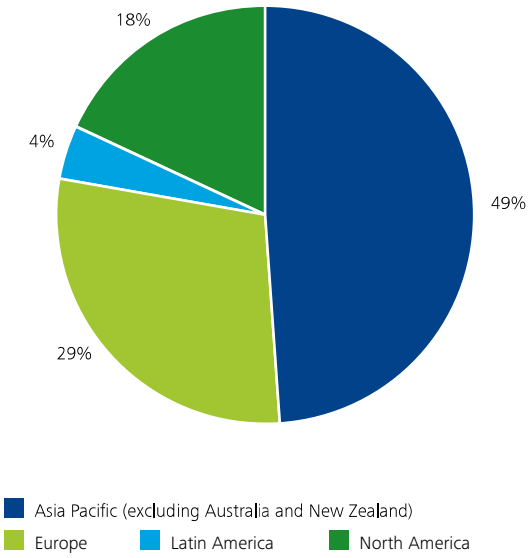
How would you classify your organization?



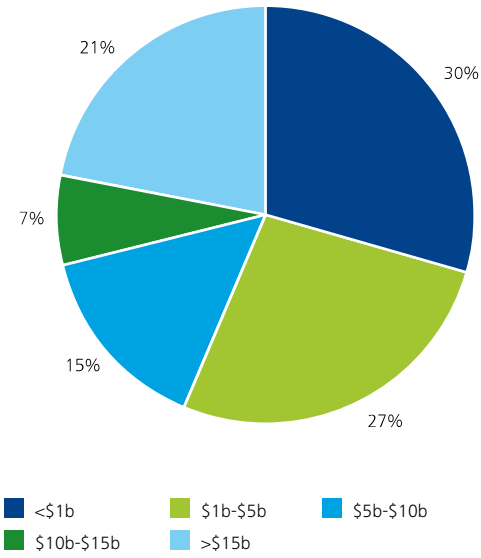
Where is your firm based?



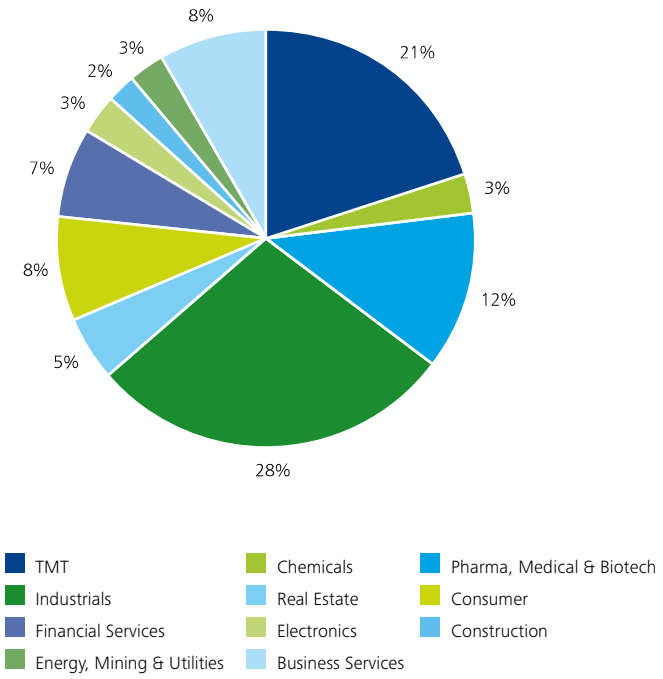
Where was your last cross-border M&A?



What was your company's most recent annual revenue (US$m)?



In which sector is your business most active globally?



Bidder experience

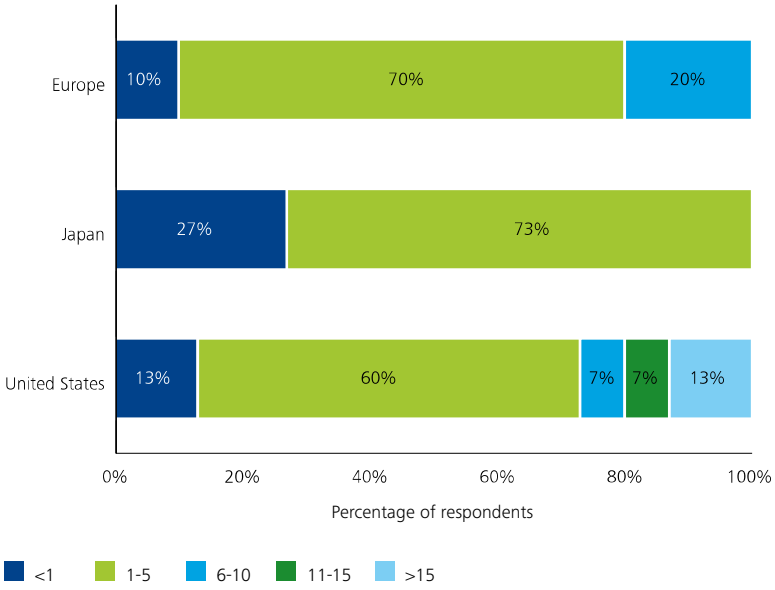
M&A is never easy. Even while undertaking a transaction in domestic markets, numerous challenges stand to derail the deal, resulting in losses to both parties. The stakes are raised considerably when venturing outside one's borders. For players new to the M&A game, those obstacles become even more pressing. While experience will not necessarily guarantee deal success, it certainly arms buyers with one more tool in their box of strategies to see a transaction through to the end.

In terms of domestic deals, respondents in the survey had varying degrees of M&A experience over the past two years. Respondents from the US completed an average 5.7 deals with European respondents completing 2.6 deals. Japanese respondents reported the lowest deal volume, with an average 1.5 deals. On a more macro scale, these trends mirrored survey respondent activity. According to Mergermarket data Japanese businesses completed 643 transactions worth US$135bn in the last two years, much less than deal makers in Europe, which saw 3,169 deals worth US$341bn, and the US, which had 6,224 deals worth US$1.2tn, come to market.

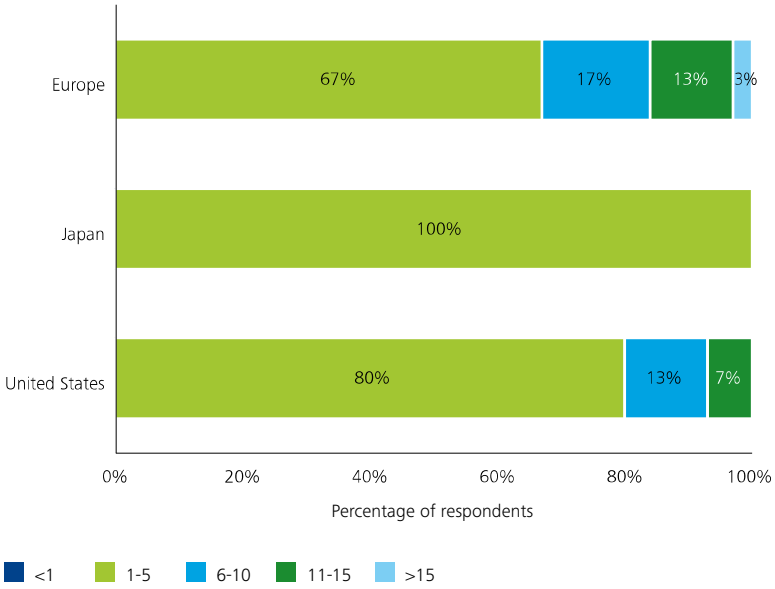
Similarly, for cross-border deals, Japanese respondents reported lower figures, none making more than five transactions since 2011. European and US-based companies, however, were comparatively more acquisitive: US respondents had an average 4.1 deals with European respondents completing an average 3.6. Again, Mergermarket data shows a vast difference in deal volumes across geographies. Japanese companies in total made 447 cross-border transactions worth US$178bn, while European bidders completed 2,418 transactions worth US$341bn with those in the US totaling 2,124 worth US$412bn.

How many deals did your company/firm complete in the last two years?

Domestic deals



Cross-border deals

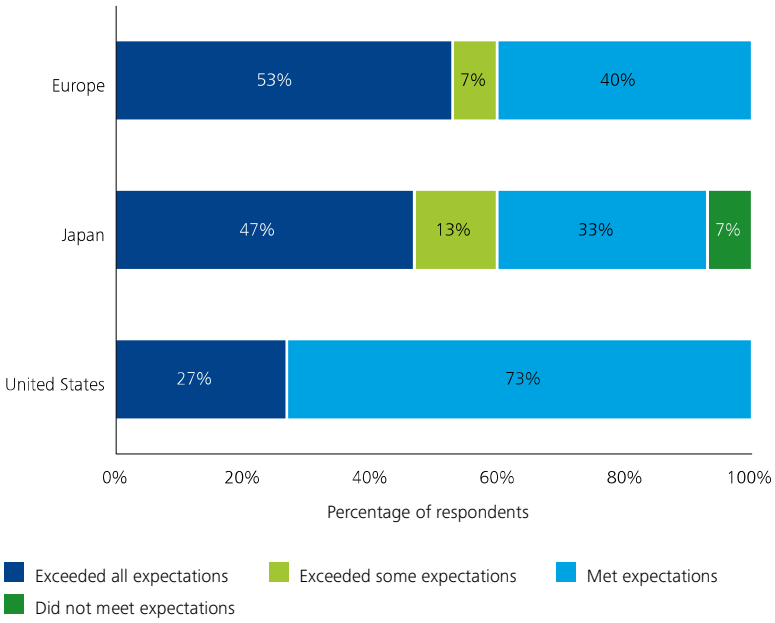


An overwhelming majority of respondents in Japan (47%) and Europe (53%) said their deals over the past two years exceeded expectations, citing various reasons from adequate preparation and timeframes to experience in the target market. A Japanese respondent that completed acquisitions in Germany said, "Our recent acquisition in Germany was strategically important as we wanted to strengthen our global presence and bring new technology and products to that market. The deals were carefully planned and we took ample time identifying targets. It was certainly not easy, but our efforts paid off."

Another respondent, a Japanese private equity investor, described his firm's approach to its acquisition in the US as surgical, with close attention paid to minute details that helped ensure shareholder value was enhanced. According to the respondent, "Our focus on the execution using clear objectives has always ensured that the success of our deals matches expectations."

In Europe, a German respondent that completed an acquisition in Japan said, "Our acquisition followed after years of close relationship building. Business relations with the target were very good and paved the way for an easy and quick transaction."

Please rate the overall successes of your recent deals.



Establishing a deal blueprint helped a number of deals across the last leg of the M&A process, according to respondents. As a result, 87% of US respondents, 73% of Japanese respondents and 83% of European respondents said their transactions met their stated objectives according to a pre-determined timeline.

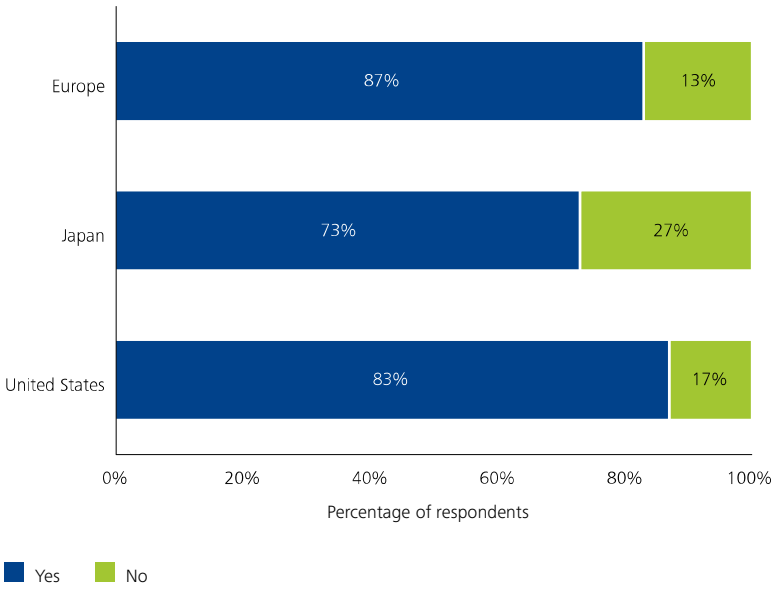
One Japanese respondent who had completed a transaction in Brazil said his company enters new markets by teaming up with local partners, a maneuver that helps increase the pace of the deal. Another Japanese respondent, focused on a South Korean buy, noted that, "We implemented our integration strategy in a tactical way which helped us in completing the acquisition on time without affecting the value of the deal. It's all about how we prepared from day one of the transaction, identifying the critical tasks as early as possible."

Communication and effective leadership were also key to completing deals on time, according to many respondents. "We did not provide any opportunity for confusion or misunderstandings to hinder the deal. Thus, we always promptly discussed issues as they arose," said a Japanese corporate investing in the US.

Deals, however, did not always stick to established timeframes. Respondents cited several reasons for these delays, from macroeconomic uncertainty and regulatory issues to poor planning and mismanagement. In some cases, too much time was spent on finalizing the deal terms and completing negotiations, ultimately destroying the underlying objectives of the deal.

Across geographies, however, valuation issues played heavily in delaying the deal. In one instance, a Japanese corporate completing a transaction in Singapore said, "We did not want to go ahead with the deal without peace of mind or in a state of confusion about whether the price we are paying is right for the current market."

Did your recent M&A transactions meet their stated objectives within a pre-determined timeframe?



Doing due diligence right

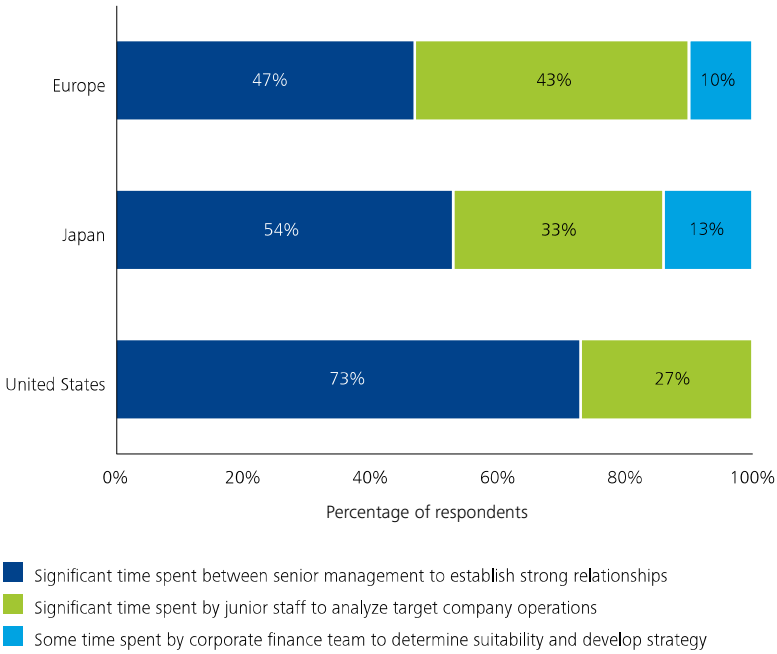
The current competitive market has made it more difficult to source targets and see M&As through to completion. Building a relationship with the target ahead of time can help pave the way for a successful M&A and PMI. Indeed, extra time spent with the target's management and developing a multi-dimensional understanding of their position can benefit both parties in the long term.

According to a large percentage of respondents from the US (73%), Japan (53%) and Europe (47%), a considerable amount of time was spent between senior management at both companies. One Japanese respondent said senior management was used because they "can efficiently identify the potential sources of value creation from the deal and can create an impact on the target's management which greatly increases the probability of the success of the deal. Establishing a commanding relationship is easier when the senior management is involved directly."

These answers stand in contrast to wider trends among Japanese corporates, which have at times sent executives who may not hold the final authority to important negotiations. When prompt decision making is required, these executives must report back to their superiors, resulting in lost time, according to Mergermarket intelligence. Similarly, convoluted chains of command can obstruct deal procedures, with personnel involved in negotiations given different instructions on how to proceed.

For European respondents, a German respondent said it was essential for senior management to spend time directly with the target and its management, citing that it is the most effective way to understand the target and find common ground. The respondent continued, "It significantly reduces the time between the stages of the deal and makes communication more effective as time taken to make decisions across the chain is cut."

How much time and to what extent does your organization spend with the target company prior to acquisition?



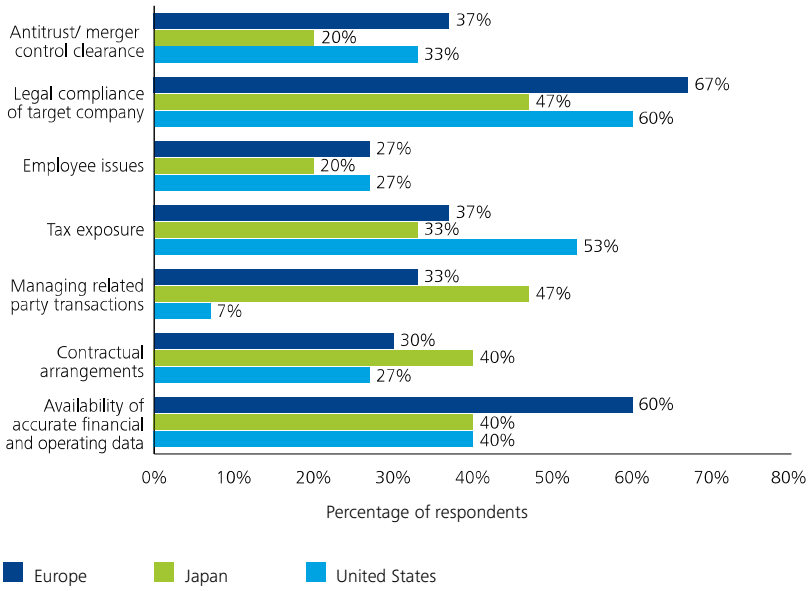
Due diligence is an important part of the process for identifying assets included in the transaction while bringing to light potential problems or inconsistencies within the target company. Respondents from each region most often cited legal compliance of the target company as the biggest due diligence challenge. In most cases, respondents turned to local legal advisors to overcome this obstacle.

Respondents also cited the availability, or lack thereof, of accurate financial and operating data as a potential stumbling block, with 60% of European respondents and 40% from Japan and the US saying this was a major challenge. A Japanese respondent making an acquisition in China said his company conducted due diligence until they were satisfied with the results and were certain the figures were not doctored. Another respondent, a German investor that had completed a transaction in Japan, described a sophisticated due diligence approach to ensure that decisions were made based on the most accurate information. "We prioritized our due diligence work and focused our search. Our due diligence teams were made up of a broad group of accounting, legal, operational, regulatory, industry and other relevant experts."

Japanese respondents cited managing related party transactions among the highest due diligence priorities. One such respondent said, "Related party transactions are diverse and often complex making them a severe corporate governance challenge and for any big transaction it becomes even more challenging. The only solution is to take and spend time in understanding the company in detail and identifying the parties and their interests."

Tax exposure arose as a challenge among 53% of US respondents, a hurdle they overcame by using external advisors and local professionals with expertise in the target company's jurisdiction.

What were the key due diligence challenges you faced while conducting M&A?



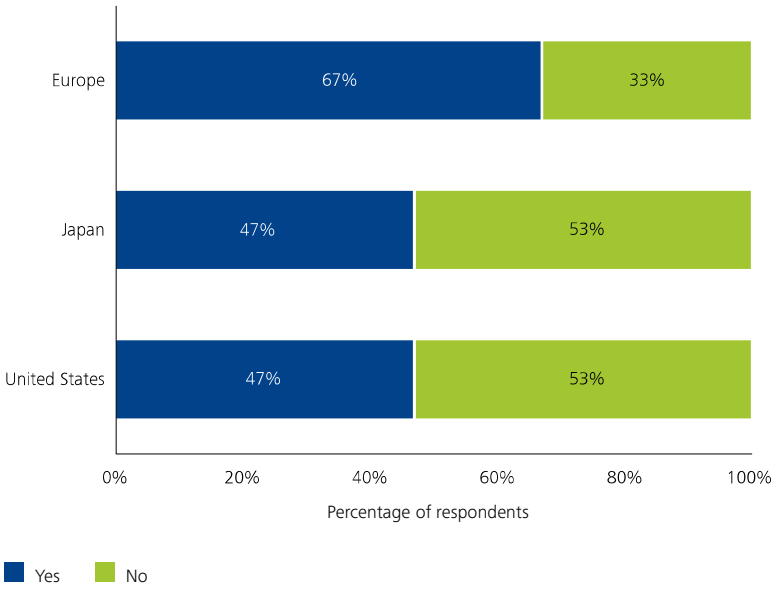
One of the challenges investors face is knowing when to pull out of a bad transaction, a problem exacerbated by the amount of time and resources that may have already been committed to the deal. Yet, being able to walk away is a seal of M&A sophistication.

Fewer than half of respondents from the US and Japan (47% each) said they were willing to abandon a deal if unattractive elements arose. One Japanese respondent who had completed a transaction in the US said, the "outcome of the deal would significantly affect our position in the market and create or destroy our reputation as a successful investment manager. Thus we try to get through the deal by overcoming any unattractive elements." A number of Japanese respondents who answered "No" cited intricate plans and relationship building prior to the deal that prevented the deal from reaching a point of collapse. Few, however, elaborated on scenario planning for an exit strategy from the deal process should problems arise.

Other Japanese respondents described their willingness to walk away, with one saying that while this kind of situation had yet to arise "if we did find any sort of unattractive elements at any stage of the deal we would prefer to pull out. It's too much of a burden to carry on with the deal especially knowing that the deal will yield no real value."

European respondents (67%) most often said they would back out of a deal upon the discovery of discrepancies. A German buyer said, "We will not hesitate to call off a deal if we find unattractive elements or unusual practices even late in the M&A process. Any sign of fictitious records is enough for us to walk away." Other European respondents shared similar aversions to unnecessary risk. A UK respondent said, "Our objective in any deal is to improve financial results and shareholder value and during the deal if we find out that because of unattractive elements we will not be able to meet our objective we would certainly walk away from the deal."

Was your organization willing to walk away from a deal if unattractive elements were discovered, even if late in the M&A process?



Pre-closing and planning for post-merger

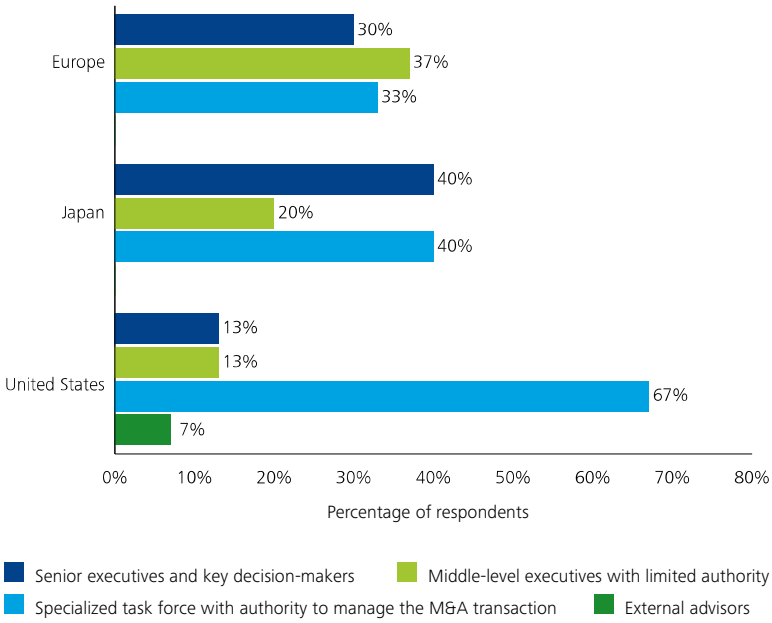
Japanese respondents said senior executives and key decision-makers (40%) as well as a specialized task force (40%) were used during their recent M&As. The fact that Japanese respondents were evenly split shows a shift away from the traditional top-down management structure of Japanese corporate culture in favor of a more diversified approach.

One Japanese respondent highlighted this practice, saying a special task force is a "must to perform day-to-day work. Our specialized task force includes executives with experience from all fields so that there is adequate internal control." Another Japanese respondent also said that a specialized task force is essential, especially when conducting cross-border M&A. Senior decision-makers, the respondent said, cannot be bothered with the M&A deal's basic issues since they have greater responsibilities to deal with – a specialized team can complete these tasks more efficiently.

European respondents were evenly split, citing that senior executives (30% of respondents), mid-level executives (37%) and a special team (33%) were used in their recent M&As.

These responses stand in stark contrast to US respondents (67%) who overwhelming stated that a specialized task force was used. US respondents were also the only ones who said external advisors were utilized to support their M&As. One US respondent that had completed an investment in the Czech Republic said external advisors were used to attain accurate financial and legal information. According to the respondent, "Often the challenges come when there is no proper governance system and access to informatoin is limited. Also the language barrier is a major issue in acquiring information. In these instances it is the advisors who are helpful in getting all the information about the target."

Who performs the day-to-day work at your company to support the M&A deal processes?

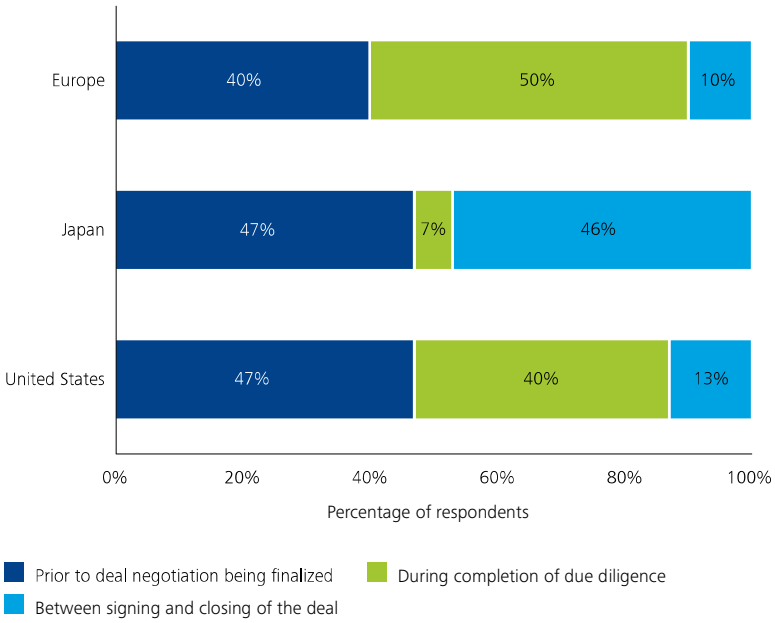


Deciding on when to start planning PMI is key to untapping a deal's full value. Although 47% of Japanese respondents stated they began laying the groundwork for PMI prior to deal negotiations being finalized, a similar 47% expressed a preference for waiting until later in the deal process to begin planning.

One Japanese respondent said in the current volatile market, many deals fail during negotiations or when finalizing the deal terms, "thus we prefer to start PMI planning once the deal is finalized and about to be signed. This gives us enough time and we are also free from the concern that resrouces would be wasted if the deal fails during negotiations." Another Japanese respondent, also citing the competitive environment as a reason to delay planning, said a deal cannot be termed "complete" and fit for integration until a contract is signed and the deal closed. According to that respondent, "PMI is a complex process which needs complete focus and attention so we prefer to start integration after the deal is signed so that we can completely focus on integration."

Respondents from the US and UK, on the other hand, were keen to start PMI sooner, with 87% of US respondents and 90% of European respondents doing so before the deal was signed. A respondent from the UK said, "We started PMI planning after the due diligence phase. Early planning helps in gaining all the critical information required for integration so that after due diligence when all the necessary approvals are obtained we can begin integration immediately rather than spending a lot of time waiting to gather the necessary data and making critical decisions in a rush."

When did post-integration planning begin in your last few M&A transactions?

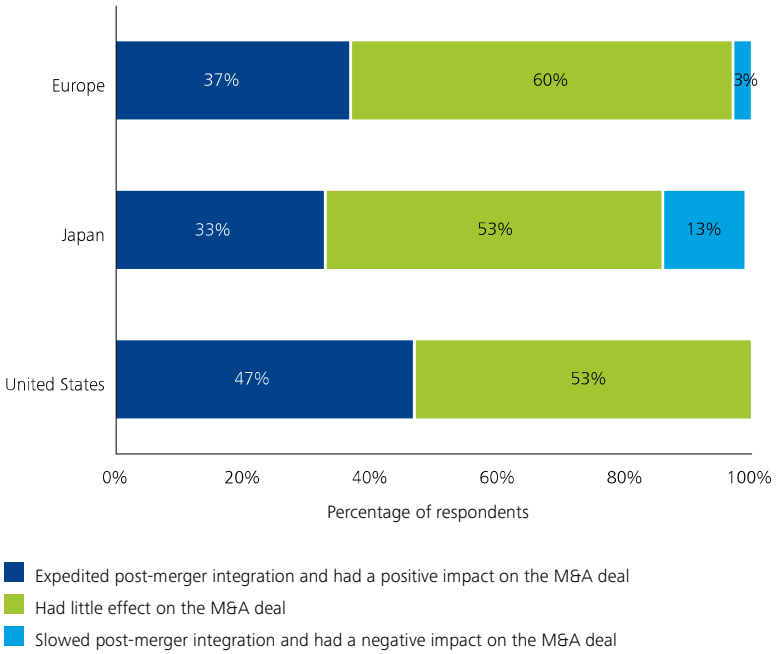


Of respondents, those from Japan (13%) were among the highest percentage of respondents who said that conducting post-integration planning at their chosen time, often later in the deal process, slowed the post-merger phase and had a negative impact on their transaction. Those respondents admitted that planning should have started sooner, and noted that value may have been lost due to the delay.

According to 47% of respondents from the US and 37% of respondents from Europe, moving along with planning sooner than their Japanese counterparts actually expedited PMI. Only 3% of all European respondents said that their chosen time to initiate PMI planning slowed the process or had a negative effect on the deal.

Most European and US respondents were quick to move onto this planning phase after due diligence revealed few risks. "With the positive outcome of the due diligence phase we were confident that we will not back out of the deal and so we immediately looked to start the integration process," said a respondent from the US who had recently conducted an M&A in Japan. A German respondent echoed this response, adding that delays in PMI can result in value erosion. "In many instances these delays are hard to recover from and the realization of benefits never happens. Thus if the PMI happens on time and the completion goes as planned, this maintains the business flow and increases the value of the deal."

What was the effect of conducting planning at the chosen time (based on your previous answer) on the post-merger integration process and overall M&A deal?



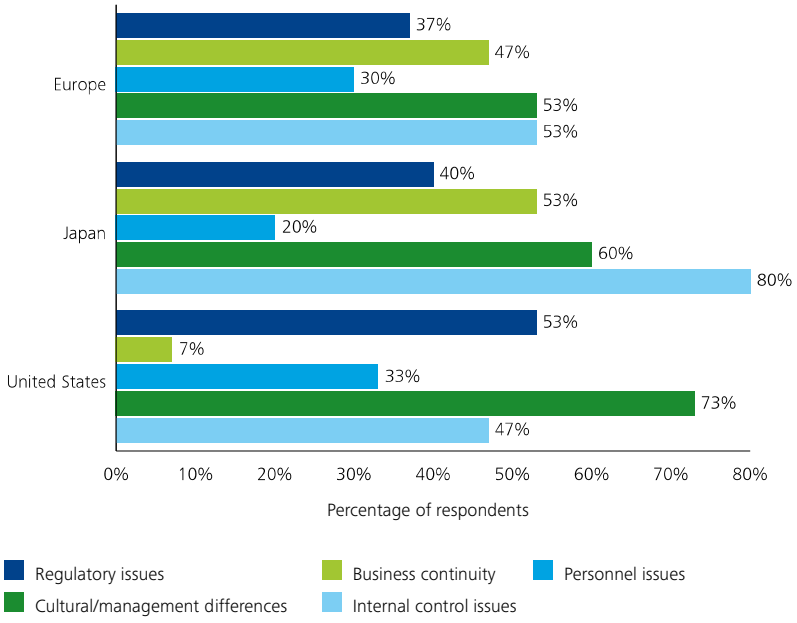
Making mergers that last

An M&A brings two distinct cultures, be it national or corporate, face to face. While various challenges can cause disagreements between parties in the deal or force delays in integration, respondents cited cultural issues as one of the biggest obstacles. Among respondents from the US, 73% chose these cultural obstacles as the largest challenge to PMI; 53% of respondents in Europe chose the same option.

Respondents from Japan said internal control issues (80%) and cultural and management differences (60%) were the largest challenges to integration.

According to one Japanese respondent, despite globalization, cultural issues are still a major challenge. Language differences, lifestyle, attitudes toward work, among others, all have a major impact during the integration. "To overcome these challenges it becomes a necessity to use local managers and give them enough authority," the respondent continued. Another Japanese respondent echoed this belief, saying "The most difficult part of integration is managing the cultural differences and bringing the two different teams together. Changing the attitude and work culture of one company to match with the other is an extremely difficult task."

What are the key challenges you faced in integrating acquired companies post-merger?

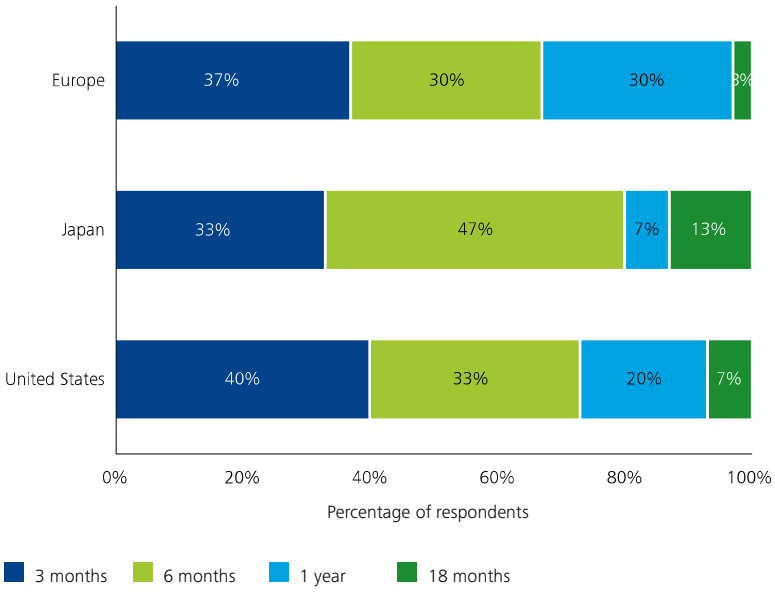


Integrating business cultures and the attitudes of acquired employees and management takes time. A higher proportion of Japanese respondents said their transactions took up to 18 months to complete, respondents that also started later in their post-integration planning.

According to Mergermarket intelligence, Japanese companies conducting M&A are slower to start the PMI process compared to acquirers in other countries such as the US and UK, resulting in value diminution of potential deal synergies. Delayed starts to PMI and the lack of a standard procedural platform are contributing factors, trends that companies may need to further consider to more effectively realize the value of potential synergies from their acquisitions.

Respondents from Europe and the US said that resolving issues early in the process allowed them to gain control of their acquired assets and effectively integrate the two companies. While scale and regulatory complications delayed parts of the deal, these respondents agreed that adequate planning helped alleviate strains later in the deal process.

How long does it take to get control of key issues post deal?



While a larger proportion of Japanese respondents (33%) said they pursued an aggressive approach to PMI, a number of those respondents said this speed was taken without adequate planning, in something of a last ditch effort to get the deal moving forward. Some respondents later realized a more neutral approach should have been taken.

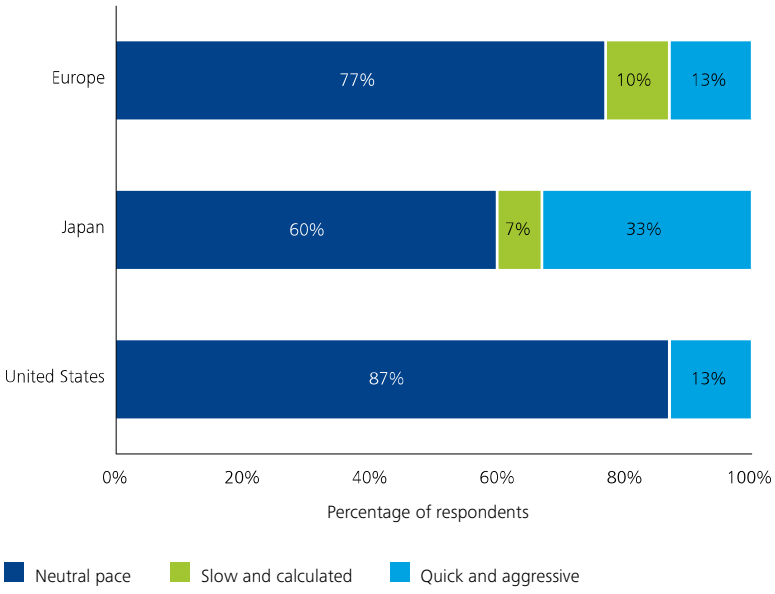
Other companies in Asia-Pacific, such as those in India or China, are more aggressive in driving integration, similar to Western-style PMI. Chinese competitors engaged in M&A with Japanese corporates also tend to have quicker decision-making processes, according to Mergermarket intelligence.

Most Japanese respondents preferred a neutral pace (60%) to PMI. Many deals reach roadblocks during PMI, leading to the company losing face or even experiencing value erosion. After the acquisition has been complete, PMI should be a calculated process conducted by clearly identifying and prioritizing tasks, one respondent said, going on to note that "PMI is a very important part of a successful M&A deal but if done with negligence it can prove to be disastrous."

Similarly, most deal-makers in the US (87% of respondents) and Europe (77%) preferred a neutral pace and said PMI needed to be more controlled. "A pace that is too slow or too fast will result in failure. Integration is equally complex and an important stage of M&A. A great deal of effort and understanding is needed, and this of course takes time. But if integration is done too slow then it starts affecting production as a considerable amount of resources are wasted," said one US respondent.

Only 10% of European respondents, all of whom were from Germany, and 7% of Japanese respondents preferred a slow, calculated approach to PMI. This methodical approach was used so that the integration team could ensure every issue was thoroughly addressed, providing a strong adhesive for the combination of companies, according to a German respondent.

What kind of emphasis was placed on completing post-merger integration?

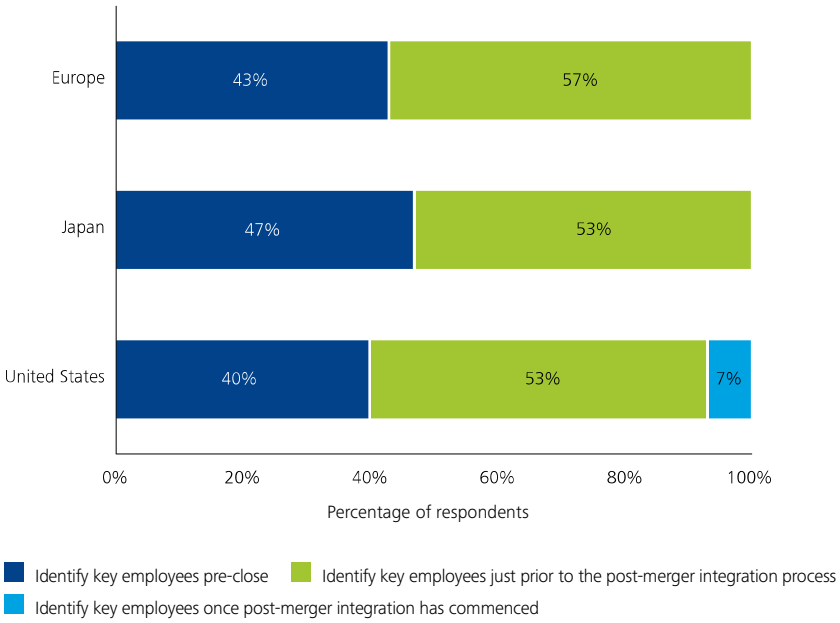


Retaining key employees, particularly managers familiar with daily operations, is critical for business continuity, therefore it is essential to identify key employees to retain in the new merged entity as soon as possible. Successful buyers will enable leaders from the acquired company to play a visible and active role, address and manage cultural differences, and develop an effective communication strategy.

US, European and Japanese respondents agreed that identifying key employees before the PMI phase was vital to business continuity. Only a small percent of US respondents (7%) waited until PMI had begun to start the retention process. A Japanese respondent that had completed an acquisition in the US said, "HR issues are the most difficult to manage during PMI and thus it is important for the company to identify these key employees so that the company can understand their capabilities and define their role in the new acquired entity."

Waiting until after PMI to identify key staff leaves ample opportunity for these employees to leave the company, according to a respondent from the Netherlands. These employees, experienced and able to work within the acquired company's frameworks, add value to the merger in that they can assist with the integration process and help maintain corporate functions.

What has been your typical approach to employee and management retention during the deal process?

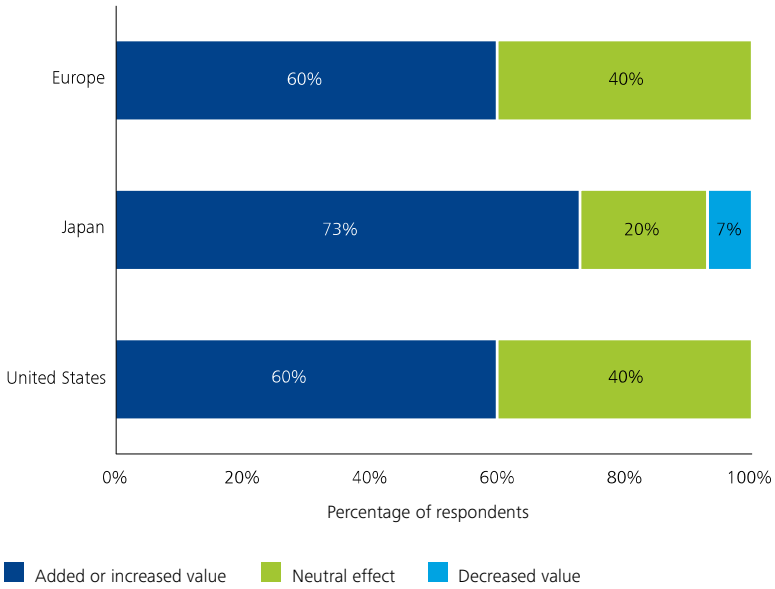


Respondents overwhelmingly agreed that their recent deals added or increased value for their companies. Only one Japanese respondent answered otherwise, and that respondent had also cited delays earlier in the negotiation process that negatively affected the deal. A German respondent noted, "The success factor for our transactions was our ability to quickly integrate the acquired entities into an organization and since we did this successfully in our recent deals they have added value to our company."

The reasons M&A deals lose their value are as numerous and diverse as the deals themselves. A number of German respondents said poor or incomplete planning and delayed implementation can lead deals to sour. An inability to quickly identify all the potential areas of synergy, particularly where the newly merged organization can achieve substantial cost savings, was another reason.

Japanese respondents (7%) cited inexperienced practitioners in the deal room as one reason for decreased value or deal failure. Lack of communication eventually could lead to lack of cooperation between parties. Similarly, identifying and choosing targets with comparable strategies and goals can be the difference in making or breaking a deal. As one Japanese respondent notes, "Not any company can be acquired just because they are in the same business. The thinking should be alike for the buyer and the seller."

What was the effect of the overall deal on your company?



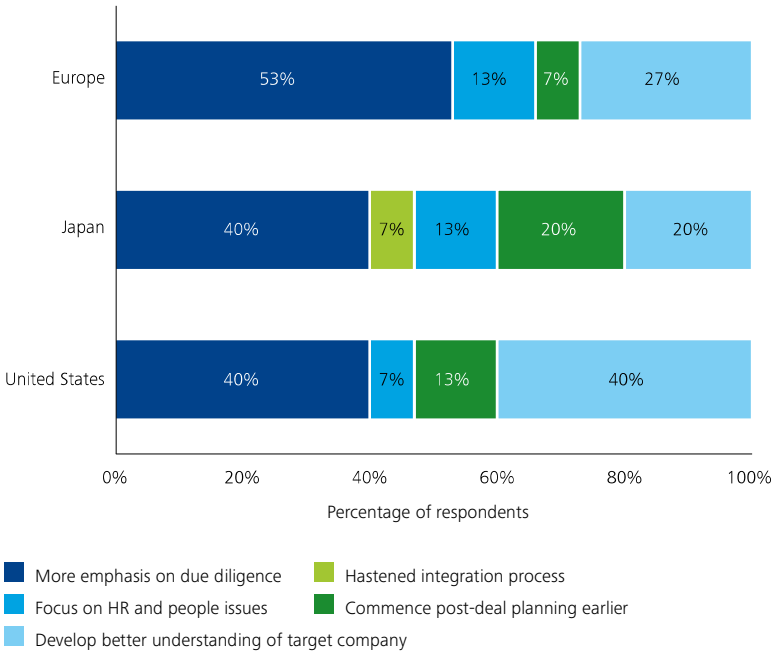
Respondents in the US and Japan (40% each) and those in Europe (53%) agreed that more emphasis was needed on due diligence, a change they would make in their next acquisition. Japanese respondents recognized that conducting an M&A deal itself is a major undertaking and if the deal is completed without conducting due diligence properly then the success of the deal will be minimal. Indeed, performing a complete and accurate investigation cannot be understated as the due diligence process will help keep the deal's value intact as the acquisition moves forward.

European respondents noted that ensuring a smooth integration depends on identifying, prioritizing and measuring synergies long before the deal goes through. According to a Netherlands-based respondent, "We understand that succeeding in maximizing long term value relies on integration planning at the due diligence stage." Indeed, according to Mergermarket sources, PMI planning should be done in parallel with due diligence. This will allow the acquiring firm to hit the ground running when the deal closes.

Respondents in Japan also thought commencing post-deal planning earlier (20%) in the M&A process would help expedite integration and smooth over the transition in ownership. A head start would allow M&A practitioners to not only plan for short-term issues, such as keeping the business running, but also long-term goals, including transforming the newly created entity into a successful and profitable venture.

A high percentage of US respondents (40%) said developing a better understanding of the target company would take priority in future M&As, a thought shared by 20% of Japanese respondents and 27% of European respondents. Elaborating on this decision, a German respondent said this approach would allow his company to determine if future acquisitions were a good "fit" and worth investing in, and if it could help drive the company's overall strategy.

What would you do different in your next deal?



Interestingly, Japanese respondents were the only ones who said they would try to hasten the integration process (7%) in their next M&A, a divergence from the established trend where Japanese corporates are generally more measured and meticulous with PMI. Emphasizing speed over precision would prove useful, particularly in cross-border M&A involving employees from different cultural backgrounds, since the costs of delay may exceed the costs of errors in judgment or outright mistakes. Expediting PMI may also help optimize deal synergies and provide impetus for future deals.

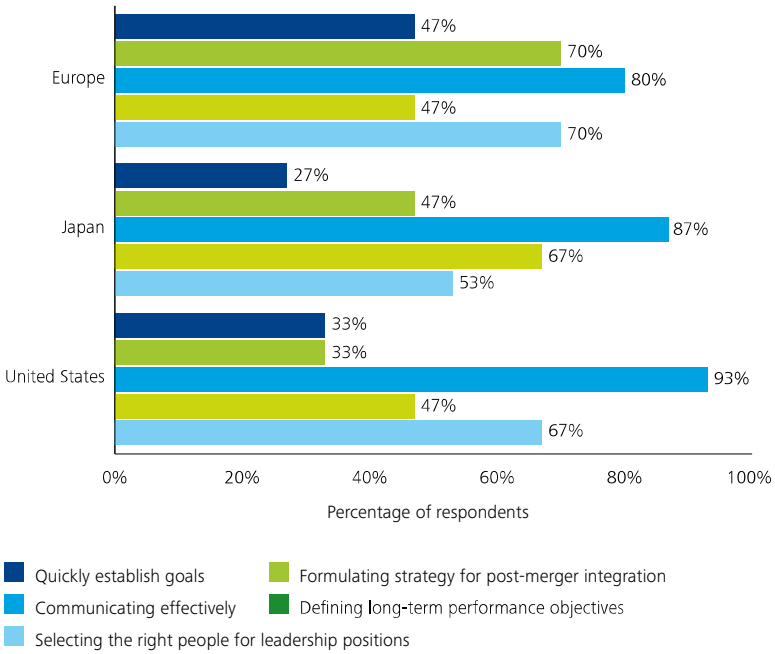
Lessons learned and best practices

Deal-makers across geographies said effective communication – rated by more than 80% of respondents in each region – was critical to their last deal success. Emphasizing communication helped create a rapport between buyers and sellers, ensuring that integration ran smoothly, and narrowed the space for misunderstandings. One Japanese respondent said that communication with all key stakeholders kept his last deal on track, yielding long-term benefits. Communication between parties can also assist in establishing a common vision for the merged entity in addition to mitigating the chance for miscommunication or mixed signals during the deal.

About 67% of Japanese respondents said defining long-term performance objectives, and close to 53% said selecting effective leadership were key to their deal success. "An acquisition or merger needs a strong leader. The leader must have the authority to make triage decisions, coordinate taskforces and set the pace. The individual chosen by us was strong on strategy and content," according to another Japanese respondent.

Formulating strategy for post-merger integration and selecting the right leadership were chosen by 70% of European respondents. While US respondents agreed that leadership selection was critical to their last M&A's (67%) only 33% said formulating PMI strategy was a crucial factor.

Which of the following were critical to your last M&A's success?



Post-merger integration: Getting the right results

Post-merger integration has proven to be a stumbling block for some Japanese corporations. As these corporations become more adventurous in their M&A endeavors, they will need to develop better strategies for the integration process. To discuss Japanese integration trends, the pitfalls these companies face, and methods of improving the process, Mergermarket spoke with Hideo Matsue, Partner, Deloitte Tohmatsu Consulting.

After months of negotiating, the deal is signed and another Japanese company becomes the proud owner of an overseas business. If finding common ground with the seller and conducting thorough due diligence weren't challenging enough, now comes the phase that will determine if value is created or destroyed: post-merger integration (PMI).

The combination of a strong Yen, competition on the home front and a desire to strengthen their overseas operations is driving Japanese corporate ambitions to expand abroad. This renewed vigor, following a lull in outbound activity prior to the financial crisis, has seen Japanese corporations make significant buys. But while Japanese corporate acquirers may have the financial means to reach beyond their borders, when it comes to integrating their buys with the rest of their macro-operations challenges remain.

The challenge to integrate is exacerbated by corporate cultural differences and language barriers between buyer and seller. While acquisitive Japanese companies continue to perfect their approach to PMI, many have already picked up best practices, says Deloitte Tohmatsu Consulting Partner Hideo Matsue.

Buyer concerns

PMI is about getting results, so it comes as no surprise that Japanese acquirers are most anxious about how to yield the full value of their deals. This is especially true as many Japanese corporations feel they are not getting the returns they expected based on how much they have paid for their acquisitions. When it comes to overseas acquisitions, these concerns only continue to grow.

Overcoming cultural management differences stands as one of the biggest obstacles facing acquisitive Japanese corporations. One of the reasons for this, Matsue points out, is that Japanese buyers often designate insufficient human resources to the integration process. This is especially crucial in cross-border M&A, and Japanese companies should be more willing to commit management and employees at all levels to the deal to alleviate any tension or cultural misunderstandings that may arise. For instance, one Japanese company assigned more than 300 people to be involved in the PMI process for a significant acquisition. The move showed the company was serious about the acquisition and willing to commit more than enough resources to effectively complete the acquisition.

Language barriers and a lack of company talent experienced in M&A is another area of concern. Since Japanese companies tend to have less experience in M&A, domestically and in cross-border as compared to their Western peers, they also may have less staff armed with the same high-level know-how to guide the transaction. To compensate for this dearth of experience, Matsue suggests Japanese acquirers improve their M&A acumen by learning lessons from compatriot companies or conducting on-the-ground research in the target jurisdiction. In this way, Japanese acquirers can develop a firsthand sense of the challenges facing the target company and start developing a relationship with target management in the run-up to PMI.

> Planning for PMI should start prior to or during due diligence. This leaves adequate time to chart a safe course for integration once the deal is completed.

Plan early, succeed often

Ideally, planning for PMI should start prior to or during due diligence. This leaves adequate time to chart a safe course for integration once the deal is completed. In most cases, this proves to be wishful thinking – decision-makers are often too busy ironing out the many details of the deal to allocate resources to PMI before the deal is completed. Similarly, many Japanese acquirers are apprehensive

> While M&A is a process, the actual deal is about the people involved. Retaining key employees post-merger and appointing the right people in decision-making positions plays a crucial part in a successful deal.

to focus on PMI until negotiations wrap up. Past deal collapses have taught many M&A practitioners to be cautious until it's more certain the deal will be completed.

And yet, the benefits to planning early are obvious. Developing a sound PMI strategy in earlier parts of the M&A timeline can actually improve and expedite the negotiation process. Issues can be properly addressed in advance and questions raised of target management. A clear vision for the merged companies can be presented to alleviate possible concerns among management and staff at the target company, Matsue says.

The pace with which PMI should be carried out also needs to be considered. Integration planning should be carried out swiftly, taking into consideration ideas from both parties. The integration process itself should be completed carefully, with time taken to understand cultural differences and allow for all parties' voices to be heard.

Matsue also suggests that companies consider using a chief integration officer (CIO) to assist with planning and to lead the integration process. Even experienced M&A practitioners are able to learn lessons from a CIO that may be implemented in future transactions.

The human side of PMI

While M&A is a process, the actual deal is about the people involved. Retaining key employees post-merger and appointing the right people in decision-making positions plays a crucial part in a successful deal. To effectively engage employees, and entice them to stay, open lines of communication are essential, as is a certain degree of candor to assuage fears of downsizing or business relocation.

Human resources and managing human capital can be a somewhat perplexing process for the inexperienced Japanese acquirer, especially when engaging in cross-border M&A. Incentive packages and bonuses, not to mention benefits packages, often differ wildly between Japanese and foreign companies. The expenses from these components of a foreign business can add up quickly, and Japanese buyers need to be aware of regulations and expectations in foreign jurisdictions, Matsue notes.

In the long-term, however, retaining key management, even at a hefty price, will prove invaluable. Oftentimes, the acquired staff, perhaps acquirers themselves in previous buys, can provide insight into how to conduct effective M&A and PMI.

Integration around the world

For many Japanese corporates, the decision-making process is a middle-up approach involving considerable consensus building. In general, the process lacks transparency, and once a decision is made it can be difficult to undo, Matsue says. Additionally, the representative sent to negotiate with management at the target company may not wield the authority to make decisions, but rather may be expected to relay information back to upper management before being sent back to the deal table, which tends to delay the negotiation process.

This is changing, albeit slowly, but already Japanese corporations have a myriad of examples from around the world in which to draw best practices in PMI. While sometimes aggressive deal-makers, acquirers from the US tend to be quick to put together special task forces when conducting M&A. This has proved useful when arriving at the PMI phase, as the specialized teams reinforce the integration process. The use of external advisors also helps integrate parties involved in cross-border M&A.

In Germany and other European countries, companies will sometimes acquire minority stakes in targets to start a relationship. Japanese companies also take this approach. Later, when a larger deal is in the works, this helps in allowing for a smoother integration process.

Relationship-building also helps the target get a better understanding of how the buyer operates and if the two would be a good "fit".

Asia-Pacific acquirers, too, have developed sound strategies for PMI. Indian buyers are known to engage in pre-deal socializing to develop a rapport with target management, a practice that builds trust between parties and allows PMI to be conducted more quickly and efficiently, according to Mergermarket intelligence. These buyers have also been known to leave business operations at acquired companies in place. For example, when Tata Motors bought Jaguar Land Rover in 2008, Tata Motors allowed management at the acquired company to remain in place and conduct business as usual. A similar approach was taken by South Korean Doosan Infracore when it bought construction vehicle maker Bobcat in 2007.

Indeed, noteworthy best practices exist for M&A practitioners to implement and expand upon, tools that will invariably help acquirers as they embark on cross-border forays. While no two acquisitions are alike, these lessons, matched with personal experience, can help acquisitive corporates across the world perfect the art of PMI.

Making the Cut: Yielding Value from Carve-outs

To highlight the process and value-creating prospects of carve-outs as an effective M&A strategy, as well as carve-out trends among Japanese corporations, Mergermarket spoke with Tadashi Kubo, Partner, Deloitte Tohmatsu Financial Advisory M&A Transaction Services, and Patrick Shearer, Executive Officer, Deloitte Tohmatsu Financial Advisory M&A Transaction Services.

Be it removing a non-core asset or disposing of a distressed business unit, the carve-out is an effective tool for surgically removing and selling one or many divisions within a company. The post-financial crisis world saw a huge uptick in carve-outs as companies struggling to make ends meet disposed of non-core or underperforming operations. Today, however, the tactic is being used to meet strategic corporate goals as opposed to simply being a means of financial survival.

From the United States to Europe and even in Asia-Pacific, carve-out and divestiture activity has improved markedly since 2009, with Mergermarket data showing deal values increasing across the world. In Japan, divestiture activities has been somewhat muted in comparison, however, Japanese corporates have shown increasing interest in carve-outs to reinvigorate value creation within their businesses, notes Tadashi Kubo, M&A Partner at Deloitte Tohmatsu Financial Advisory M&A Transaction Services.

Carve-outs, advises Patrick Shearer, Executive Officer for Deloitte Tohmatsu Financial Advisory M&A Transaction Services, are complex and can impact various aspects of both the seller as well as the business being carved-out. Given the complexity, it is critical for a company to have a clearly defined carve-out strategy to maximize value from such a transaction.

Rewards of divesting

The benefits of completing a carve-out are manifold, foremost of which are financial rewards. According to Mergermarket data, divestments and carve-outs yielded monetary gains worth US$47.9bn in the US, US$32.7bn in Western Europe, and US$7.9bn in Asia-Pacific, including Japan, in 2012.

Aside from generating cash, carve-outs can also help reduce net debt and shed non-core or underperforming assets while allowing a corporation to focus on its core operations. Proceeds from carve-out transactions also allow the seller to invest in higher-growth businesses, explains Shearer.

For the buyer, carve-outs are an equally attractive opportunity to create value. Rather than purchasing an entire company, carve-outs present smaller, neatly-packaged business units that can provide a performance-enhancing boost to the purchasing company's operations.

"Buyers looking for something very specific can often times go in and acquire what they want in carve-out transactions without worrying about the overhead of a larger corporate entity," says Shearer. "We've seen a number of situations where companies buy a carved-out business unit that was underperforming and then turn it around and make it more profitable than it was within its larger parent company."

Ensuring a clean cut

A well-planned blueprint for conducting the carve-out is essential. This is true for any organization and especially so for companies that have little or no experience in completing carve-out transactions.

"It really starts at the beginning, with a company having a process for deciding what businesses fit within the longer term corporate strategy and those that do not. In essence, deciding on what's core and what's not core to its operations," says Shearer. "It is often very difficult since some of these entities are so embedded within the larger corporation that a systematic process is necessary to assess the business on a stand-alone basis including operational, financial, information systems, human resources, legal and other key aspects of a business."

There are certain preparations a company can take, often referred to as "sell-side" diligence, that can enhance a company's carve-out process. Given the complexity and labor intensive nature of carve-outs, companies should ask themselves what external resources (e.g., accountants, legal, consultants) are needed to supplement the internal leadership team guiding the company through this challenging corporate event. One of the key benefits of performing sell-side diligence early on is identifying problem areas and devising plans to mitigate the identified areas before these are brought to a seller's attention by a potential buyer.

In addition to determining which aspects of the business will need to be provided by a buyer post-transaction, it is critical for sellers to provide the assumptions used in creating the carve-out stand-alone financial statements. Buyers especially appreciate having the benefit of seller provided third-party cost estimates for functions currently provided by the seller that buyer will need to replace post-acquisition. "Identifying potential synergies that could be attained by the buyer after the acquisition also benefits the seller in the form of a potentially higher deal price", Kubo notes.

Japanese carve-out trends

Driven by the need to focus on core operations, strengthen balance sheets, and raise capital, carve-outs are becoming more popular among Japanese corporates. Volatility in the market, increasing competition and shifting macroeconomic conditions are also pushing Japanese corporates to embrace carve-outs for strategic purposes, states Shearer.

Since 2009, Japanese companies have completed divestitures and carve-outs worth more than US$1bn, according to Mergermarket.

"It's being used as a tool to cycle out lower-growth businesses so these corporations can focus more on innovation and high-growth businesses," Shearer says.

There is, however, a hesitancy among Japanese businesses to sell off assets without first considering other options. In Japan, there is the long-standing social contract around loyalty and obligation from both employers and employees. Scaling back production or divesting non-core assets, and effectively the employees, in those operations would be a breach of that contract. Unsurprisingly then, carve-outs are generally not the first option, affirms Kubo san, adding that with competition increasing from other countries in Asia-Pacific those options are running out.

"Some companies are divesting of non-core operations to survive," states Kubo.

Another trend is seeing Japanese corporations carving-out business units and combining them through joint-ventures with other domestic corporations. "Tie-ups like these are helping Japanese companies survive against competitors as market shares shrink", adds Kubo.

> One of the key benefits of performing sell-side diligence early on is identifying problem areas and devising plans to mitigate the identified areas before these are brought to a seller's attention by a potential buyer.

Transition of ownership

Once an interested buyer for a carved-out business has been found, sealing the deal often comes down to price, a smooth diligence process and increasing the likelihood that the transaction can be completed. One key area of discussion revolves around what transition support the carved-out business will need from the seller as the buyer folds the carve-out in to its operations. That usually comes in the form of a transition services agreement (TSA) entered in to between the seller and buyer.

The TSA establishes a set timeframe where the seller will continue to provide support to the sold business' operations, allowing a smoother transition of ownership as the buyer assumes control. Kubo notes that it's important to have these agreements in place on day one to help the divested unit become a functioning, value creating part of the new company.

While sellers may be hesitant to include TSAs in the deal, doing so may be critical to completing a deal. This is particularly true in cross-border transactions, where a foreign buyer unfamiliar with the local business environment may be hesitant to execute a deal without commitment from the seller involving an appropriate TSA.

Most Japanese corporates tend to offer a TSA, but keep the agreements as short as possible. Providing this service opens the deals to a wider pool of buyers, as foreign acquirers are then incentivized to pursue acquisitions of carved-out Japanese corporations.

These are very labor-intensive undertakings and require patience and commitment from stakeholders including the negotiating parties, the employees working on the carve-out project, senior management and shareholders.

Best practices

By their nature, carve-outs are complex transactions requiring buyers and sellers to have a set of best practices in place to see the deal through.

Companies should have a clearly defined carve-out strategy and create blueprints early on in a carve-out process. Certain preparations, such as sell-side diligence, can significantly enhance a carve-out divestiture process and increase deal value for the seller.

"If this is your first carve-out or you lack sufficient internal resources, companies should consider bringing on external advisors to act as guides and add support to the process," says Kubo. "These are very labor-intensive undertakings and require patience and commitment from stakeholders including the negotiating parties, the employees working on the carve-out project, senior management and shareholders."

Buyers and sellers need to create a realistic timeframe for the sale and transition of ownership. Sellers must develop an effective exit strategy, while buyers need to focus on how the acquisition will be integrated into the existing company platform. Establishing parameters, including specificity around the specific services and time over which such services are to be provided, for the TSA is also crucial.

Another option, Shearer notes, is to have the carved-out business operate as a standalone entity for a period of time before putting it up for sale. This allows a company the time to complete its preparations for a carve-out and allows the carved-out company to operate on its own, without extensive support from the parent company prior to a sale process. Any problems encountered in the carved-out unit during this period can be ironed out, minimizing uncertainty for the buyer and seller when the unit is eventually sold off.

With the effective implementation of these practices and others, carve-outs will continue to be an effective tool for M&A and divesting assets. This is especially true as companies look for new ways to deploy resources and remain competitive as ups and downs in the economy and shifting market forces compel corporates to adopt new business practices to survive and succeed.

A case in cross-border integration

When a Japanese resources corporation needed assistance integrating a foreign investment with its core business, it turned to Deloitte to provide guidance and ensure a smooth transition of ownership. Masahiro Kotaka, Senior Manager, Deloitte Tohmatsu Consulting Post M&A, discusses the deal and integration process.

Faced with shrinking domestic demand and higher operating costs, one of Japan's largest energy and resources companies turned to cross-border M&A to further internationalize its business. In previous years, the company had completed an overseas acquisition, providing it with new market access and a series of best practices for future deals. As prospects on the home front continued to dwindle, the energy company turned its sights to international targets once again.

Target and goals

The acquisition involved the purchase of a major retail business: an independent petroleum products distributor with an import terminal and multiple gas stations. The purchase would give the Japanese company access to downstream parts of the supply chain. It would also allow the Japanese company to increase the sales volume of its oil supplies while diversifying its geographic presence.

The acquisition would present opportunities for the resources company to enhance its petroleum products business in a growing overseas market, where demand was increasing. As part of its long-term strategy, the Japanese company would utilize this deal to strengthen operations abroad and expand its business across the Pacific Rim.

Sourcing began in 2011, with formal negotiations commencing in early 2012.

Planning for post-merger

A dedicated team was assembled to complete due diligence and lead the M&A process. Once the transaction was close to signing, the focus turned to post-merger integration (PMI). The Japanese company enlisted Deloitte to create and execute a PMI blueprint and provide its full spectrum of global services to support the deal.

PMI would be completed through a three step process, the first involving integration and functional blueprints. To pave the way for the rest of the merger, the integration blueprint would set down company goals and plot a course to effectively complete the integration. To help employees at the acquired company, the Japanese buyer provided information on its history and business scope to help the new employees better understand their new owner.

Regular gatherings and relationship-building meetings were organized with target management. This ensured that the Japanese company's message and goals were effectively relayed to all parties and that managers at all levels understood that the lines of communication were open.

The second blueprint created a path for integrating functions and internal structures – including finance, HR, IT, and internal controls – of the acquired company with its Japanese owner to enhance the deal's value and realize synergies. A PMI kickoff meeting was held in January 2013 to allow managers at both companies to voice their opinions on how best to approach integration.

Regular gatherings and relationship-building meetings were organized with target management. This ensured that the Japanese company's message and goals were effectively relayed.

Overcoming obstacles

Like any deal between businesses from different cultural or corporate backgrounds, challenges arose that could have derailed the deal. The Japanese company's lack of experience in PMI also left room for misunderstandings to escalate into possibly deal-breaking disagreements. Again, Deloitte stepped in to help the company clear these hurdles.

When it came time to implement integration, a process the company had only done previously with domestic investments and on a smaller overseas acquisition,

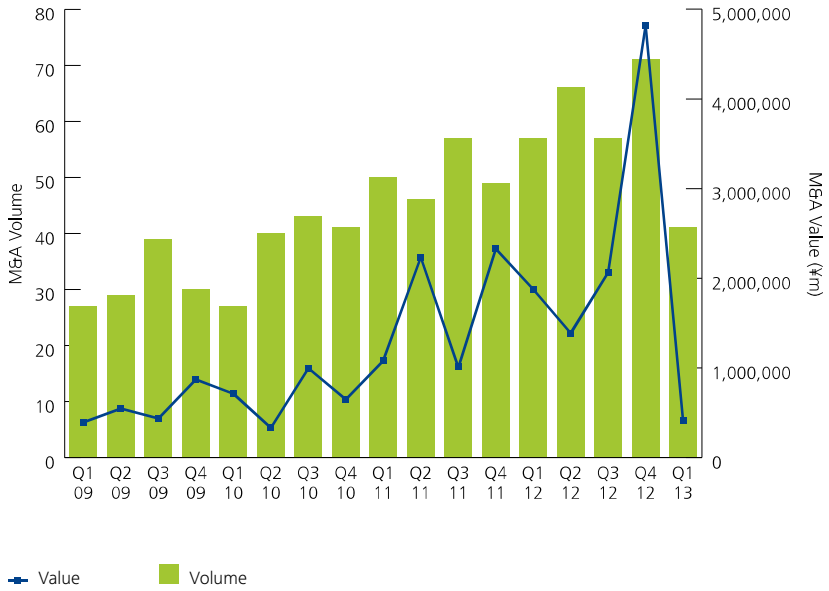
Deloitte helped the company customize policies suited for an international integration. It also helped the two find common ground when target management insisted that a number of its HR, IT and internal policies be left in place post-merger. Deloitte also advised top management to meet with the target's leadership to form personal bonds.

Results

The second stage of Deloitte's PMI planning support wrapped up in Q1 2013 and involved a series of co-planning discussions between mid-level managers. These regular meetings helped the two companies maintain their course. With Deloitte's assistance, the two companies completed the development of a mutually agreed functional blueprint along with more detailed implementation plans, overcoming the resource shortage of the acquired company. While it has yet to be completed, the third phase of the integration – implementation and execution – is set to achieve its stated objectives within its pre-determined timeframe.

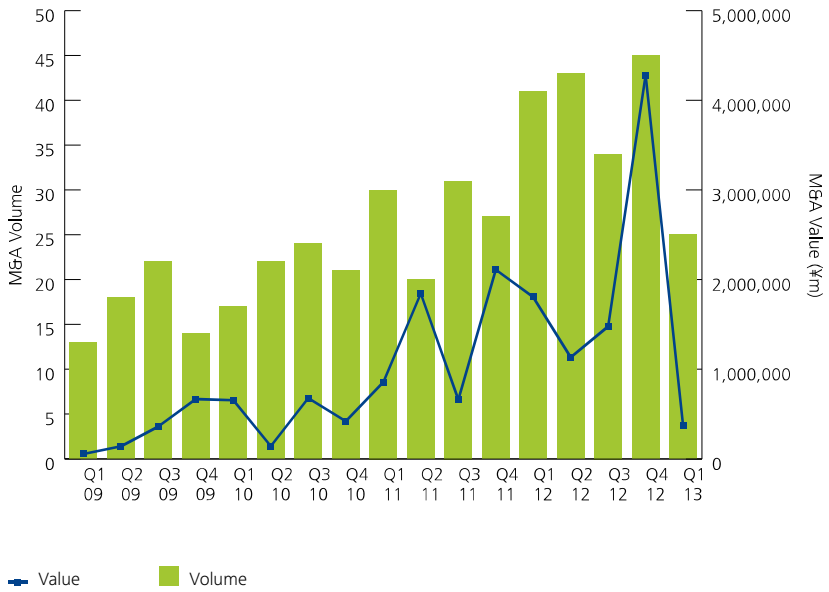
Historical Data

Japanese outbound M&A activity



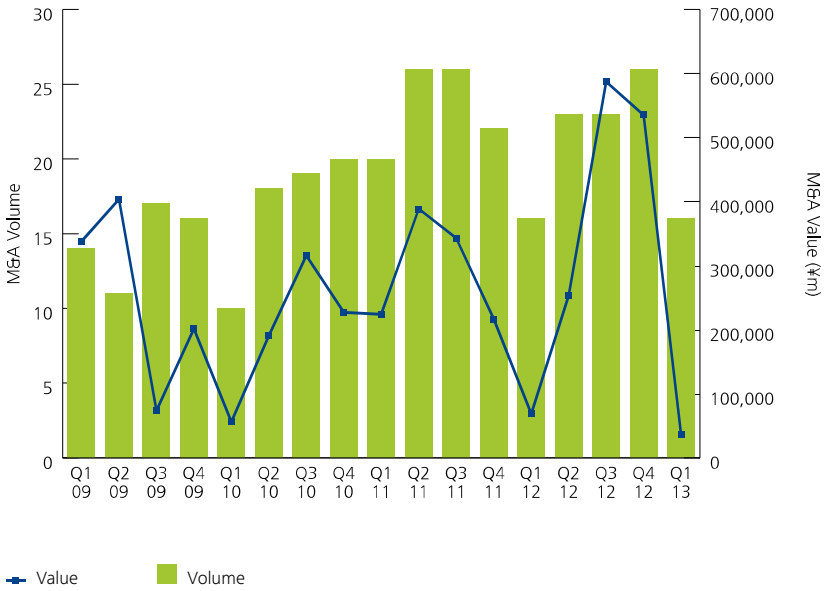
Source: Mergermarket

Japanese outbound M&A activity - Non-asian targets



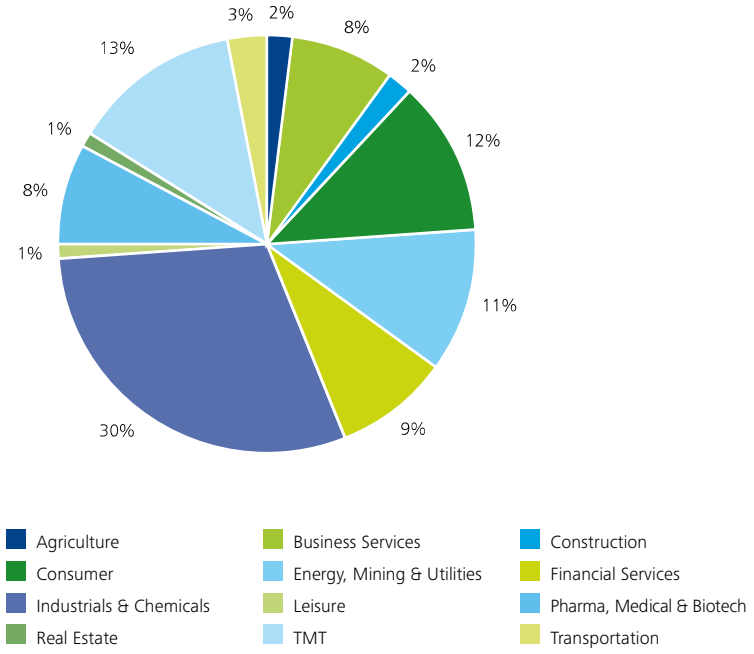
Source: Mergermarket

Japanese outbound M&A activity - Asian targets



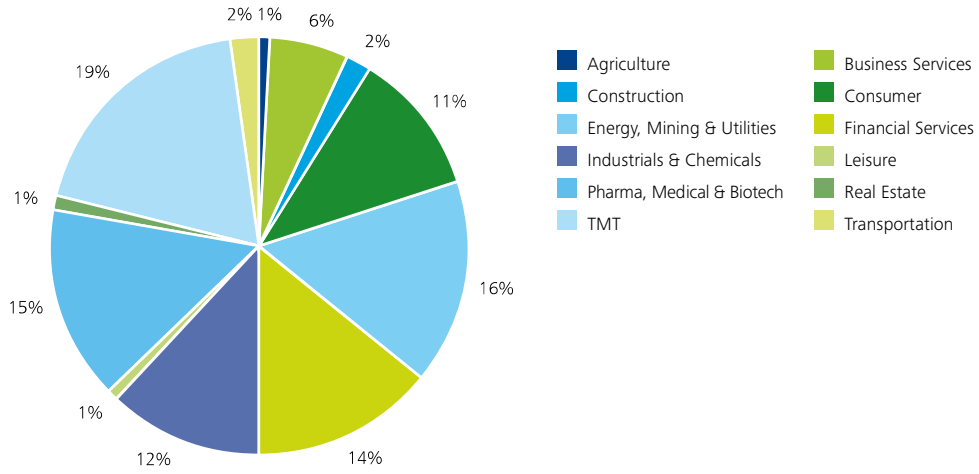
Source: Mergermarket

Sector split of Japanese outbound cross-border M&A by volume, 2009-Q1 2013



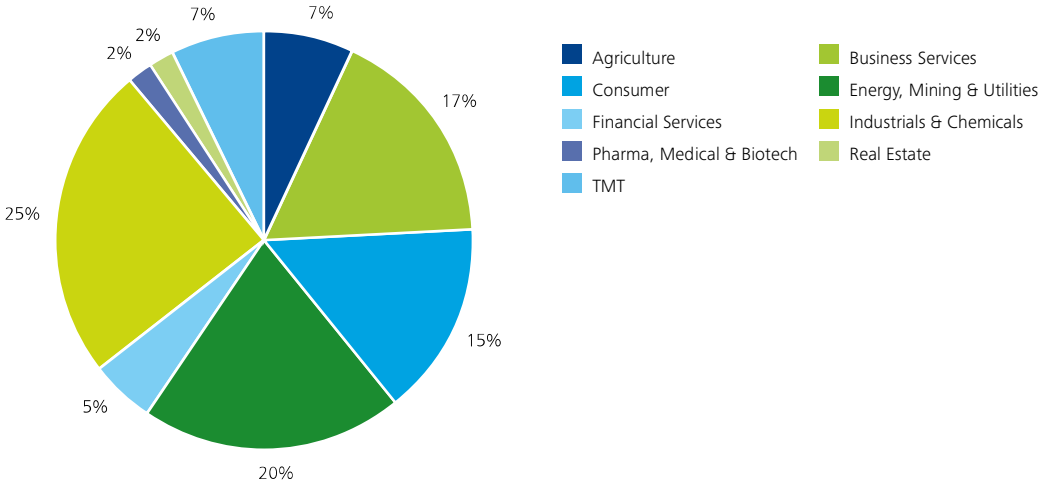
Source: Mergermarket

Sector split of Japanese outbound cross-border M&A by value (¥m), 2009-Q1 2013



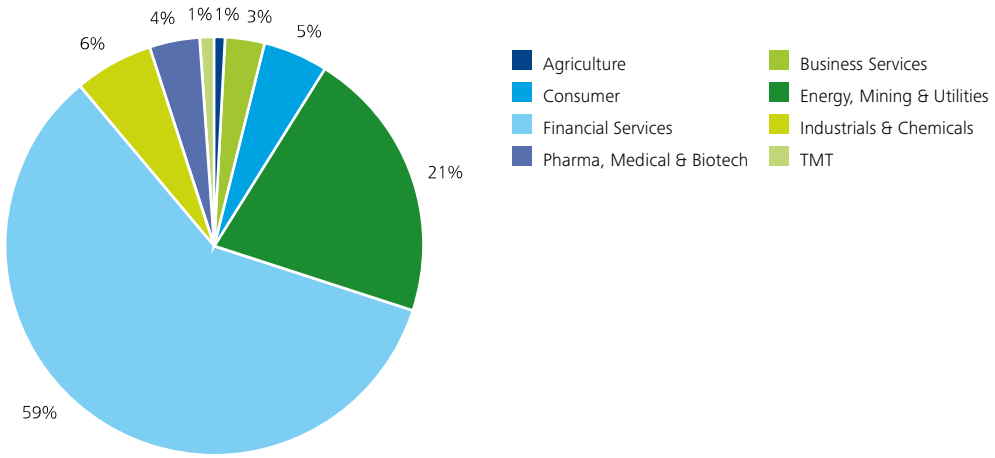
Source: Mergermarket

Sector split of Japanese outbound cross-border M&A by volume, Q1 2013



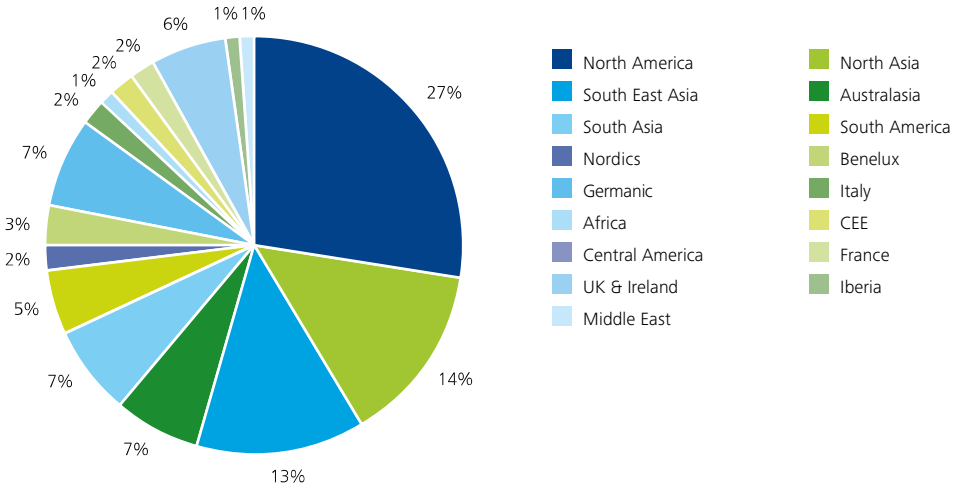
Source: Mergermarket

Sector split of Japanese outbound cross-border M&A by value (¥m), Q1 2013



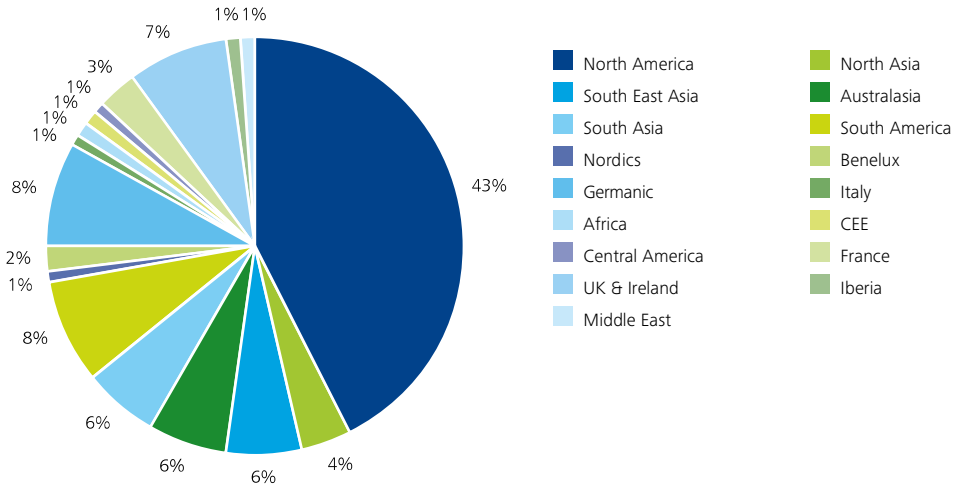
Source: Mergermarket

Geographic split of Japanese outbound cross-border M&A by volume, 2009-Q1 2013



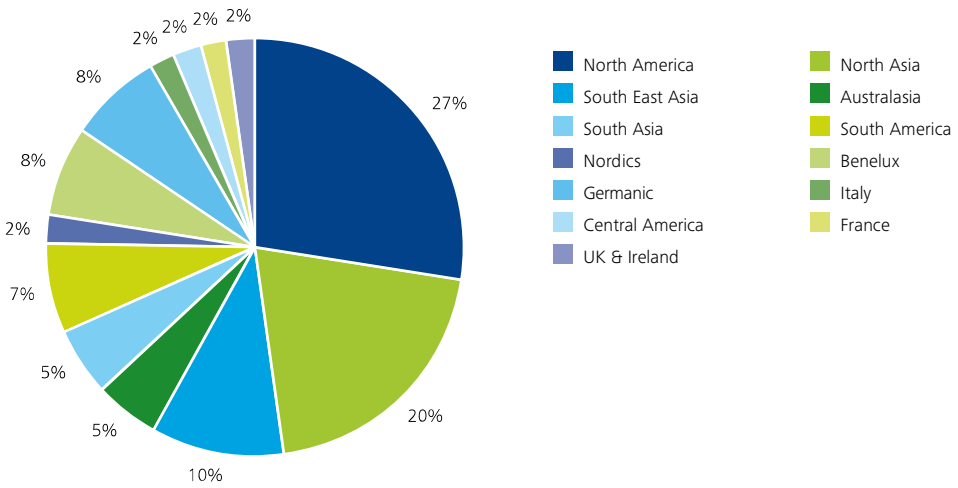
Source: Mergermarket

Geographic split of Japanese outbound cross-border M&A by value, 2009-Q1 2013



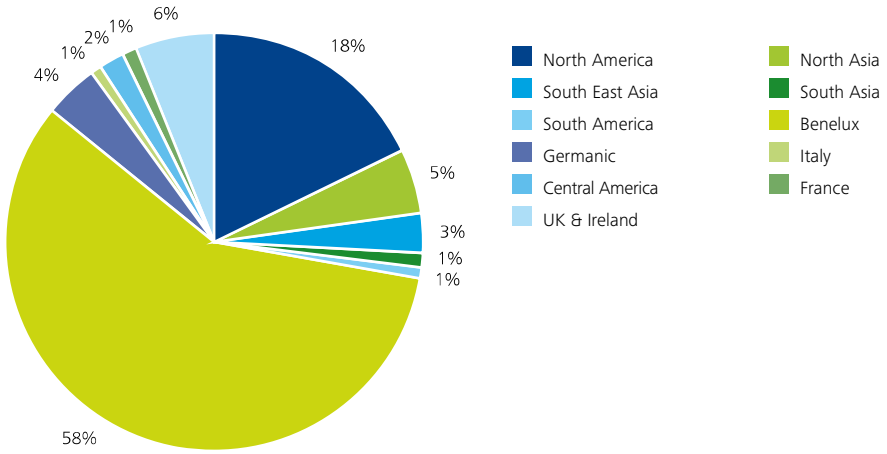
Source: Mergermarket

Geographic split of Japanese outbound cross-border M&A by volume, Q1 2013



Source: Mergermarket

Geographic split of Japanese outbound cross-border M&A by value, Q1 2013



Source: Mergermarket

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About Mergermarket

Mergermarket is an unparalleled, independent mergers and acquisitions (M&A) proprietary intelligence tool. Unlike any other service of its kind, Mergermarket provides a complete overview of the M&A market by offering both a forward-looking intelligence database and a historical deals database, achieving real revenues for Mergermarket clients.

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