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Clean rooms

Delivering top-line synergy in life sciences M&A

M&A Institute

Life science industry deal premiums are at record highs.[1,2] In 2015, acquirers in deals exceeding $1 billion paid an average share price premium of 57 percent.[3] These record premiums have not deterred life sciences companies from aggressively pursuing inorganic growth opportunities. From 2014 to 2015, deal value rose 25 percent, to $393 billion. The year before, it rose more than 200 percent.[4]

Where can I realize more revenue?

Where can I mitigate revenue leakage?

Is there a way to make my portfolio more efficient without driving away key customers?

How can I put my sales representatives at ease about the territories and positions they'll have after our merger closes?

Companies expect returns on large investments. Traditionally they have sought it in cost and scale synergies, but at these prices, that may no longer be enough. Top-line growth expectations are becoming the new "table stakes" for investors. Yet of the 25 largest life sciences mergers and acquisitions (M&A) deals in 2015, only two announced target revenue synergies.[5] By comparison, all but four announced target cost synergies.

When deals do specify revenue targets, they have proven elusive. Of the life sciences deals over $1 billion in value that closed in 2013 and 2014, nearly 30 percent failed to achieve their projected revenue growth targets for 2015.[6,7]

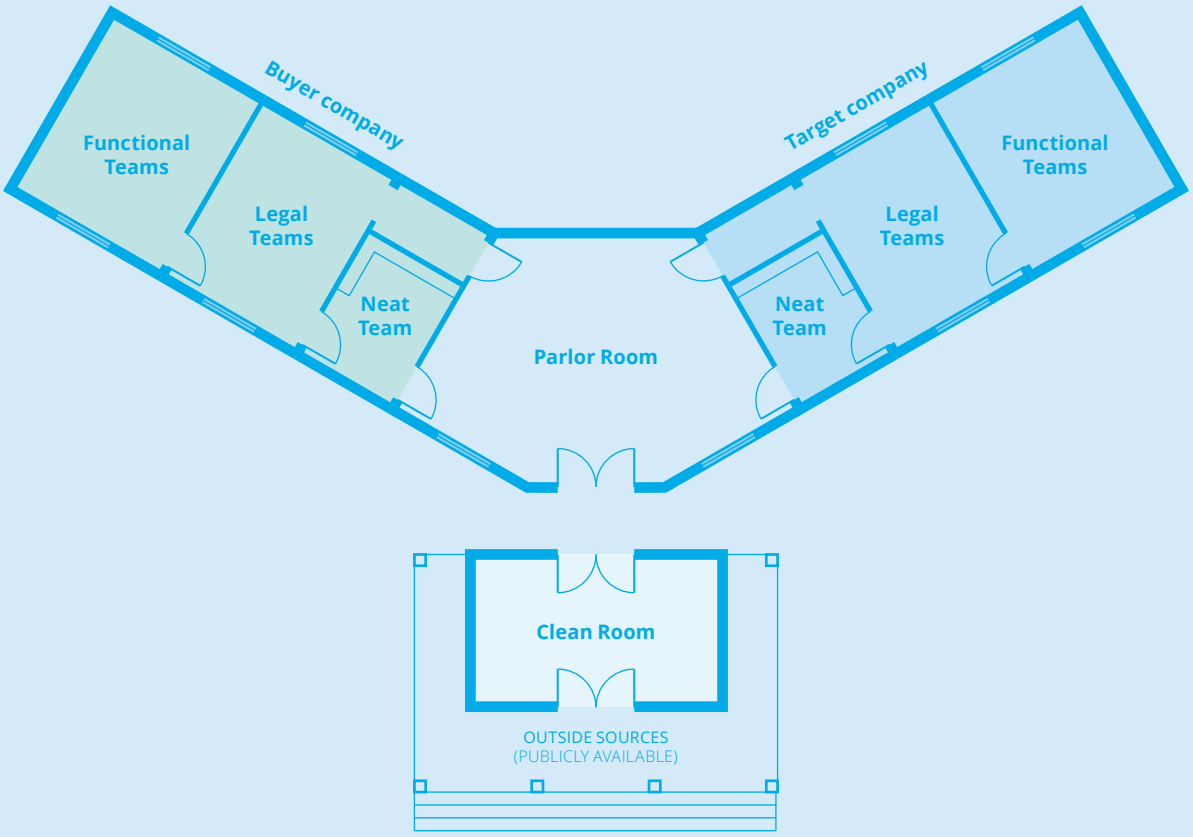
What makes it so difficult for life sciences companies to announce revenue synergies? Why do they consistently fall behind in their post-close revenue targets? One important factor is that the investor community tends to significantly discount these synergies in their financial models. If the revenue side isn't represented in the model, a company has less incentive to spend time chasing it during the short window available for diligence activities.

These factors, however, should not deter companies from having internal revenue synergy estimates and conducting revenue analysis prior to close. This way, they would be able to start executing on the top-line targets immediately after close and ensure that they exceed the market's expectations.

Analysis in a clean room, which is often an underutilized resource, can be extremely helpful in such scenarios and can be a valuable vehicle that can help companies perform the top-line analysis post-deal announcement but much ahead of close. With only a small investment of time, effort, and cost, companies can leverage this construct and comply with antitrust rules to analyze competitively sensitive data and expedite planning to capture the available revenue upside.

Anatomy of a clean room

An informational "airlock"



Functional Teams
Functional integration teams are responsible for supporting the process by responding to data requests and providing input when applicable.

Legal Teams
Legal representatives from both sides participate in all joint interactions and provide guardrails for the execution of the process.

Neat Team
Subject matter experts provide competitively sensitive information to the Clean Team. They need legal approval to interact.

Parlor Room
A mechanism for conducting interactions between Clean Team and others outside the Clean Team environment with legal oversight.

Clean Room
Secure data environment to collect and analyze sensitive data by a team of designated employees or third-party consultants. Enables planning within boundaries of law.

What is a clean room?

A clean room is a secure environment in which consultants, designated employees, or a mix of both can receive competitively sensitive information from both pre-merger entities without violating antitrust laws. In this environment, they can analyze that information to identify and measure revenue synergies that could realistically happen soon after close.

The clean room construct is relatively easy and inexpensive to implement. Because they are frequently staffed by consultants, clean rooms can also free employees to keep focusing on their daily jobs. Experience has shown clean rooms can be especially relevant in transactions that include one or more of these factors:

- High synergy expectations and focus
- Short period of time to achieve mandated synergies
- Significant time to legal close
- Low level of trust between organizations
- High level of customer or geographic overlap
- High level of product or portfolio overlap

The more overlap there is in either customers, geographies, or product offerings, the more potential conflict of interest there is to avoid pre-close—but also the more potential synergy there is afterward. The diagram shows how people and information from the acquirer and target organizations can come together through a "parlor"—think of it as an informational "airlock"—to work together in the clean room without contaminating those outside it.

Revenue synergy and growth opportunities

There are numerous opportunities, based on extent of overlap in the business, that the life sciences companies can leverage post an acquisition to meet or exceed the shareholders' expectations.

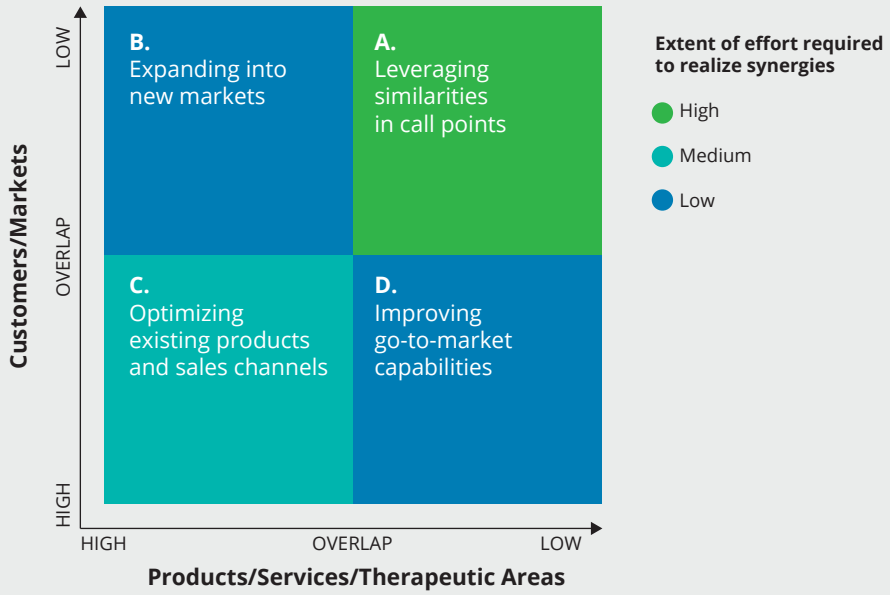
For the combining companies, accurately charting the overlap between their customers, markets and products, services, or therapeutic areas would go a long way in helping identify multiple opportunities to capture revenue synergies. The analysis is usually intuitive, but timing can become an issue. Before the deal, it's unethical to share the necessary information, and after close, it's often too late.

Most life sciences deals fall into one of four categories defined by the quadrants in Figure 1. The extent of overlap between customers, markets and products, services, or therapeutic areas can make it easier or harder for the combining companies to identify synergy opportunities they can prioritize for capture.

"We had two legacy companies with three primary overlapping lines of business, all of which were growing faster than the market. With extremely high margins, any additional revenue growth was a great way to drop cash to the bottom line. With the heightened focus on growth, a clean team was critical to accelerating analysis to minimize disruption and accelerate additional revenue capture by leveraging various cross-refer and cross-sell initiatives. In my opinion, a clean team drives four key elements of successful integration planning: protection, process, experience, and immediacy. A clean team establishes a protective environment that allows companies to analyze data while adhering to antitrust laws. Second, clean teams, typically staffed by external consultants, bring process and experience which leads to immediacy and acceleration of the decision-making process."

SVP & business unit president of a global medical device company

Figure 1: Synergy opportunities based on extent of overlap



Quadrant A
There is no significant overlap in either customers or products. Companies can:

- Identify call point similarities to explore cross-selling opportunities
- Leverage strong presence in non-overlapping accounts to expand
- Explore opportunities to create new business models with the enhanced product portfolio

Quadrant B
High overlap in the product portfolio but no significant overlap in customers or markets. Companies have the opportunity to:

- Expand presence in untapped areas or underdeveloped markets, increasing revenue and footprint of the combined organization
- Introduce enhanced product portfolio at non-overlapping customers through differential pricing options

Quadrant C
High overlap between customers and products. This can pave the way for companies to:

- Identify cross-selling opportunities with the optimized product bag
- Renegotiate contracts or pricing discounts with overlapping customers to reflect enhanced supplier power and optimized portfolio
- Position overlapping products through differential pricing to cater to a broader spectrum of customers

Quadrant D
High overlap between customers and markets but no significant overlap in products. Participants in these deals may be able to:

- Identify upsell opportunities at accounts with enhanced product bag
- Renegotiate contracts or pricing discounts with overlapping customers to reflect the enhanced product portfolio
- Improve go-to-market capabilities by leveraging a wider array of products and services

Coming back to the main question: If life sciences companies have multiple opportunities to realize revenue growth synergies, why don't more of them dedicate sufficient time up front to front-load revenue synergy capture?

The answer is legal peril. Antitrust laws such as the Hart-Scott-Rodino Antitrust Act and the Sherman Antitrust Act prohibit companies from sharing competitively sensitive information and colluding in the marketplace prior to the close of the transaction. If companies cannot share information while they are still separate, it is difficult for them to properly estimate or plan for revenue synergy capture.

A clean room can help overcome these challenges. Because it provides a legal way for joint teams to sequester themselves with information their colleagues elsewhere are not allowed to see, they can get a critical head start on the analysis that lets merging companies front-load the revenue synergy capture that's lurking in their M&A transactions.

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What analyses can a clean room perform?

Based on the synergy opportunities identified earlier, several analyses could be performed in a clean room to front-load revenue synergy capture.

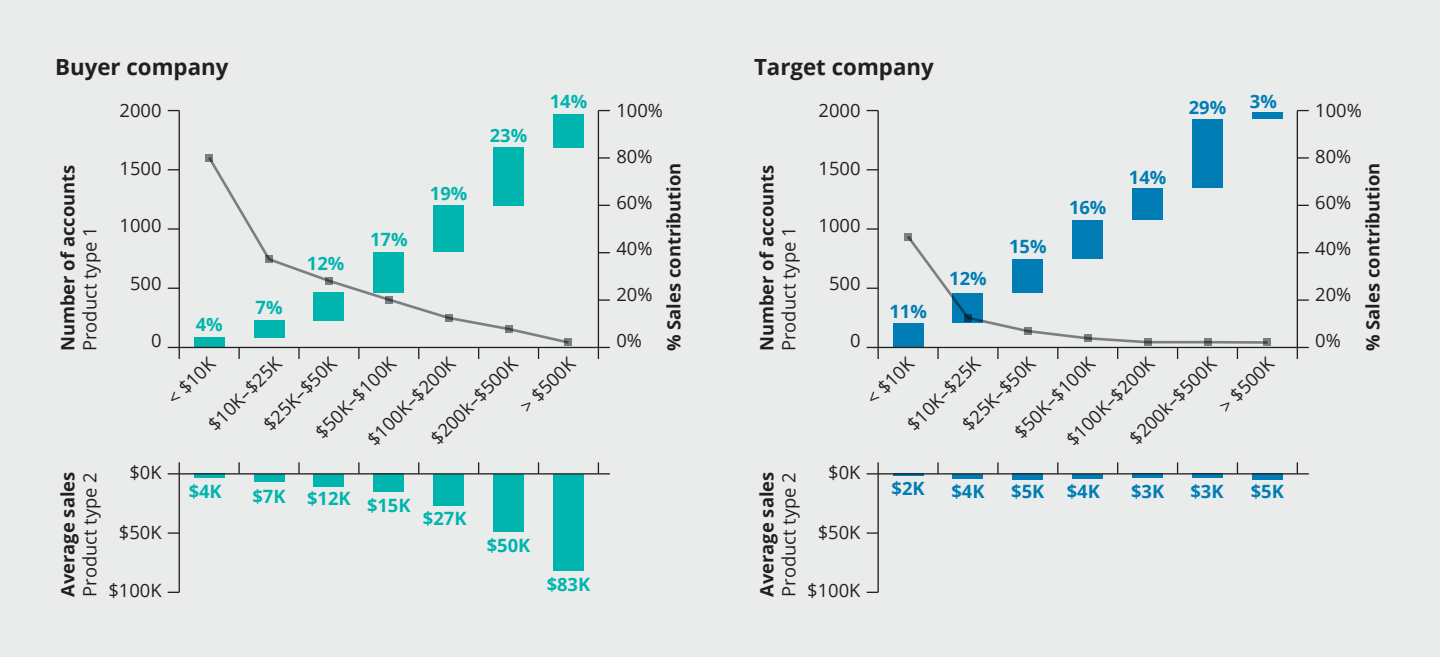
Cross-sell/up-sell analysis

An analysis of product sales by account and by sales representative could help determine a matrix of accounts and representatives that would result in significant synergies.

The combined company's sales organization could use this matrix to focus on rolling out targeted programs among those representatives to capture value at their respective accounts.

Figure 2: Cross-selling analysis

Potential to drive significant upside by introducing BuyerCo's products at TargetCo's accounts



Sales channel optimization

A comprehensive analysis of account overlap between the two companies could help to create a right-sized, focused sales force with clear lines of responsibility. Importantly, conducting this analysis in the clean room can allow sales leaders to "hit the ground running" on Day 1 and accelerate end-state planning for the go-forward sales channels, thereby mitigating revenue disruptions though channel disruption.

Distributor evaluation

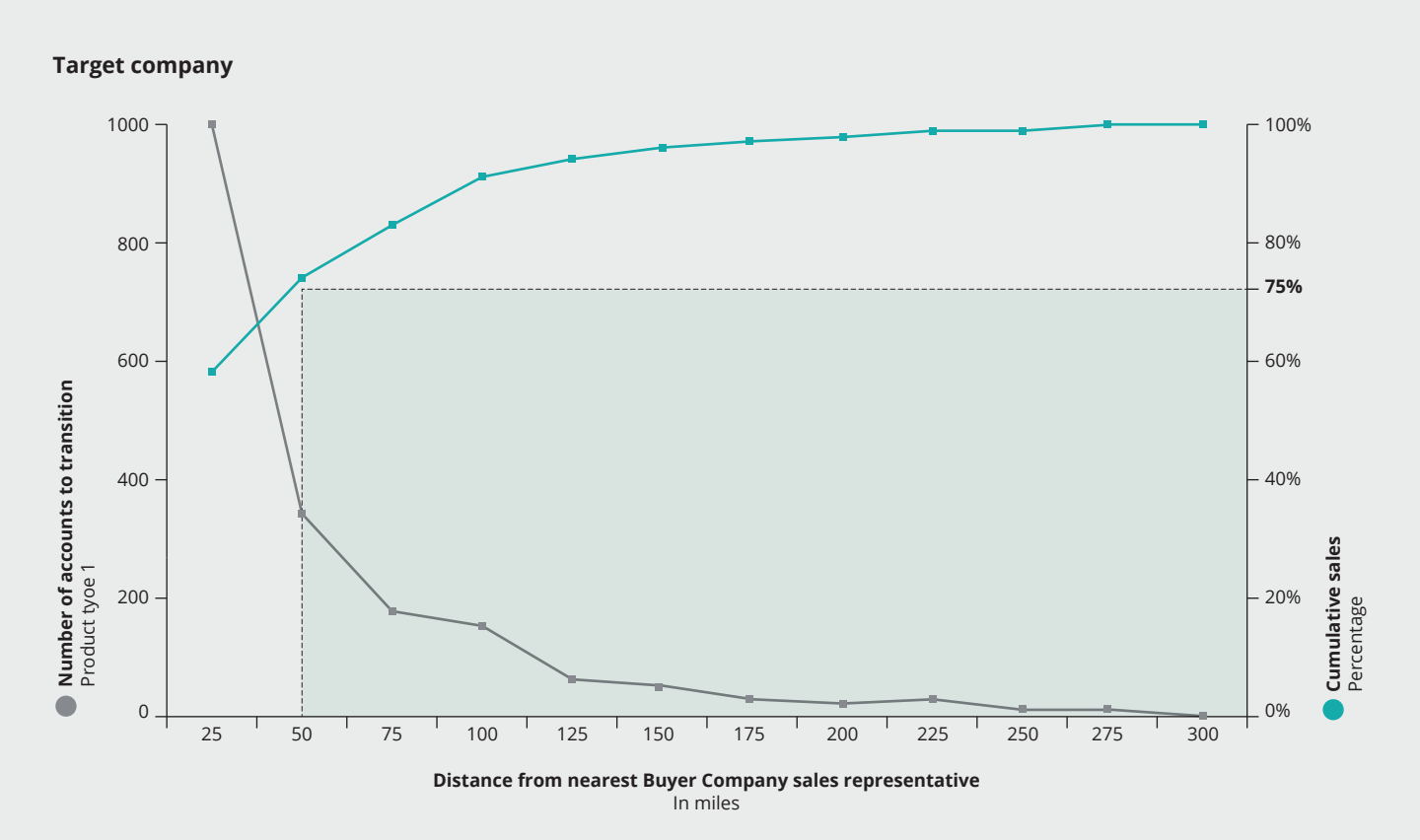
A comparison of distributors across the two companies' various dimensions such as sales, geographic coverage, non-compete agreements, buyout costs, or termination costs can also prove vital in assessing distributor relationships and determining which sales channel, distributor or direct, would serve the future sales organization more effectively.

Portfolio optimization/product prioritization

An analysis of product sales and call points can be instrumental in determining which bundles a more focused sales force should take to market. Additionally, overlapping sales of products by SKU can also be used to identify a leaner and more productive product bag for the future sales organization while minimizing customer disruption.

Exhibit 3: Account transition based on call point analysis

Mitigate revenue leakage through coverage of accounts by nearest best-fit sales representative



Scenario analysis

An analysis of sales by geographic areas and coverage type (direct sales force vs. distributors) can be used to identify all possible scenarios that the sales leadership could face on Day 1. This analysis allows the leadership to prioritize these scenarios for addressing immediately post Day 1 to mitigate revenue leakage.

Heat map analysis

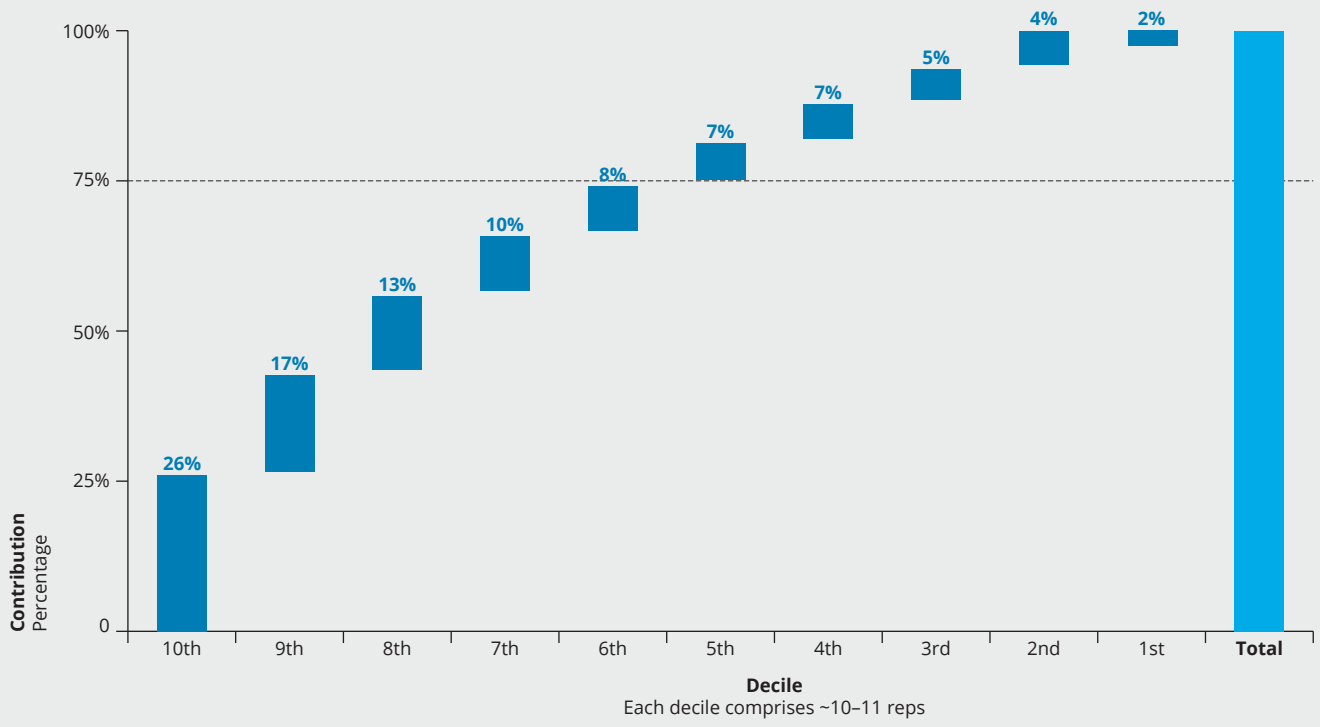
An analysis of sales force headcount, relative sales, and account penetration by geographic area can help the future sales leadership study the strength of the current sales organization and also arrive at an ideal construct of the future sales organization. This analysis provides a visual tool to reallocate sales representatives across geographies, specifically underpenetrated ones, to drive upsell and cross-sell opportunities.

Day 1 communications

A comprehensive and accurate cross-walk of hospitals, customers, accounts, healthcare practitioner consultants, and other relevant stakeholders can be used to design and accurately implement Day 1 communications and customer experience strategies.

Exhibit 4: An estimate of sales distribution across deciles

Reduce flight risk by identifying key sales representatives to target for retention on Day 1



The stakes are high

Rising life sciences deal premiums make the challenge of accelerating synergy capture more important than ever. Acquirers need these wins to deliver on investor expectations—and to drive efficiency and top-line growth.

The press of time and the risk of antitrust violations can discourage companies from conducting revenue analysis post close, but it doesn't have to be that way. Clean rooms can be effective in improving M&A delivery and expediting synergy capture by providing an avenue for rigorous analysis of competitive data ahead of closing. Using that accelerated data capture and analysis, leadership can focus on execution and synergy capture immediately after close. Clean rooms can play a crucial role in multiple areas, including exploring opportunities to cross-sell and up-sell, enhancing sales channels, and fine-tuning the portfolio.

Used wisely and in a cost-efficient manner, a clean room is an extremely versatile tool that can help acquirers achieve a significant competitive advantage. After all, the best way to justify high deal premiums is to deliver not only cost savings but also revenue growth that exceeds investor expectations.

"Looking at our businesses now, all three business lines are beating the plans and there is healthy amount of cross-selling underway. The quick-win analysis, account transition analysis, and account/channel overlap analysis completed within the clean room have played a big part in us getting to these results so quickly."

SVP & business unit president of a global medical device company

Case study

Leveraging clean room analysis prior to merger between med tech companies

In a bid to become a premier player in its market segment, a global medical devices company acquired one of its peers. The acquisition allowed the company to provide a more comprehensive product portfolio, with significant scale and scope to enhance profitability.

Pre-merger, these companies relied on two different sub-segments for a majority of their revenues. Furthermore, they were stronger in different geographical areas: One company had significant presence in international markets, while the other was stronger in the US market. As a result, the acquisition presented some attractive revenue synergy opportunities through cross-selling and portfolio enhancement. Ten percent of the combined revenue was the planned revenue synergy target for this deal.

Issues

Revenue synergies were a key value driver for the strategic rationale of the deal. Yet prior to close, the companies could not share any competitively sensitive data. Further, the initial plan was for the sign-to-close period to last four months, an extended "vacuum" during which no channel, territory, or product analysis could take place. This threatened a significant delay in the realization of revenue synergies as well as disruption in the channel while territory alignment decisions were delayed. This type of disruption can be a real issue for revenue leakage and talent retention, and the client asked for our advice in mitigating these risks.

Facing this reality, Deloitte advised the client that a clean room would be the most effective way to produce the analytics it would take to facilitate the types of decisions these companies would face immediately upon closing.

Approach

The construct for the clean room was set up with all the necessary and required stakeholders, including representatives from legal, commercial, and finance. The charter for the team was to develop comprehensive dashboards. These dashboards mapped all customers and territories on both sides to one another so that a side-by-side comparison could be made at the sales representative level for key performance indicators (KPIs) that would help facilitate the difficult task of sales representative selection. The relevant KPIs that were gathered were:

- Overall sales and account coverage information for the sales representative
- Percentage of overlapping and non-overlapping sales with other sales representatives
- Performance of the sales representative with primary sales overlap with the representative under consideration
- Tenure of the representative under consideration
- Year-over-year performance of the sales representative (overall and at the account level)

Once complete, the dashboards went through several cycles of review. A detailed governance plan identified key participants, timing, scope, and responsibilities during the selection process. When the close was extended beyond the initial four-month window, the clean team added several other dimensions: For example, contracted healthcare professionals were mapped between the two companies, performance reviews were introduced as an additional data point in the dashboards, and contract reviews for distributors were completed to understand the financial implications of potential buyout and change-of-control payments.

Clean room impact

The output of the clean room had an immediate impact—both financially and from a change management perspective. Once close was announced and Day 1 celebrations were complete, the commercial teams immediately came together to plan their territories and channels. The financial results were tangible in that the duration of uncertainty in the channel was reduced significantly, and as a result, the risk of continued revenue leakage was significantly mitigated. Once the territories had reached the end-state alignment, the new sales representatives were equipped with more comprehensive product bags, and could begin to fulfill the revenue synergy estimates.

Risk reduction is a key component of why a clean room can provide benefit to clients. Markets will never respond kindly to increased risk, so the more companies can reduce it, they more likely they will be to see positive effects on share price and the support of their investor communities.

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Endnotes

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