

M&A

— *from* —

PLANNING *to* INTEGRATION



Executing Acquisitions and Increasing Shareholder Value

Robert J. Borghese & Paul F. Borghese

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and Increasing Shareholder Value**

**Robert J. Borghese
Paul F. Borghese**



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Although this book is a good introductory text on the M&A process, it is not meant to be purely for academic study (e.g., read once for an end-of-semester exam and then used as a paperweight, if it makes it onto an executive's desk at all). Rather, it was developed as a step-by-step tool that can be referred to again and again in a multitude of M&A-related situations. What makes the book different from many of the more theoretical books already published on this popular topic is that it includes a plethora of

actionable insights from practicing M&A professionals, especially Joseph Connolly, Steve Sammut, and Fred Militello. We would especially like to thank Paul Morin for substantial contributions to several sections of this book, including performing due diligence, managing integration, and developing an acquisition scorecard.

We also are significantly indebted to the many management thinkers whose work is referenced throughout this book. For certain specific sections of our *M&A Strategy Guide*, (Part II of this volume), our objective was not to reinvent any wheels, but rather to put new, insightful spins on well-tested ones that are relevant to some aspect of the M&A process. To this end, we included many frameworks, checklists, and perspectives developed by influential business writers on a variety of topics, including leadership, strategy, and scorecarding.

Also, this book would not have been completed without the ever-present support of our friends and colleagues. We particularly would like to acknowledge Jovanka Ciales, Michael Bertoline, Peter Briscoe, Daryl Capuano, Jim Cardillo, Brian Corbett, Henry Hsia, Jason Kaplan, Zuhair Khan, Ian MacMillan, Gary Miller, Joel Port, John Quinn, Eric Raimo, Vicky Schwartz, Richard Shell, Eric Siegel, Leslie Smith, James Spady, and Robert Thompson, all of whom have shaped our thinking over the years.

Finally, we would like to thank our family for providing us with fantastic opportunities to grow and educate ourselves. We especially need to thank our parents, Helene and Salvatore Borgese, who have provided us with a shining example of one of the most important types of mergers that any of us will ever experience.

THE TREASURY'S ROLE IN MERGERS AND ACQUISITIONS

The treasury's role in corporate finance activities over the years has grown from one of managing cash and treasury transactions to one of providing strategic financial advice and guidance. Although technology and process improvements have helped to foster this evolution, the recognition of treasury's value to the success of the organization is a key component of the transformation. That recognition comes from the company's most senior leadership, analysts, and shareholders, as treasury professionals exercise skills such as strategic planning, technology consulting, leadership of self-directed work teams, and management of cross-functional economic efficiency projects.

In the case of mergers and acquisitions (M&A), the dismal track record of many value-destroying integrations has prompted a greater involvement of operational functions in the due diligence process. Traditionally, due diligence was handled by an investment banker, attorney, or M&A specialist—the treasurer would become involved only at the integration phase. Today, most organizations realize that the groundwork for a successful integration is laid well before the transaction is completed. Tight resources and a drive to achieve stated performance targets has led senior management to rely on internal resources to ensure that transactions are completed smoothly. As such, more and more frequently treasury is charged with validating the deal's potential value and confirming the representations made by the acquisition target. Frequently, treasury also is instrumental in investor relations activities, dilution recovery, and operational integration.

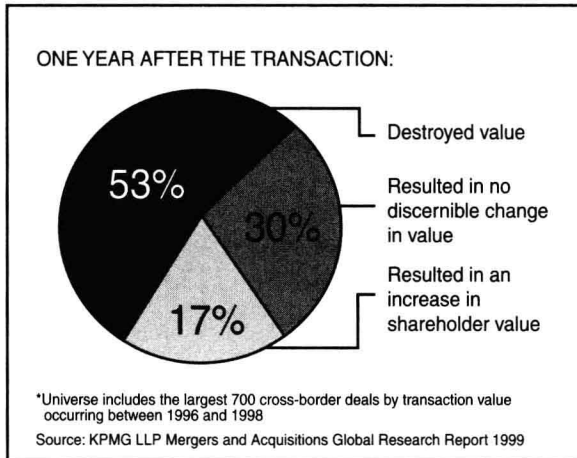
As the role of financial professionals continues to expand, the practical experience and strategic vision treasury brings to the table in a merger is vital. Appendix G, "The Due Diligence Process in Mergers and Acquisitions: Treasury's Role," is a summary of a presentation made at the AFP 21st annual conference in 2000. The discussion focuses on the role treasury can play in the M&A process and the issues that are imperative to deriving value from the transaction and achieving the desired results from the integration.

INTRODUCTION

Every day it seems there is a new merger and acquisition (M&A) deal splashed across the headlines. All are portrayed as glamorous, bold solutions, which will lead to fantastic increases in shareholder value. Unfortunately, the glad-handing and backslapping at the press conference where the deal is announced usually fade to a more somber scene, which often ends in downsizing, culture clashes, and destruction of shareholder value.

Decades of corporate experience coupled with extensive academic research from as far back as the 1960s indicate that such value destruction is the norm and not the exception (see Figure I-1). Value destruction can only be avoided if corporate executives who are planning and executing corporate acquisition programs are armed with a structured program that will guide them through the M&A process and force them to think clearly and critically about that process.

And the need for M&A guidance is on the rise. At the time of this writing, preliminary data released by Thompson Financial Securities Data indicates that U.S. companies executed acquisitions valued in excess of \$1.84 trillion in 2000, which is an increase of nearly 18 percent from the approxi-

FIGURE I-1 How Mergers* Affect Shareholder Value.¹

mately \$1.56 trillion worth of deals completed the year before. As the volume and pace of M&A activity have increased, so too has the number of corporate executives who are thrust into the role of managing some aspect of an acquisition. Corporate executives at these combining companies, who may be very competent in their respective functional areas, suddenly must execute merger and acquisition transactions with little or no training. *M&A from Planning to Integration* provides such corporate executives with the structured framework that will guide them through the M&A process and force them to think clearly and critically as they proceed through each step in a transaction.

To rationalize the process of a merger and acquisition transaction it is necessary to reduce it to a series of discrete steps. Virtually all merger and acquisition transactions should proceed through the following steps:

Step 1: Thinking Through Strategic Objectives

Step 2: Assessing Structural Capacity

Step 3: Identifying and Screening Potential Acquisition Targets

Step 4: Performing Due Diligence

Step 5: Valuing the Acquisition Target

Step 6: Selecting the Appropriate Legal and Tax Structures for the Transaction

¹Unlocking Shareholder Value: The Keys to Success—Mergers and Acquisitions. A Global Research Report, 1999. Reprinted with permission from KPMG.

Step 7: Managing Integration

Step 8: Monitoring Progress through Acquisition Scorecarding

Step 9: Implementing an Acquisition Feedback Loop

While each of these steps takes on a different level of importance, depending on the particular transaction at hand, together they form the basis of a structured framework for thinking about merger and acquisition transactions. These nine steps form the basis for the structured framework that is referred to as *The M&A Strategy Guide*.

As an aside it is important to note that throughout this book the term “M&A” is intended to cover both mergers and acquisitions, even though these two forms of transactions differ significantly in their legal and tax implications. Moreover these terms are often used interchangeably. A more precise definition of each is included in *Step 6: Selecting the Appropriate Legal and Tax Structures for the Transaction*. Also, for the sake of convenience, the book refers to “acquiring” and “target” or “acquired” companies. Although many transactions are portrayed as “mergers-of-equals,” one company’s management team usually dominates—if not during the transaction, then at some point afterward. By “acquiring” a company, what is meant is this dominant entity.

OVERVIEW OF THE M&A STRATEGY GUIDE

At the core of *M&A from Planning to Integration* is the nine-step *M&A Strategy Guide* (Part II of this volume), which outlines a methodology designed to assist the corporate executive in formulating, structuring, and executing a transaction. *The M&A Strategy Guide* rationalizes the acquisition process by dividing it into a series of discrete steps and outlining the basic issues that arise as each step is taken.

A STRATEGY-LEVEL TOOL

The value of *The M&A Strategy Guide* to the corporate executive is the discrete yet organic approach it brings to the acquisition process. Too often, executives become overly focused on the details of the transaction. Time after time, corporate executives experienced in M&A advise focusing on the

big issues. *The M&A Strategy Guide* therefore should be thought of as a strategy-level tool that will keep executives on track and force them to think clearly and critically about the transaction.

Step 1: Thinking Through Strategic Objectives

As with any endeavor, *defining strategic objectives* should be the first step. Therefore, the *Guide* begins with the step entitled “Thinking Through Strategic Objectives.” The management of an acquiring company must be able to clearly articulate the reasoning behind its growth strategy. Some of the most common reasons for pursuing merger and acquisition transactions include: increasing geographic reach, expanding product and service offerings, providing liquidity for company founders, and acquiring promising new technologies. Step 1 forces corporate executives to clearly articulate their reasons for pursuing growth through M&A. This first step is crucial, because all of the remaining steps flow from the strategic decisions made at this early stage.

Step 2: Assessing Structural Capacity

The second step in *The M&A Strategy Guide* is *Assessing Structural Capacity*. Many companies skip this self-assessment step, focusing rather on defining criteria for prospective targets and performing due diligence on identified targets. The acquiring company, however, must first assess its own readiness and capacity to embark upon an acquisition strategy before assessing the target company. This step outlines the issues that should be considered by a potential acquirer prior to embarking upon such a strategy.

Step 2: Assessing Structural Capacity, identifies the areas that should be the focus of such a self-evaluation program, including: (a) readiness of the acquisition team to tackle strategic, legal, financial, and operational aspects of the acquisition program; (b) assessment of the financial strength of the acquiring company; (c) analysis of the value of the acquiring company; and (d) assessment of the ability of the acquiring company to use pooling-of-interests accounting or purchase accounting in consummating a transaction.

Step 3: Identifying and Screening Potential Acquisition Targets

The third step is *Identifying and Screening Potential Acquisition Targets*. This section of the *Guide* offers practical guidelines for selecting potential acquisition targets and covers such factors as the composition of the search team, the definition of acquisition criteria, the sourcing and screening of appropriate targets, and the initial contact.

Step 4: Performing Due Diligence

The fourth step is to *performing due diligence* on the potential acquisition target. This section of the guide reviews the four main areas of due diligence, namely strategic, financial, legal and operational.

Step 5: Valuing the Acquisition Target

The fifth step is *Valuing the Acquisition Target*. Many books have been written on corporate valuation, however, these books usually delve into the financial underpinnings of the valuation models without providing the reader with a clear understanding of strategic concepts, which ultimately determine whether the acquisition will increase shareholder value. This section of the *Guide* reviews and discusses two core concepts in valuation: (1) *intrinsic* value and (2) *synergistic* value. It then provides a brief overview of two of the most common methods of determining intrinsic value: (1) *discounted cash flow methodology* and (2) the *market-multiple method*.

Step 6: Selecting the Appropriate Legal and Tax Structures for the Transaction

The sixth step is *Selecting the Appropriate Legal and Tax Structures* for the transaction. This is a complex task, requiring a thorough understanding of the acquiring company, the target company, each of their respective objectives, and the legal, tax, and accounting treatment of each transaction structure. These issues are complicated and constantly evolving, and can only be navigated with the assistance of expert legal and tax counsel. The purpose of this step is to provide corporate executives with a basic understanding of the various transaction structures so that they are at least conversant in these issues.

Step 7: Managing Integration

The seventh step is *Managing Integration*. Recent research indicates that poorly planned and executed integration is one of the main causes of failed acquisitions. Managing the integration of acquired companies is a complicated task, requiring close attention to a number of variables. The *Managing Integration* section provides suggestions on leadership in the context of M&A; taking advantage of M&A restructuring to instill good management philosophies in the newly combined organization; and the key variables that executives must address during the integration process. These include: (a) effective communication; (b) human resource issues; (c) legacy relationship issues; and (d) optimization of cross-selling to the customer base.

Step 8: Monitoring Progress through Acquisition Scorecarding

The eighth step is *Monitoring Progress through Acquisition Scorecarding*. The Acquisition Scorecard should provide the decision maker with a holistic view of the enterprise without overwhelming him or her with too much information. This is accomplished by selecting and monitoring a few key business metrics, including: (a) financial; (b) innovation; (c) customer; (d) internal operations; and (e) human resources.

Step 9: Implementing an Acquisition Feedback Loop

The ninth and final step is *Implementing an Acquisition Feedback Loop*, which demonstrates how the acquiring company can take lessons learned from one acquisition and use them to better plan and execute subsequent transactions.

These steps also incorporate conceptual frameworks (such as those developed by Professors Michael Porter, John Kotter, and others), which have been adapted and expanded to illustrate their relevance in the broader framework of *The M&A Strategy Guide*. Originally, these tools were developed to help executives address management problems not necessarily related to an acquisition strategy. The purpose of including these tools in the *Guide* is to demonstrate how these tools may be relevant in planning and executing an acquisition.

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