Merrill DataSite® and The M&A Advisor Present

A VISION FOR M&A: BEST PRACTICES FOR CREATING A WINNING ACQUISITION STRATEGY

VALUABLE GUIDANCE FROM THE MOST ACTIVE MIDDLE MARKET M&A PRACTITIONERS

BEST PRACTICES OF THE BEST DEALMAKERS

FIRST EDITION: PART 5

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"There should be no deal before there is a strategy – a deal is one method to accomplish a strategy. A company should not create a strategy around a target because you think it may be attractive. Develop the strategy and then find the targets that best fits your strategy."

- Harry Durity, New Mountain Capital

Introduction

Drawing on the experience and expertise of the "best in class" dealmakers, The M&A Advisor, together with the leading provider of virtual deal management services, Merrill DataSite®, publishes the quintessential dealmakers guide series - **"The Best Practices of The Best M&A Dealmakers."**

Profiling the proven strategies and unique experiences of the leading M&A practitioners, "The Best Practices of The Best M&A Dealmakers" series is distributed in regular installments for M&A industry professionals in both print and interactive electronic media. Previously published features and chapters are also available in the online library of Merrill DataSite and The M&A Advisor.

We are pleased to present **Part 5 - A Vision for M&A: Best Practices for Creating a Winning Acquisition Strategy.** This installment discusses the best practices for developing an effective M&A acquisition plan as part of the overall corporate growth strategy. On the following pages, you'll find helpful observations provided by candid interviews with leading buyers, sellers and advisors, as well as timely insights into the most current trends.

A Vision for M&A: Best Practices for Creating a Winning Acquisition Strategy

Mergers and acquisitions are playing an increasingly prominent role in corporate growth strategies in recent years, a trend that is likely to keep on growing. Many companies view M&A as a viable mechanism to more quickly achieve a number of objectives - to grow their product line, enter into new markets, and fuel long-term corporate growth. Done well, it has proven to be a very effective strategy.

Nonetheless, executing a value-creating M&A strategy is far from easy. As numerous market studies have pointed out, for many companies, M&A activities have often resulted in eroding, rather than creating value. Several reasons for failure have been cited – a lack of proper due diligence, poor understanding of the post-merger integration process, and external factors brought on by changes in the global market.

But one of the most important measures of a company's ability to succeed in the M&A market is the presence of a well-defined investment thesis and strategy. In a recent study, Bain & Company surveyed 250 senior executives who had been involved in sizable acquisitions. More than 40 percent admitted they had no investment or strategic thesis behind their transactions.[1]

However, certain companies have established a successful M&A track record. What makes these companies successful? Focus, commitment and experience. Companies who have consistently yielded the best returns tend to be frequent acquirers, and careful students of their own work. They focus on what they do well, and they apply what they learn from each acquisition to refine their overall strategy.

ADP, a multi-billion dollar company and one of the world's largest providers of business outsourcing solutions, offers an excellent example of how much value a company can realize when its M&A acquisition plan is firmly anchored to a strategic plan. Harry Durity, senior advisor at New Mountain Capital and former senior vice president of worldwide business development for ADP, led ADP's team through 120 transactions in a 10-year period, yielding a compounded annual return of 20 percent for ADP's shareholders over that period. Durity believes ADP was able to establish a high return for its shareholders as a result of developing its M&A acquisition strategy and taking the time to evaluate its performance on past transactions.

"Our board of directors was committed to continued improvement in our M&A process, and as part of this focus, asked the management team to review all the acquisitions completed over that

1. David Harding and Darrell Rigby, Bain & Company, Winning in Turbulence: Pursue Game-Changing M&A and Partnerships, (Boston: Harvard Business Press), 2009.

"Successful acquirers that focus on enhancing or leveraging their distinctive capabilities have been rewarded with deals for which the compound annual growth rate (CAGR) averaged 12 percentage points more in shareholder return."

10-year period. We went through a very detailed analysis and learned a lot about how good we were – or not – at defining our strategies, identifying targets, doing the nuts and bolts due diligence, and integrating our acquisitions. What it came down to was this – what level of return did the shareholders receive for the capital they invested? While not every transaction was a complete success, and there were two or three that were in the failure column, we still generated a compounded annualized return of approximately 20 percent across all of the deals. We also identified areas of strategy, deal process and post merger integration that needed further refinement."

One critical key to success, noted Durity, was the company's commitment to adhering to its strategy to guide all M&A decisions. "'Strategy first' was a key factor," Durity said, "I won't tell you that we nailed it every time for every deal, but more often than not, the strategy preceded the deal."

The second factor was the board and management team's willingness to analyze its own performance and commitment to make changes for improvement. "For example, as part of this, we discovered that we were not very good at integrating our acquisitions into the culture of ADP and this diminished post-merger returns," he said, "So we did a comprehensive study of how other acquisitive companies accomplished their integrations and decided our approach wasn't best-in-class." ADP, under the leadership of Durity, subsequently redesigned its integration process.[2]

Another differentiating quality of successful companies is that they keep their M&A acquisitions well within their core competencies, an approach that has yielded solid returns. A recent study by Booz & Co has shown that successful acquirers that focus on enhancing or leveraging their distinctive capabilities have been rewarded with deals for which the compound annual growth rate (CAGR) averaged 12 percentage points more in shareholder return than M&A deals by other buyers in the same industry and region.[3]

Other experts have noted that successful acquirers are extremely adept at timing. A Boston Consulting Group study found that serial acquirers, compared with single acquirers, do a higher proportion of their deals at the start of an M&A wave, when deal premiums are low and the choice of targets is greatest.[4] Still other studies have found that the most successful acquirers focus on smaller sized deals and privately held, rather than public companies. All of these aspects are clearly important, but as many experts are quick to point out, they need to be anchored to a well-defined strategic plan, of which the M&A acquisition strategy is one component.

2 A more detailed discussion of best practices in M&A post-merger integration can be found in the Best Practices of the Best Dealmakers Guide chapter titled, "The Dynamics of Culture."
3 Gerald Adolph, Cesare Mainardi, and J. Neely, "The Capabilities Premium in M&A," Strategy+Business, Issue 66, Spring 2012, Booz & Co.
4 Jens Kengelbach, Dominic C. Klemmer, Bernhard Schwetzler, Dr. Marco O. Sperling, and Alexander Roos, "How the Top Serial Acquirers Create Value - Does Practice Make Perfect?" BCG Perspectives, 4/5/11. Boston Consulting Group.

Additionally, according to many deal experts, the most successful companies create an acquisition strategy that includes the following components:

- **A concise investment thesis** backed by a well-defined strategy to identify and channel the acquisition focus.
- **A broader cross-functional** team that gets involved early and stays involved throughout the strategic planning process and execution.
- **An objective critical analysis** including an internal assessment of their own company as well as an assessment of external factors that can impact successful value creation.
- **A formalized discipline to identify and evaluate targets,** consistently applied to every opportunity.
- **Metrics to measure** progress toward value creation.

The following pages provide insights into how the most successful acquirers address each of these areas.

I. Creating a Concise Investment Thesis

Vision can mean many things to many people. For practical purposes, we'll define the corporate vision as "an aspirational description of what an organization would like to achieve or accomplish in the mid-term or long-term future. It is intended to serve as a clear guide for choosing current and future courses of action.[5] Strategic vision answers where the company will compete, why it chooses to compete there and on what basis it will compete…The strategic plan or competitive strategy defines how the organization will compete in chosen markets to win. It comprises the integrated set of actions, including M&A, that will be taken to achieve its goals.[6]

Expert dealmakers recommend that every company take time to discuss, define and document their corporate vision and the potential strategies that can be applied before advancing to M&A acquisitions. This is critical to ensure that M&A acquisition decisions are considered with the overall growth strategy in mind – not in isolation. This sounds like a basic exercise that virtually every company should have completed long before embarking on its M&A acquisition strategy, but in reality, many have not.

Serial acquirers and large multinational companies most likely have a documented vision and strategy, according to investment banker Michael Goldman, a founding partner and managing director of TM Capital, but this is very often not the case for small to midsized firms. When he encounters clients who are poised to buy a company without having a plan in place, he advises them to "do their homework."

5 http://www.businessdictionary.com/definition/vision-statement.html
6 Kenneth Smith and Alexandra Reed Lajoux, The Art of M&A Strategy, (New York: MacGraw Hill, 2012), 94.

"Sometimes we find we have to actually slow the client down so that we can help them really achieve their ultimate goal," he said, "There is always a temptation to go ahead and do the deal that is at hand. But our fundamental goal is to help them build shareholder value, not get a deal done. We encourage them to take a step back, and we help them do their homework, so that when we end up completing a transaction for them, it's not just that the deal got done – it's that we helped them complete a deal that is going to build value."

The Role of the M&A Acquisition Strategy in Corporate Growth

A good acquisition strategy includes well-defined goals, coupled with guidelines that channel the efforts of the M&A acquisition or corporate development team. Companies use M&A to achieve a variety of objectives:

- **Develop a Corporate Portfolio** - Private equity firms and holding corporations use M&A acquisition and divestiture strategies as a primary means to create financial returns for their shareholders. These companies build a portfolio by acquiring platform companies that typically operate as standalone, rather than integrated entities. For example, private equity firm Castle Harlan has built a thriving business, with roughly $6 billion in capital commitments, by employing an investment thesis that targets companies with strong defendable market positions that are go ing to thrive in both good and mediocre times, and can be purchased for a reason able price. "Of all of the opportunities we consider, half are dispatched fairly quickly because they don't meet our criteria," he said. "Identifying the good investments is hard work, but by keeping your nose to the grindstone and looking at a lot of things, out of every thousand opportunities, a few good companies with the qualities that we want will appear, even in relatively difficult times." [7]

- **As a Product or Market Expansion** - Many companies view M&A as an effective way to expand their existing product line and also enter into new markets. For ex ample, Jarden, a consumer product company that has grown from $250 million to $6.5 billion in 10 years, has expanded its product line in its existing markets and its footprint into new markets largely through acquisition. Expert dealmakers ad vise acquirers that this can be difficult to achieve and it takes a long-term commit ment to realize value, especially when venturing into foreign markets. "Our company just bought a $70 million Brazilian company that specializes in the outdoor product space," Franklin said, "But it will be three years before we see an impact on revenue for the initiatives we are putting into place today."

- **Consolidation Strategy** - Some companies may embark on an acquisition strategy to maintain competitive scale or scope in the face of economic, market or regulatory

changes. This trend is evident in the telecommunications industry, which has changed dramatically as a result of new technologies and changing regulations that have yielded new ways for consumers to communicate. Certain companies such as Verizon have protected their market share by developing a long-term growth strategy with steady M&A acquisitions to reposition the company for the future.

- **Future Positioning** - An M&A acquisition strategy can also useful in helping companies leverage external opportunities to position themselves for future initiatives. In such cases, an acquisition may not necessarily be attractive for its ability to create revenue in the short term, but as a weapon to protect or position the com pany for future advantage. For example, a company may determine that it needs to acquire companies who bring new technologies or business practices that will help transform the company for future growth. If this is articulated in the growth plans, it can help ensure that the original intent is retained once an acquisition is complete.

Keeping a clear view of the reasons why an acquisition strategy is being deployed is crucial, yet there is always the risk that original intent can be obscured by the day-to-day policies and procedures that make a company run. Experts recommend that the strategic reasoning behind the acquisition is clearly communicated – on an ongoing basis – to everyone affected by it.

“My company has bought good companies specifically because they know how to do things that are different than what we do,” said Alex Vacca, Corporate Director of Business Assessment for a global security company, “In those cases it becomes really important to preserve the autonomy. It goes back to the rationale you articulated when you started looking at a deal in the first place. That’s why writing down that rationale and knowing it makes sense, because you can lose sight of the whole reason that you bought the company - to preserve its unique approach and heritage. You vertically integrate it and then you wreck it.”

Balancing M&A With All Other Options for Growth

A good M&A acquisition plan should be balanced with all other growth mechanisms at a company’s disposal. M&A is exciting work that, when all goes well, can deliver tremendous upside to an organization. Part of its attraction is that it has the potential to deliver value much more quickly than organic growth.

“For example, you may decide you want to expand your sales into the Argentinian market,” says Francisco Cerezo, partner at Foley Lardner, LLP, “One approach is to build out your own distribution operations, but it may take several years to gain market share. Conversely, you may be able to acquire a company, use their existing channel, and be selling your product into the market in as little as a year’s time.”

It's easy to see why, when an acquisition can act as such an accelerator of business, it can be tempting to focus on M&A acquisitions as "the" investment strategy. But dealmakers like Cerezo advise clients to consider all their options – organic growth, partnership and M&A acquisition. Depending on the circumstances, a company may be able to create greater value more quickly by pursuing a joint venture, strategic alliance, marketing/operating agreement or de Novo startup as viable alternatives to M&A. In the example above, Cerezo noted, "Is acquisition the right approach? Another option may be a joint venture with a strong distributor. You gain an experienced partner who knows how to bring your product into a new market, for potentially much lower cost than an acquisition."

"All options should be weighed equally when you're making decisions to expand or change a business," said Vacca, "The question to ask is, 'Are we better off buying this, developing it internally or approaching it with a partner?' For any given opportunity, it may be that M&A sounds like it could be the right thing. But to think of an M&A strategy as distinct from the corporate strategy, R&D strategy or partnership strategy, I think that's wrong. It leads people to a make a lot of inconsistent choices."

One critical factor, according to Mark Sirower, principal at Deloitte Consulting and U.S. leader of the firm's M&A Strategy practice, is being able to concisely define the role that M&A is going to play in your company's growth strategy. "Is it going to account for 10% of the growth strategy? Or is it 20%, 30% or 60%? Until you get to that, you're just kind of following deals," he said.

A Balancing of Definition and Flexibility

An acquisition plan should be definitive enough to direct the team's efforts, but also broad enough to allow for a range of possibilities. "If your strategy is too rigid, you may dramatically lower your probability of success," said Brad Gevurtz, head of investment banking for D.A. Davidson & Co. "For example, you may decide that you want to acquire a top-tier consumer products company that will give you access to Brazil, and that you don't want to pay a full price for the company – and in setting these criteria, find no match. So the 'best' strategy in theory leads to a failed acquisition policy in practice. As a result, if you establish a more flexible set of criteria, you could get a company that meets 90 percent of what you want. Don't let the "perfect" theory crowd out the best deal. Should you be rigid or flexible? If you can be flexible, you have a much better chance of being successful."

Equally important, a company's M&A acquisition strategy needs to be flexible, but not reactive. Patience and conviction are critical, according to Goldman. "On the buy side there are tremendous lead times. The time is extensive and the probability tends to be low on any particular target," he said, "So being steadfast in your approach, focused and having conviction that 'this is what I want to do' is really important. If your strategy is changing every six months and if the lead-time for getting anything done is eight months, you're not going to complete any transactions. Once you set the course, having some conviction about it is important."

> "It is always best if the management team has a proven, successful track record in completing acquisitions and integration because that could be one of the biggest risks."

II. Creating a Broader Cross-Functional Team

The M&A acquisition strategy may be executed by the corporate development team, or in the case of small to mid-sized firms, members of the company's senior management – typically legal, financial, operational and sales operations. One point that all deal experts emphasize is that M&A experience is a must, whether it is met by internal or external resources.

According to Cerezo, some of the most successful acquirers he has worked with have built extremely competent deal teams staffed by senior legal and financial professionals who've had successful careers working for investment banks and law firms that specialize in M&A. "These companies place enormous importance on having the right M&A experience on their team, because they can see that it drives better deals," he said.

Functional expertise, however, is taking on greater importance in day-to-day corporate development. "The best and the leading practices that we see are those in which the company has incorporated functional involvement in corporate development thinking," noted John Potter, a partner in Transaction Services for PwC, "At times other than when an acquisition is on the table, the functional people need to be involved. How well understood is the strategy across the functions?"

Active, Ongoing Participation by Functional Management

Deal experts like Potter believe that the companies have a greater chance of successfully creating value when functional management is closely connected with the areas of growth acquisition that corporate development is focused on. This orients them so that when the opportunities do arise, they bring the perspective of the larger strategy to the table.

"This is important, because they're going to be asked to look at a target and help the company assess if this is the right business and if it is going to fit into their growth strategy, so they need to be connected," Potter said, " Secondly, they need to put on a lens that doesn't say, 'Let me compare them to me, but rather let me compare them to what we want to be. Is this additive? Help me assess what this is worth to us.'"

For Castle Harlan, it is important to include functional managers from its platform companies on the team. "You have to have a deep understanding of the industry from both the investment team

and the management team from the platform company," said Joyce Demonteverde, vice president for Castle Harlan, "It is always best if the management team has a proven, successful track record in completing acquisitions and integration because that could be one of the biggest risks in terms of executing an M&A growth strategy. Otherwise, integrating companies can take longer and be more challenging than originally thought."

Early Assessment of Human Resource and Other Organizational Factors

M&A experts also recommend that human resources should be involved early in the planning process. This is the best way to effectively assess and plan ahead to address organizational and cultural elements of the deal. Human resource managers can be instrumental in identifying critical employment practices that have a significant impact on the financial, legal and organizational structure of the deal. For example, companies considering acquisitions in European countries must be prepared to deal with a much more restrictive employment environment that does not readily allow employee reductions as in the U.S. Or, companies unknowingly take on huge costs as a result of problematic pension plans.

Then there is the enormous issue of cultural integration that every acquirer must address, whether dealing with domestic or cross-border acquisitions. Many deal experts have noted that the lack of a strategy for addressing culture is one of the most important risks a company can face. In Vacca's opinion, a poor strategy for addressing culture is one of the most important risks a company can face, because culture is so hard to measure.

"When you look at a typical deal team, you have technology people, lawyers checking the IP, financial people checking the numbers, etc. These are all concrete, easily defined quantifiable tasks, which come back either above or below the hurtle rate. Based on all those numbers, you decide yes or no for the deal," Vacca said, "Culture is non-quantifiable and that makes it tempting to think it's not important. And once you think something is non-important, you don't look at it simply because you can't measure it easily. This is where companies end up getting into trouble."

Some companies have addressed this challenge by adding professionals like Vacca, who is both a corporate strategist and a trained social scientist, to the strategic planning team. "As a social scientist, I'm accustomed to dealing with non-quantifiable factors. Providing the deal team with the means to evaluate and incorporate non-quantifiable factors such as culture into the deal process is a big differentiator," he said, "I am not saying non-quantifiable factors trump quantifiable or vice versa, but you have to consider both."

Strategic Communications Planning

Deal experts also advise companies to include communications as part of the strategic planning process. In M&A just as anywhere else in the world, perception often is reality – and the company

that plans its communication strategy in conjunction with the M&A acquisition strategy has a much better chance of conveying its desired message to its internal and external audiences. Failure to plan in advance can result in communication voids or misinterpretations that could result in negative rather than positive support of the transaction.

This is such an important aspect of M&A planning that advisors such as FTI Consulting have built M&A communications strategy into their client services. Clients rely on FTI to help them create a plan that addresses a multitude of situations. One imperative, according to David Roady, senior managing director at FTI, is to craft the right message as it pertains to each of the various stakeholders.

"Typically when you are looking at a transaction, most c-suites are looking primarily through the eyes of the investor audiences – 'Will the transaction be accretive to earnings? Will I be able to generate X synergies, in what time frame, and is this consistent with strategic rationale?'" Roady said, "Most companies do a pretty good job of communicating that. What they don't do is communicate to employees. Many times, the press release is the 'be and end all' of the communication and they'll fail to engage employees by failing to give them that same level of understanding as to 'how will this align with the corporate strategy, how will this affect me and how will we/I work together with my new colleagues at the target company?'"

Another important risk, Roady noted, is the failure to understand the impact of today's 24/7 media cycle and the rapid escalation of how a message can be rolled out. "So if someone else takes your message or the deal leaks, you lose control of the perception of a given transaction," he said, "So what we reinforce is a multi-stakeholder communication strategy where all of the stakeholders are hearing from you first as opposed to having social media, bloggers and traditional media pick it up and the story unfolds outside of your control."

The goal is to bring communications into the planning process early, allowing time to create the kind of multi-level plan that allows the company to, at least initially, control the flow of information about its acquisition. Without a communications plan in place, the buyer and seller, at a minimum, lose a valuable opportunity to present the positive attributes of a given acquisition. Even worse, they may find themselves in a reactive, rather than proactive communications dynamic with their stakeholders.

III. Conducting an Objective Critical Analysis

According to Goldman, one of the key characteristics of successful acquirers is their willingness to objectively assess their own organization before they embark on an acquisition plan. They take the time to form an understanding of their own core strengths and weaknesses, their market position, competition, and where the real opportunities are in their existing and adjacent markets.

“That self-assessment takes time, research, and effort – and it takes thinking about your own company in a critical fashion, the way a third party might look at it,” he said, “Companies don’t often like looking in the mirror that starkly, but it is really important at the beginning of an acquisition program. Our clients who do this difficult and sometimes tedious homework before they start thinking externally and reaching out are much better positioned to succeed.” In fact, Goldman has seen clients drive very favorable returns by taking the time to perform this sort of self-assessment and gap analysis. For example:

> “One of our long-term clients was Immucor, Inc., a company in the blood transfusion diagnostics market. When we started working with the company, their market value was under $100 million. They were just sold last year for over $2 billion. This was a company whose board and management team really were able to look at themselves, recognize where the gaps were and then move aggressively to fill them. They completed some domestic acquisitions to help consolidate their market position and some international acquisitions that gave them entree into new markets. Other acquisitions were done to move the company into next-generation technology that would’ve been much more difficult to develop internally. These things do not happen overnight, so start to finish, this was probably about a decade-long process of making a series of acquisitions, building value, integrating businesses and ultimately realizing on that value. But I think the key was in each case, the acquisitions provided the right strategic fit at the right time, and that combination makes all the difference.”

An acquirer’s own corporate culture should be included in the assessment process. The better the investment team can articulate the most important aspects of its culture, the more successful the company will be in executing its acquisition strategy. According to Vacca, one of the most important characteristics acquirers should know about themselves is their organization’s ability to embrace change.

“Companies often overestimate their own willingness for change,” he said, “So for example, you can say that in order to fully realize the value of this deal, you have to let this business unit operate quasi-independently, and management nods their head and agrees. But as soon as they buy the company, they start to say, ‘we can’t really let it do that, can we?’ It would be much better for the company to acknowledge that it wasn’t really willing to follow through on the autonomy in the first place. Instead, they often overestimate their willingness to change before a deal and once the deal is done, they get nervous about what they signed up for and it doesn’t work.”

This self-assessment is particularly important for companies considering cross-border acquisitions. From a transactional perspective, does your company have the M&A experience to handle these deals or do you need additional outside expertise? Does your company have the diversity of skills necessary to manage an acquisition in another country?

IV. A Formalized Discipline to Identify and Evaluate Targets

Successful acquirers have developed a formalized process that "filters" potential targets based on the criteria defined in the investment strategy. Successful acquirers use this filter process consistently for all potential opportunities. This has proven to be an effective way to prevent the temptation of considering "hot" deals that look attractive but do not fit the profile.

"Deals can exist in dissociation," said Vacca, "People can get excited when they see something interesting in writing and get a little carried away. I've seen other companies as well as my own get caught up in this but the discipline we use tends to shut that down early, because it usually doesn't work out well."

How Evaluation Guides Strategy: An Iterative Process

During his tenure as senior vice president of worldwide business development ADP, Durity and his team employed a structured methodology that measured every target opportunity according to the company's investment thesis. This enabled the team to ensure that its business goals were present throughout the decision process. It also yielded an iterative process that allowed the company to test its thesis:

"Every year, we'd look at approximately 400 to 500 potential transactions. Of that total, 60 to 70 percent would get dispatched fairly quickly," he said. Opportunities would be evaluated in the following way:

1) Is this potential opportunity "on strategy?" Is it a good strategic fit? Half of the opportunities probably fail for that reason. It doesn't mean they get dispatched in a moment's time, because there may be a lot of dialogue around a particular opportu nity – about whether it is on strategy or not, or a review to determine if our strategy was correct in light of changing market conditions? In this rapidly changing world, you should be asking yourself, "Are we right here? Here is something of value that the target is doing – why are we not doing something like this?"

   That kind of dialogue should be on going as a healthy vetting process because you should constantly be testing your own strategies. "Are we right here? Has the world changed or is there something going on that we aren't aware of? Should we think about altering our strategy?" This line of dialogue doesn't mean you should be changing your strategy frequently, but you should be testing it.

2) Does this company meet our financial requirements, (whatever they happen to be)? Every company has it own criteria. This may come down to a simple hurtle rate; what will it take to acquire the company; what are the target's earning and cash flow? What sort of realistic financial synergies can we bring to this target and what will be the financial impact? Probably another 20 percent of potential opportunities will sift out at that point because of missed financial objectives.

3) Do the deal mechanics fit? For example, is this an auction or a proprietary corporation-to-corporation deal? What is the environment around this transaction and are there dynamics with which we are comfortable? There are some auction environments where you are just wasting resources to be in the pile, and internal resources are scarce. If you're looking at 500 or 1000 opportunities a year, you need to be focused on the deals you can get done, not on the things that are so contested that you're just not going to complete. Some of that discussion, by the way, takes place at first level of screening as well. How do we think about the deal dynamics and is there a way that we can change the deal dynamics to be more in our favor?

4) First level of due diligence. If an opportunity makes it through these filters, now is the time to dig into the company, most likely in an electronic data room. While it wasn't the case ten years ago, virtually every deal we see now has an electronic data room.

In Durity's experience, developing a sound acquisition strategy takes thoughtful analysis and discussion from all members of the development team as well as business unit management. It also requires a high level of communication between team members. He's seen the best results when the team periodically gets together for face-to-face meetings.

"Eyeball-to-eyeball contact builds esprit de corps among the team. Today, it's harder to build that spirit of cooperation because many members of the team can be scattered in many geographic locations," he said. But there is tremendous value in getting everyone together around the table to go over what they've learned, what issues they've bumped into, and what additional resources they may need. This prevents critical information from being siloed, and ensures the best due diligence and superior outcomes."

Every company has its own criteria for evaluating targets that are unique to its organization, industry and long term goals. Strategic buyers may take a different long-term view than portfolio companies, particularly if their goal is to integrate the new acquisition into the organization. But for portfolio companies, the filter needs to also include the exit strategy.

Noted Demonteverde, "It's important to have an idea of how you think you would exit an investment before you even get into the investment. This will help inform how attractive the investment is to begin with, and will also dictate some of the decisions you make in terms of building that company to a certain scale, etc."

Creating a filter is invaluable for many reasons:

- Prevents overpaying – A number of factors can drive up the bidding and entice buyers to pay more for a target than the value it can deliver. This is especially true in competitive markets where there are many buyers looking for attractive targets. One way to ensure that you don't over pay is to adhere to your acquisition criteria.

- Provides a basis for comparison – Does the acquisition have to be the leader in the mar ket niche or are there other competitors who may meet the acquisition criteria for a more attractive price? Applying the same filter to all will enable the team to compare "apples to apples" more easily.

- Prevents "one-off" acquisitions that do not fit the investment thesis.

- Prevents team from wasting valuable time and resources pursuing deals outside the investment strategy.

Ultimately, adhering to a formalized filter for evaluating targets ensures that the company's original goals are being considered in every potential opportunity.

The Importance of External Factors in Assessing Opportunities

Nowadays, in addition to performing a deeper dive into a potential target, successful companies are spending much more time to learn about external factors that can impact the acquisition's ability to create value. This includes a "deep dive" into the targets industry, market, competitors, and other external factors that may affect a target's ability to create value.

Without this intelligence built into the strategy, a company may find that it takes much longer to realize value, or the venture may even fail. Cerezo has seen this problem occur when U.S. companies enter into a new country without understanding its demographics. "For example, a large U.S. consumer goods chain launched a campaign to expand its sale channel into Puerto Rico but failed in its first attempts," he said, "Because its new stores were based largely on its U.S. store models. The company did not understand the particular buying habits of the local population or its local competitors. As a result, their new stores did not appeal to the Puerto Rican consumers. They had to completely start over. They were eventually successful but it took much longer and cost them much more to establish a presence."

> "One way to ensure that you don't over pay is to adhere to your acquisition criteria."

This can also be a problem for companies who target a specific country as part of their growth strategy. "We work with many companies who want to grow their sales by selling their products in China," said Al Ernest, senior consultant and partner for advisory firm East West Associates, "People have this great vision of 1.5 billion people in China. Yes, there are 350 million people with a disposable income at this point, a group as big as the U.S. population. But their disposable income is not nearly as large as ours. Then you have a cultural difference with respect to product demand and acceptance, also the Chinese are thrifty, how will thrift affect your product offering. So you have to look at whether your product even fits the culture or not. It's all part of developing a viable China strategy."

In Goldman's view, many companies have become pretty proficient at understanding the risks that are internal to a particular target they are considering, but there is still a gap in the area of assessing external risks.

"You can review a potential target's financials, look at their performance and go into their structural and legal issues," he said, "But none of that will really speak to whether or not there is a competitor who is about to introduce a competitive product that will substantially impact the company or whether the markets the target is serving are going to change in some fundamental way in terms of their growth characteristics." External due diligence on factors such as this, he noted, can be more challenging, yet it can be just as important in assessing the risks of the deal and deciding whether or not it will be a value-building acquisition.

V. Put Metrics in Place to Measure Progress Toward Value Creation

Another critical differentiator of the most successful acquirers is that they don't lose sight of their investment goals for a particular acquisition once the deal is done. Ernest believes that acquirers have a better chance of succeeding when they build success metrics into their strategic plan.

"The most successful company has created an excellent vision, mission and business case, and they don't put it in a drawer after the acquisition and expect to run the business," he said, "Instead they keep it in front of them so they know what their goals are, they have good metrics and they can track their progress."

Metrics to Ernest means the development of a good pro-forma, P&L, or budget that begins with research to develop the top line, the sales, revenue and the margin, and then goes all the way down through start-up costs to get to the bottom line. "Is the bottom line going to fit your vision

and your metrics? You need to invest the time in this exercise up front to ensure that the strategy you've developed is based on a business model that can deliver value," he said.

This may be a standard exercise for U.S. companies buying companies on their home turf, but it can be decidedly trickier for U.S. companies buying targets in emerging markets. One danger is that if the metrics that were applied during the planning phase of an acquisition strategy differ from the actual cost factors in place once the deal is done, value can quickly be eroded.

In cross-border acquisitions, companies need to be especially mindful of the source and the timeliness of the data being used to build their business case. For example, companies interested in acquiring an asset in China may first develop their own business case and then bring in advisors such as East-West to validate their numbers.

"When you're thinking of acquiring a company that is 8,000 miles away from your corporate headquarters, it can be difficult to have a true sense of the cost factors that should really apply," said Ernest, "Cost structures vary from region to region in a country like China. The availability of certain kinds of skilled labor also varies, as does the availability of materials that we take for granted here in the U.S. So you may find that you need to bump up your cost factors in a much different manner than you do on U.S. acquisitions. Otherwise, you'll be losing value from 'Day 1,' or it may take much longer to ramp up than your model called for."

In situations like this, where the risk factors can be very high for companies entering new markets, it may be wiser to choose another option such as a joint venture, strategic alliance or marketing/operating agreement.

Such partnerships can be challenging to manage, but they can also allow companies to try a new growth strategy with less risk than they'd carry by taking on an acquisition. They may also make better financial and strategic sense in certain situations.

There is definitely a time and place for such transactions according to Jeff Golman, Vice Chairman and Head of Mesirow Financial's Investment Banking practice, "but you have to have a clear objective or purpose as to why you're entering into the arrangement and an understanding of what each party is going to be looking to take from the other," he said, "For the most part, we see these transactions in cases where a company is getting into a new line of business and wants to "dip their toe in the water" because it is not their core area of focus. This is a way to minimize the risk, yet see if the opportunity is something that could make sense."

Golman also noted that such arrangements may make more sense in growth strategies where geography comes into play. He said, "If you're going to be doing a deal in an emerging market such as Latin America, India, China or even Russia and you don't have indigenous people and operations there, I think it would be foolish to do a significant material deal in that jurisdiction without engaging with a partner who knows the culture, how business is done, how to go to market, etc. That would be our advice."

SUMMARY

"The days when you could find a great company where the owner has never been contacted by a buyer and the seller is unaware of what his company is worth are over. You can assume if you find an attractive company, the owner has already been called numerous times by strategic buyers, private equity buyers and bankers."
Brad Gevurtz, Head of Investment Banking, D.A. Davidson & Co.

Today's M&A market is a high stakes endeavor that is less and less forgiving of new participants with little experience. Sellers have become much more sophisticated and are demanding that buyers come to the table with much more than a financial reward. More companies are considering foreign investment as a means to drive corporate growth. Traditional buyers are increasingly competing with sophisticated acquirers from emerging markets. All of these factors require broader and deeper intelligence into how and where an M&A acquisition plan should be developed and deployed.

Yet in the face of so many risk factors, leading deal advisors commonly raise three points of recommendation to help buyers improve their odds for success: 1) take the time to develop a well-thought out acquisition strategy; 2) conduct thorough due diligence and 3) plan in advance for a sound integration strategy.

It's fairly straightforward advice, and perhaps easily followed, if M&A was the buyer's only focus. But even the most acquisitive companies can only complete so many acquisitions in a given period of time. Furthermore, even though most buyers are experienced executives, much of their focus has been on running their business.

"That's the challenge – how to bring the infrequent nature of M&A to the same level of execution that you do on the day-to-day business that is front and foremost in most company's minds," notes Potter, "It's a balancing act that is important to recognize."

As the first step, all buyers are best served by investing the time to develop a sound acquisition strategy and testing it through experience and feedback from other seasoned deal advisors.

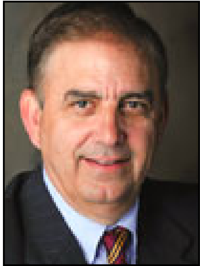
Contributor Biographies

John K. Castle is the Chairman and Chief Executive Officer of Castle Harlan, Inc., a private merchant bank. During his business career, Mr. Castle has owned or controlled companies such as Delaware Management, Ethan Allen, Ames True Temper, and Perkins. Prior to founding Castle Harlan in 1986, Castle was President and Chief Executive Officer of Donaldson, Lufkin and Jenrette, Inc. He also served as a Director of the Equitable Life Assurance Society of the U.S. John has also committed a substantial portion of his time to public service. He has been elected a Life Member Trustee of the Massachusetts Institute of Technology, and serves as a Director of the MIT Investment Management Company. Previously, he was Chairman of the Columbia-Presbyterian Health Sciences Advisory Council and has served as a member of various Harvard University Visiting Committees, including the Harvard Business School. Further, in the medical field, he has published various titles related to family health including America's Top Doctors and New York's Top Doctors. John received his bachelors degree from the Massachusetts Institute of Technology, his MBA as a Baker Scholar with High Distinction from Harvard, and two Honorary Doctorate degrees.

Francisco J. Cerezo is a Partner at Foley & Lardner LLP where he is Chair of the Latin America Practice, Co-Chair of the International Practice, and a Member of the Transactional & Securities Practice. His practice focuses on corporate and international matters, advising U.S. and foreign companies, family groups and sovereigns doing business in the Americas and the Caribbean. He has extensive experience in corporate and financial services, cross-border transactions, strategic corporate counseling, mergers and acquisitions, and public-private partnerships. Mr. Cerezo is also a member of the firm's Automotive; Hospitality, Resort & Golf; Insurance; and Energy Industry Teams. Mr. Cerezo has been featured or cited in numerous publications, including the American Lawyer, Latin Lawyer, Miami Herald, Financier Worldwide and the Daily Business Review. He is also a regular television commentator on matters of international and corporate law, with appearances on CNN en Español and CNN Headline News. Mr. Cerezo was listed in Chambers USA: America's Leading Business Lawyers, an annual listing of the leading business lawyers and law firms in the world (2010 - 2012). He was selected for inclusion in the Florida Super Lawyers – Rising Stars® (2009) lists in the areas of international, mergers & acquisitions, and securities & corporate finance. Mr. Cerezo was the recipient of the John Edward Smith Child Advocacy Award. Mr. Cerezo earned his J.D. from Columbia Law School. He received an LL.M. in European Union Law from the Universidad Complutense de Madrid. He earned an M.A. from the University of Virginia and a B.A. from Washington University in St. Louis. Mr. Cerezo is admitted to practice in Florida and New York. He speaks fluent Spanish and conversational French.

Joyce M. Demonteverde is a Vice President of Castle Harlan. Prior to joining Castle Harlan, Ms. Demonteverde was an investment professional at J.H. Whitney & Co., where she focused on investments across a number of industries including consumer, specialty manufacturing, healthcare and business services. Previously, she worked in the Healthcare Investment Banking Group of Goldman, Sachs & Co., where she focused on merger advisory and debt and equity financing transactions for global healthcare clients. Ms. Demonteverde is currently a board member of Baker & Taylor. She graduated Cum Laude from Harvard University with a B.A. in Economics, and earned her M.B.A. from the Harvard Business School. She currently serves on the Associate Committee of the Harvard College Fund.

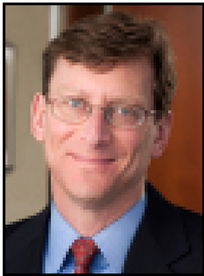
Harry Durity is a Senior Advisor at New Mountain Capital, which he joined in May 2005. From 1994 to 2005, Mr. Durity was the Senior Vice President of Worldwide Business Development, Head of Merger and Acquisitions group, and a Member of Executive Committee at Automatic Data Processing (NYSE: ADP). Prior to that, Mr. Durity worked for Revlon Consumer Products Company as a Senior Vice President of Corporate Development, where he also served as a Member of the Executive Committee at the company. From January 1990 to January 1993, Mr. Durity was president of the Highlands Group, a boutique mergers and acquisitions advisory firm. Prior thereto, he served as a Vice President/Corporate Development for RJR Nabisco, a consumer products company, from October 1980 to December 1989. He also served as a Senior Consultant at Arthur D. Little in their Managerial Economics department and started his career at Firestone Tire & Rubber Company as the Chief Economist. Mr. Durity was a Director of National Medical Health Card Systems (NASDAQ: NMHC) and is a Director of OrthAlliance Inc. (NYSE: OCA). Mr. Durity holds a B.A. from Western Maryland College with additional studies in Merger and Acquisition at the Darden School, University of Virginia and obtained a Master's degree from Washington State University.



Al Ernest is a Principal and Senior Operations Leader at East West Association. Prior to joining East West, Al Ernest had more than 30 years of domestic and international experience in technical, manufacturing and leadership positions with Owens Corning. During his career with Owens Corning, he held numerous position in the US and China. In the US, he held positions as: Scientist, Senior Scientist, Project Scientist, and Lab Director at the Owens Corning Science and Technology Center in Granville, Ohio. In 1986, Mr. Ernest received the prestigious "OC Innovators Award" for his development of the SSLII pipe insulation closure system, still an exclusive product offered by Owens Corning today. In 1995, Mr. Ernest accepted a position as Plant/General Manager of the "Building Materials Asia Pacific" Guangzhou, China plant. From Guangzhou, in 1999, he became the Plant/General Manager of the Second Owens Corning plant in Shanghai China. After setting up the Shanghai plant, Mr. Ernest accepted the Senior Management position "Director of Manufacturing and Engineering", his responsibilities included: Operations, Manufacturing, Engineering, Capital Sourcing and Science and Technology. He has set up Greenfield plant operations in China and Korea as well as relocated Manufacturing Plants from North America to China. Mr. Ernest built or relocated facilities throughout China and Korea, including Anshan, Tianjin, Wuhan, Nanjing, Beijing, Jiang Yin and Asan. Since 2005, he has been consulting with American and Chinese companies on operations and manufacturing.

Martin E. Franklin is Executive Chairman at Jarden Corporation. Mr. Franklin was appointed to the Board of Directors on June 25, 2001 and served as Chairman and Chief Executive Officer from September 24, 2001 until June 13, 2011, at which time he began service as Executive Chairman. Mr. Franklin is also a principal and executive officer of a number of private investment entities. Mr. Franklin also served as the Chairman and/or Chief Executive Officer of three public companies, Benson Eyecare Corporation, Lumen Technologies, Inc and Bollé Inc. between 1992 and 2000. Mr. Franklin also serves as a Director of Promotora de Informaciones, S.A. and Justice Holdings Limited.

Brad Gevurtz is the Head of Investment Banking for D.A. Davidson & Co. He is on the firm's Public Equity Commitment Committee and heads both the Private Equity and Fairness Opinion Commitment Committees. Prior to joining D.A. Davidson, Brad worked for over 20 years on Wall Street as a senior banker and in management roles at JP Morgan Chase, KeyBanc Capital Markets, and Broadview Int'l (now Jefferies Broadview). He has significant experience in M&A, private placements, and public offerings, and has worked with clients such as Alltel, AT&T, Cadbury Schweppes, Computer Associates, Comsat, GE, IBM, Toyota, Verizon, and Xerox. Brad is a former board member of Thinking Machines Corporation and a former member of the valuation committee of OVP Venture Partners. He has spoken at industry conferences and has been quoted in numerous publications about corporate finance and M&A issues. Brad has a B.A. with Distinction in Economics from Pomona College, a J.D. from the University of Oregon School of Law, and an MBA with Honors in Finance and Accounting from Columbia University, where he was elected President of the top academic honor society.

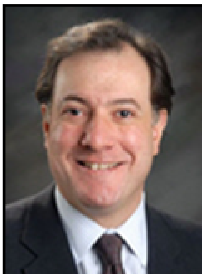


Michael S. Goldman Michael is a founding partner of TM Capital who joined with his colleagues to establish the firm in 1989. He has been responsible for some of TM Capital's most complex merger, acquisition, financing and restructuring transactions for publicly traded and privately held client companies. Michael has developed specialized industry expertise by assisting clients across key industry sectors including healthcare, industrial products, business services, consumer products and retailing. He is a member of the board of directors of Keystone Screw Corp., and previously served as a member of the boards of directors of Lazer Inc. and Immucor, Inc. (NASDAQ). As a board member and as an advisor to Immucor for over a decade, Michael was responsible for myriad transactions executed by TM Capital that helped build Immucor's market value from under $100 million to over $2 billion. He began his career at Thomson McKinnon Securities Inc., where he worked in the mergers & acquisitions department from 1983 to 1989. Michael received a Bachelor of Science degree in Economics with a concentration in Finance from the Wharton School of the University of Pennsylvania. The experience of founding and serving as an owner of TM Capital since its inception has been central to Michael's development as an investment banker, enabling him to consider not only the financial aspects, but also the personal, social and strategic issues that drive transactions. After over 25 years of advising clients and executing assignments, these unique aspects of each situation continue to keep advisory work a fascinating challenge for him.

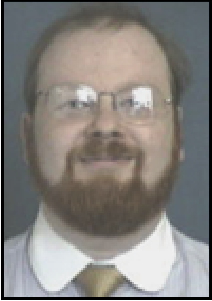
Jeff Golman is Vice Chairman and Head of Mesirow Financial's Investment Banking practice and is a Member of the firm's Board of Directors. He has more than 30 years of investment banking experience. Prior to joining Mesirow Financial in 2001, Jeff was a founding partner of GGW Management Partners, LLC, a management-oriented investment group formed with Madison Dearborn Partners, Willis Stein & Partners and The Pritzker Organization. Prior to that, he was a managing director at Lazard Frères & Co., LLC and opened its Chicago office in 1988. He also served as vice president in Salomon Brothers' Chicago Banking Group, focusing on mergers, acquisitions and corporate finance, and practiced law at Katten Muchin & Zavis, specializing in corporate law and tax. Jeff is a Certified Public Accountant and holds his FINRA Series 7, 8, 24 and 63 licenses. He earned a B.S. from the University of Illinois and a J.D. from Northwestern University School of Law. Jeff is on the board of directors and is a leadership council member of the Cystic Fibrosis Foundation, and is a member of the development council for B.U.I.L.D, Inc. (Broader Urban Involvement and Leadership Development).

John Potter is a partner in PwC's Deals specializing in providing strategic, financial, economic and accounting analyses involving complex business and transaction issues to both private equity and multi-national corporate clients. He also has extensive experience in the capital raising process and financial reporting requirements, which provides an integral connection throughout the deal process. John's experience includes both buy-side and sell-side due advisory work across the deal continuum from strategy to execution. His clients range from middle market to large cap corporations and private equity firms. His experience spans the US, the UK and other developed and emerging markets. John has a Bachelor's in Business Administration from the University of Notre Dame and a Masters of Business Administration from the Kellogg School of Management. John is a Certified Public Accountant.

David Roady is the Senior Director and Head of Strategic Communications - M&A Practice at FTI Consulting. He advises clients on critical communications and business strategies facing enterprises during moments of change, including mergers & acquisitions, merger integration, restructurings, business transformation, and regulatory and litigation issues. Mr. Roady leads the multi-practice team advising Allstate and also is a senior member of teams that advise The Coca-Cola Company, FTI Consulting, Citadel, Legg Mason, and Radian. Since 2008, Mr. Roady has led M&A teams that advised The Coca-Cola Company, Allstate, KCI, Teva, Cooper Industries, and Tokio Marine among others in their respective acquisitions. Mr. Roady joined FTI Consulting with 10+ years of experience in mergers & acquisitions and merger integration, most recently as Senior Vice President in M&A for Marsh & McLennan & Co. and as a Director in Corporate Development for American Express. Since graduating from the Harvard Business School in 1999, Mr. Roady has served as an investment banker at UBS in London and led multi-national teams in M&A and most aspects of corporate financial management including treasury, investor relations and business development.



Mark Sirower is a principal at Deloitte Consulting in New York and U.S. leader of the firm's M&A Strategy practice. Previously, he co-founded and built the Transaction Services Strategy Group at PricewaterhouseCoopers to over 50 professionals in four years. For five years prior, Mark was global leader of the M&A practice with The Boston Consulting Group in New York where he developed the BCG corporate development framework and innovative approaches to crafting and executing corporate, business, and M&A strategy. Prior to joining BCG, he taught Mergers and Acquisitions at the Wharton School and consulted extensively on strategy and valuation issues in M&A transactions. Mark actively advises corporate and private equity clients in growth strategy and innovation, M&A strategy and governance, target screening, commercial due diligence, synergy testing, investor relations, and post-merger integration engagements. He also advises boards on governance issues related to M&A decisions. He has been most active in helping consumer goods, financial services, industrial goods, and pharmaceutical companies rethink and grow their businesses profitably through M&A. He focuses on transforming clients from merely reacting to growth opportunities to having the capability to proactively determine growth priorities, find the best opportunities and grow shareholder value. He has a reputation for leading-edge thinking, outstanding client relationships, and for spotting talent and developing and mentoring successful consulting teams.



William Alexander Vacca, Ph.D., is Corporate Director, Business Assessment, for a global security company. In this role, he is responsible for assessing and forecasting the broader strategic, financial, and technological trends affecting the global defense industry and evaluating options for the company's strategic trajectory. He joined the firm in 2001. Dr. Vacca has also done pro bono research and analysis for OSD-Director of Net Assessment, Naval Research Advisory Committee, and the Industrial College of the Armed Forces. He serves as lead for the TechAmerica (f/k/a GEIA) Defense Industry Outlook team. A native of Milwaukee Wisconsin, Dr. Vacca received his BA in Political Science from Miami University of Ohio in 1995. He earned an MA in Political Science and International Relations from the University of Kentucky in 1997, and a Ph.D. in the Political Science at Rutgers University in 2009. His work has been published in Survival, Parameters: The Journal of the US Army War College, and The Wall Street Journal. In 2011 Dr. Vacca was named to the 25th Anniversary Board of Advisors for the Belin-Blank Center for Talent Development and Gifted Education at the University of Iowa. Dr. Vacca is a member of the International Institute of Strategic Studies, the International Studies Association (Security and Intelligence sections) the Royal United Service Institute, the Navy League of the United States, and the Association of Old Crows. He is married to the former Eva Vychodilová and resides in San Pedro, California with their two sons, Niccolò and Tomi.

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