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Strategies for the Downturn: Effective Mergers & Acquisitions

Forum

Date: 22 April, 2009

Hosts

Accenture

Chair

Charlie Wagstaff, Criticaleye

Panel

Andy Tinlin, Executive Partner and Head of UK Corporate Strategy Practice, Accenture

Mikael Kramer, Vice-President and Head of Mergers and Acquisitions, Vattenfall

Anil Hansjee, Head of Corporate Development EMEA, Google

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*This write-up is based on the proceedings of a recent Forum held for Members of the Criticaleye community. Participants heard a panel of experts discuss **strategies for the downturn: effective mergers and acquisitions.** Following three short introductory speeches, the panellists were asked questions by the audience. Aside from the speakers, no names or companies have been noted to encourage open debate. To watch a video of this event, please sign into the Criticaleye website at http://www.criticaleye.net and click on Insights, TV.*

Introduction

The current downturn will have a profound impact on consumers and enterprises alike. In the face of such economic uncertainty, many companies' outlooks are limited to survival, so growth is far from their minds.

However, while many organisations are struggling, enterprises with strong balance sheets may find the current environment highly conducive to creating value from acquisitions. In a climate of reduced competition for acquisitions, lower prices enable acquisitive companies to make bolder 'strategic plays', gaining market positions they would have previously not had the resources to fund.

While these opportunities constitute the 'silver lining' of the current climate, executing M&A is fraught with challenges and never undertaken lightly. The keys to successful M&A during a downturn are the same as ever. Ensure the underlying valuation correctly measures realistic revenue potential; stay true to growth strategies and examine targets that fill an identified need; properly address synergies and effectively execute the integration of an acquisition so the enterprise can meet the operational and financial targets justifying the deal.

Speeches

Accenture's Executive Partner and Head of UK Corporate Strategy Practise **Andy Tinlin** began explaining that Accenture's experience in working in cross-sector pre and post-deal acquisitions has demonstrated that M&A are coming back strongly in both the private equity and corporate worlds.

Those companies making M&A decisions, not as survival strategies, but based on laying the groundwork for substantial future success, will emerge strongest in the next decade. And while valuations are low, cash buyers are strong. Andy then shared his views and knowledge on individual sectors:

Banking

Partly due to government intervention and the differing nature of credit markets, the main issue for financial services is uncertainty. Banks know that they need to adapt and move to different operating models, and therefore must ask fundamental questions such as: *How do we address customers? How do we manage our supply chain? How do we manage cultures of different companies coming together?*

A culture of fear and mutual disrespect has led to an unusual level of antagonism in some recent mergers.

Resources

Specifically in the oil and gas sector, there is a lot of of volatility driven by oil prices and end-markets. More M&A activity is expected in the next few months with buyers seeking good-priced assets below market values.

Products/manufacturing/pharmaceuticals

Strong cash buyers are entering into alliances or making acquisitions and companies that would previously have gone to the external market for debt funding are also freeing up cash internally and preparing themselves to make deals. A positive secondary effect of the credit crunch is the drive to making businesses fitter before acquisitions.

Communications and high-tech

With customer acquisition and retention being a fundamental objective, more activity is expected in this sector. The value chain has been progressively re-orientated towards different people owning customer relationships, which is a source of value in acquisitions.

Public services

Around Europe, and increasingly in the UK, Accenture has encountered much thinking and capability brought into governments to help manage mergers of departments. Furthermore, they are being run closer to corporate entities than they had in the past. This could draw significant management resources from the corporate sector.

Accenture has learned these lessons from successful M & A activities over the last few years:

1. **Leadership** Since the last recession was in the 1990s, this is many leaders' first experience of steering their company through choppy waters.
2. **Resourcing** The more resources you apply earlier, to get things right earlier, the more successful the merger will be.
3. **Customer focus** The more focus on the customer from the outset, the more easily a combined operating model is realised, keeping a competitive position in the marketplace.
4. **Integration** It is important to focus on the areas of most value: customer, supply chain, core-operating model and some back-up for shared services. Companies should merge and combine resources as quickly as possible. Realistically, what doesn't happen in the first 3-6 months probably isn't going to later.
5. **Re-focus** This is a great opportunity for companies to re-focus their portfolios with the swapping and reshaping of assets.

Vattenfall's Vice-President and Head of Mergers and Acquisitions, **Mikael Kramer** continued, explaining that his company's last seven to eight years of growth was mainly based on active mergers and acquisitions. Working largely in utilities, the downturn has yet to hit Vattenfall as severely as other industries. This is because their investment cycles are long, often 30 – 50 years ahead, and as an integrated utility, their business is hedged. If the downturn continues there could be problems as capital expenditure and costs are cut. Smaller energy companies however, particularly the wind industry, are suffering from difficulties in raising financing for existing projects and contracts, and need to sell.

Managing M&A in a downturn depends on whether you're buying or selling. Buying is usually interesting and positive to those involved. However, divestment is generally less interesting and popular, as it is usually too late, or at the wrong market. Timing in a downturn market is important; Mikael therefore offered the following tips to M&A professionals:

1. It is difficult to forecast currently, as you can't rely on historic numbers and need to be cautious.
2. Financing must be arranged well in advance, whereas three to five years ago it was a late phase in the process. Banks are now far more cautious and rightly request more detailed information.
3. Previously un-envisaged opportunities now exist as people have to sell and restructure.
4. With crisis awareness, previously absent possibilities can be recognised and opportunities for prudent restructuring exploited.
5. Sellers must thoroughly prepare assets and perhaps even discuss with banks earlier to initiate transparency early on and ensure there are no surprises for the buyer.

Google's Head of Corporate Development EMEA, **Anil Hansjee** began by describing how his company's corporate development practices, predominantly acquisitions and investments, have shifted in this current economic environment. Acquisitions have driven growth, particularly in new product areas and typically with products that add to the core. The current economy requires a need to reassess and although the Financial Times says M&A are back, the following difficulties remain:

1. Deals are being withdrawn that were agreed in more positive times.
2. Difficulties exist in getting capital to fund.
3. There are difficulties in reaching agreements on valuation
4. Deals already done, with a high preponderance of debt, are seeing defaults or restructurings causing unwinding.

Deals are still difficult to execute and a consequence is that board members have a rational tendency to hold back, rather than risk the core business. However, we could be at that tipping point where evaluations are at such a discount, that every time an executive looks at their core business, they evaluate opportunities for mergers and acquisitions rather than do nothing or grow organically. There are three key points for corporate development teams to make to their board:

1. Evaluation opportunities.

2. Now you can actually take the category leader in a field and, via an acquisition, enter into a new or related area. The Oracle-Sun deal is a good example.
3. There is less competition, as in the current environment there are fewer buyers well positioned from an earnings growth and balance sheet perspective.

Corporate development departments should be ready to execute on these transactions when the board shows interest. Anil provided the following steps of advice to ready M&A teams for quick execution of deals:

1. It is imperative that there is a clear investment thesis aligned to the strategy of the company. Focus on protecting and strengthening the core and secondarily, to create options to exit the downturn with increased flexibility and dynamism.
2. Be prepared with a target list rather than simply responding to inbound targets surfacing from banks.
3. Be pro-active and well-networked. M&A teams should work with line business teams and establish strong internal relationships with sales and product directors. Establish a presence in the external business community with bankers, advisers, private equity shops and generally with people who are in the know about deals so opportunities that fit the target list can be moved upon.
4. Funding and due diligence both now take longer. Negotiation takes longer when there is a difference in value perception, and if the asset is close to bankruptcy, operating within bankruptcy code is an art in itself.
5. Due diligence can't be under-estimated: don't presume the asset's stock price is low just because the market prices are. Question the business model and consider the new post-recession world.

Post-merger integration is one of the main reasons why deals fail. It is therefore essential to focus on human relationships and cultural issues, as these remain the predominant reasons for deal failures.

Finally, this economic environment has given rise to new thinking and different ways of using capital within deal structures, whether through joint ventures and minority investments, joint deals with private equity firms and partnering or alternative structures that may lead further down the line to full mergers and acquisitions.

Question and Answer Session

Do joint venture or minority interest deals work in practice?

Anil: Although joint ventures are complicated, there is a need to remain open-minded and not discount operational complexities. Minority investments also shouldn't be ruled out, as clauses can be structured to give full-acquisition rights.

Andy: Joint ventures often don't work and are particularly challenging at people-based companies and where there is a need to combine sales forces. Minority interests can work when regarded as an investment, rather than a trading platform.

Mikael: Vattenfall do not normally do minority investments with strategic investors so the business can be run independently from competitors, except in circumstances where the minority has been state-owned or sold by municipalities and therefore the investor has a different agenda. Joint ventures can be run successfully when both partners have an equal ability to invest.

Can better communications and PR compensate for lack of funding for M&A activity?

Mikael: Part of success is being able to clearly communicate intentions, ie, what is being done and why.

Anil: Internally, it is convincing executives of the strategic rationale of why a deal is worth doing and the consequences thereof. In the current climate, this is taking longer. Externally, it is two-fold: the negotiation of the price with the seller with a focus on the long-term vision and the market. If it is a public company you need to communicate in order to get other stakeholders on board.

Andy: Internal communication is always important, but particularly now with current economic anxieties. Externally, with deal life-cycles being much longer, framing the strategic context for the merits of a deal is a far broader and more probing process. Finally, make sure both are aligned.

Is private equity returning to the world of M&A?

Andy: Deal volumes on large private equity deals have disappeared and were hit earliest, though mid-market deals remain buoyant. There is now a much greater focus on operational improvement with a more interventionist approach.

Is there a danger if private equity houses get over-involved in operational issues?

Andy: The first issue is the degree of intervention that the private equity firm has within their portfolio, the second is the skills and the appropriateness of the individuals carrying out those roles. The trend towards intervening in companies is increasing as a counter-balance to the lack of financial leverage as a primary tool.

Is it possible to determine cultural integration pre-deal?

Anil: It is made easier with smaller transactions, almost like dating before getting married, by going through a partnership or commercial agreement where you can get to know how they execute opportunities and observe the key individuals involved. For larger deals, outsourced services or dedicated integration teams can be employed.

Mikael: When buying companies within the same industry, both their business models and knowledge of how they should operate are understood. As important as due diligence is, the exchange of views and strategies which brings into the process interactions which are instrumental to both the companies. Most of the integration happens post-deal, by merging in an efficient way.

Anil: A successful way of dealing with cross-nation, cross-cultural issues is focusing on the clear key ethics and values of the organisation, which Google emphasise from the point of hiring.

Andy: There is now a greater focus with corporate buyers on cultural imagery as part of the pre-deal process, mapping the cultures of two businesses and likely barriers. Accenture has learned to keep new acquisitions in a separate new business division for up to three years and gradually assimilate staff into business methods.

Which mergers and acquisitions have been most successful?

Anil: Most of Google's have been successful by knowing the value and strategic importance of the acquisition and often employing the people or the core technology and embedding it in other products. If there is a good understanding of the reasons for doing a deal and how it fits in strategically, then the success is best judged internally.

Mikael: Though statistics say 70 per cent of such activity doesn't work, Vattenfalls' substantial increased dividends have come from mergers and acquisitions, through cutting costs and benefiting from subsequent synergies.

At this point the delegates and speakers were thanked for their contributions and the event came to a close.

Criticaleye (http://www.criticaleye.net), as a community of senior executives, provides members with an experiential platform that allows them to innovate and develop by sharing business experiences and

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