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Q&A

M&A Synergy: Valuation and Integration

Robert Balon and Linda Toops are Managing Partners at Clerestory Consulting LLC, a merger integration, technology adoption and operations firm. We asked Robert and Linda for their input with regards to valuation and integration from both the buy side and sell side.

M.A.: What does the current M&A middle market look like when it comes to systems integration? And how does this differ from previous market conditions?

R.B. & L.T.: As we are sure you are aware, middle market M&A activity is down 86% from just one year ago. Therefore, today's mergers have absolutely no room for failure. We shepherd two distinct types of mergers; those that involve integrating operations, strategic/portfolio mergers, and of course mergers that expand capabilities.

Though M&A activity is down, recent mergers are demonstrating a greater reliance on integrating operations. At the height of 2007, mergers and acquisitions yielded returns that sometimes, but not always overlooked integration from a monetizing perspective. Today's deal market, however, provides high yield opportunities for deal makers on both the sell side and the buy side that are able to leverage systems integration.

M.A.: What are the most important factors deal makers should consider when weighing the integration process and the execution of any transaction?

R.B. & L.T.: Integration mergers are particularly critical for a number of reasons. First, business managers must execute successfully to deliver cost savings and operational efficiencies to shareholders. Given M&A market conditions, the pressure to deliver integration plans is greater than ever. Once the financial and the legal aspects of the transaction are closed, a different type of risk kicks in. Dealmakers should remember that the challenges of integration can undermine promised results.

Rapid and successful merger integration requires buyers to judge the true size and scale of the integration effort

during due diligence, before the deal is closed. All involved should bear in mind that delivering rapid and successful integration results requires a multi-faceted approach.

M.A.: What are the critical integration factors during due diligence?

R.B. & L.T.: There is no shortage of merger integration checklists, success criteria, or recommended steps. After advising more than \$4 billion in projects with Fortune 500 clients, however, we recognize and have developed the most successful integration efforts, which share several common traits. Many dealmakers should know – or probably recognize by now – that every item on each list should not be treated with equal importance. While the latter is difficult, we recommend a prioritized approach that breaks integration down into three manageable components.

First, dealmakers need to review the strategic reasons for the transaction in the first place, and ask:

- What are the basic reasons for the transaction?
- What must both buyer and seller achieve for the transaction to be successful?
- What will the new entity be able to do after integration that it cannot do today?

For example, is the transaction so that one or both parties can:

- Add-on capabilities (e.g., innovation, R&D, sales, service)
- Acquire complementary products or services
- Cross-sell to complementary sets of customers
- Expand geographical market presence
- Achieve economies of scale by streamlining operations
- Create a new brand for the new entity.

From the buy side perspective, buyers should frequently revisit these strategic drivers and manage priorities--as more information is learned about the acquisition. From the sell side perspective, sellers should not overlook these strategic drivers when determining value.

M.A.: Do you have additional checklists that dealmakers can reference prior to or during the due diligence process; and how do these things help with leveraging value?

R.B. & L.T.: Bear in mind, no two mergers are identical, and merger integration activities are not equal in priority. Focusing execution efforts on the areas that deliver the biggest bang for the buck, in the shortest time, requires an understanding of where the greatest opportunities lie. To help frame high-priority, high-impact opportunities, dealmakers will want to pay close attention to both operations and resources:

Operational Areas

- How must functional/operating areas change to achieve our merger objectives?
- How will revenues be enhanced?
- What customer support/service opportunities exist?
- How do we avoid disrupting our most important customers?
- Who are our most important customers in the integrated entity?
- What back-office support, operational efficiencies can be streamlined?
- What is the true effort involved in achieving these things?

Resources

- How will the integrated entity change the current organization of departments and groups?
- Which groups will be combined? Which groups must remain intact?
- How do organizational changes impact facilities?
- Who are the highest performing employees?
- How will they be identified and retained?
- How will integration plans be communicated?
- What business process improvements will be implemented?
- What information technology capabilities are we buying?
- How does this fit with our current IT environment?
- What IT opportunities exist?
- How will differences in business cultures be addressed?
- What is the true effort involved in achieving these things?

M.A.: In order to execute any strategic integration post agreement, what do dealmakers need to know?

R.B. & L.T.: First, understanding a merger's true "degree

of difficulty" during due diligence helps reach an accurate integration budget and minimizes valuation surprises after financial close. Once the deal is closed, focusing execution activities on the things that matter most is the key to successfully managing complex integration efforts.

To that end, we offer some of the most effective practices for managing integration activities.

Metrics

Key business metrics, measurements, or performance indicators are defined before merger integration plans unfold. It is essential that the integration team defines what will be measured, how it will be measured, and who will answer for the results. The integration metrics form the basis for subsequent execution activities.

Communication

Mergers can involve significant levels of uncertainty, business interruptions, fear, and at worst, surprises. Well-crafted project plans are based on weekly momentum; a solid communication plan delivers the right messages to the right audiences. Stakeholders may include customers, suppliers, shareholders, and employees. Special consideration must be given to the highest priority stakeholders to minimize the risk of lost business, disruption, or undesired attrition.

Weekly Momentum

The most effective project plans contain tasks in weekly increments. Merger integration activities move quickly. Senior executives must frequently monitor progress, and stand ready to take action in key areas. More detail is not always better and monthly status reports are too infrequent. Grouping tasks into weekly buckets allows project managers to easily track progress and helps executives visualize where things stand every Friday.

Milestones

Successful mergers are not an event; they are journeys. Prioritization and weekly momentum paves the way for achieving high impact results in 30-, 60-, and 90-day increments. Project plans, merger integration dashboards, and communication plans must be aligned to deliver fundamental business results in measurable milestones that are visible to stakeholders.

Merger Integration Dashboard

Organizing activities into weekly segments is one thing; providing quick, easy, graphical visibility to progress and risks is another. The most effective dashboards highlight the top priority, high impact work streams. They allow detailed project plans to be easily summarized into a one-page executive view. The best dashboards also relate progress in key work streams to integration metrics.

M.A.: Thanks Robert and Linda.