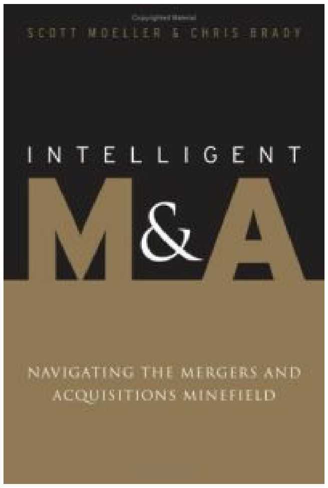

Book Intelligent M&A

Navigating the Mergers and Acquisitions Minefield

Scott Moeller and Chris Brady
Wiley, 2007

Recommendation

Scott Moeller and Chris Brady provide an insightful guide on how to be smarter about M&A. Not only do they remind you of everything that should be involved in the process, they help you think through your situation and determine how to avoid stepping on all the lurking landmines. Most mergers and acquisitions do not live up to expectations, and some actually destroy both companies. This happens when the urge to make the deal overcomes good sense and short circuits the use of sensible information. This book helps you ensure that you are pursuing the right deals. The authors provide sound advice on how to gather intelligence, how to use it to evaluate and negotiate the best deals, and how to learn from every deal – whether you close it or not. *BooksInShort* finds their book thoughtful, easy to read and wonderfully concise.

Take-Aways

- Use business intelligence wisely and you will close better, more profitable deals.
- Don't underestimate the value of the intelligence you can gather from public sources.
- Form a team to design merger and acquisition (M&A) deals that are best for your company over the long term.
- Manage your M&A advisors; do not let them use you for their own benefit.
- When you enter the M&A process, understand whether you are pursuing the target for strategic or financially opportunistic reasons.
- Be sure you understand a target's defenses before you start a hostile takeover.
- Perform your own valuation of a target firm, in addition to consultants' reports.
- Negotiation of M&A deals is a rich, varied field that requires intense mastery.
- Most M&A deals fail because the participants put too little thought into integrating the firms.
- Performing after-action analysis can help you make better M&A deals in the future.

Summary

How Intelligence Makes for Better M&A

Every business publication has articles about mergers and acquisitions (M&A), from rumors of new deals to optimism about those just closed and regrets about combinations gone sour. Some M&A transactions do succeed, but a surprising number fail to justify their business purposes or meet their early hopes, often because the buyers got hooked on closing the deal and failed to verify whether their ambitions were based in reality or fantasy. Instead, use the available tools of business intelligence to identify good ideas and determine when to walk away from bad ones.

> "By employing sufficient and first-rate intelligence as part of an M&A process, companies are able to achieve a higher degree of commercial success."

The reason to pursue mergers and acquisitions is because they promote growth, lower costs and enable you to compete better in your market. M&A is not an exact science and outcomes are far from certain, but you can take steps to improve your chances of making sound, successful decisions. The risks are real, and mistakes can be costly for both the bidding company and the target. Move through the M&A process as if you are working your way through a minefield, using every available resource to avoid disaster and reach your objective.

What Is Business Intelligence?

Great M&A decisions begin with a solid understanding of your organization, your market sector, the regulatory environment that surrounds your firm and your target company, the politics of your industry, and the prevailing social attitudes toward both businesses and the market. Many professional services and industry consultants provide M&A intelligence. If you are adept at digging through the Web, you can get a great deal of valuable information for free from public sources. Delve into these seven categories of business intelligence:

1. **"Immediate intelligence"** – Information you need to help you in the next 24 hours.
2. **"Continuing intelligence"** – More rigorously gathered data that informs your decisions andactions.
3. **"Technical intelligence"** – R&D and product development information.
4. **"Analytical intelligence"** – Useful indicators and how to update them systematically.
5. **"Internal intelligence consulting"** – Background on how to use the data you have.
6. **"Activated intelligence"** – Intelligence work in response to in-house requests.
7. **"Counter-intelligence"** – Measures that protect your sensitive information.

Acquisition Design

When you seek an acquisition, begin by making a long list of potential targets and evaluating them according to your strategic needs. Form a team and select a project manager to analyze, rank and select the targets. Conduct valuations and create structures for possible offers. If you are considering selling a company, analyze the business case. Does it make sense? Determine the value of your company, and the prices and payment structures you would find acceptable. If your firm is the seller, assemble a team to develop a long list of potential buyers. As you accept proposals, streamline your long list and work toward selecting the preferred bidder. Both sides need to work cooperatively and protect confidential information. Information leaks, whether malicious or just careless, destroy many deals. Keep your work on a need-to-know basis.

Managing Your M&A Advisors

In most large M&A deals, each side has consultants and attorneys to help with financing, tax implications, regulatory compliance, intellectual property, and operational and IT integration. Do not let these third parties run the deal. Their interests may not align well with yours. Too often, companies lose good deals because their advisors keep objecting and extending the timeline somewhere toward infinity. One of your most important M&A intelligence tasks is finding the right advisors, understanding their interests and managing them closely to serve your interests. Never let an advisor become the tail that wags the deal.

Selecting M&A Targets

M&A deals fall into two broad categories. "Strategic acquisitions" improve your market position by giving you more reach, complimentary technologies or a boost toward your strategic goals. An "opportunistic purchase" is a deal that looks good because of its price and profit potential. Strategic deals must make financial success, and opportunistic deals need to make business sense, but one facet is likely to dominate and define your primary deal-assembly considerations.

> "Merging or acquiring can be a threat to the current shareholders or a great opportunity. The outcome is never preordained."

Use the best business intelligence available to challenge your assumptions, and make sure your thinking and hopes are reality-based. You do have alternatives to M&A. Internal growth may take longer, but you can see the path ahead. Organic growth does not grab headlines, but it works. You can reorganize your firm by selling nonstrategic assets or realigning your structure to implement your vision. Look into joint ventures, strategic partnerships or small investments in a potential target. Strongly consider doing nothing and continuing as you are. The sense of urgency to do something often becomes a panic to do anything and can lead to disaster.

Defending against Takeover

Not every acquisition target is happy about the prospect. Companies developed lines of defense when leveraged buyouts (LBOs) became popular during the 1980s. Publicly traded firms face this risk because anyone can buy enough voting shares to exert control. Public firms with heavy assets are prime targets because buyers can use a company's own cash and liquid assets to help finance the purchase. Your best defense against a hostile takeover is to keep your firm private. Some public firms adopt "poison pills," preapproved actions that management will take in the face of a hostile purchase. Poison pills often involve radical dilution of existing shares, rich buyouts for top management and restrictions on replacing board members. Some firms turn to more desirable buyers ("white knights"). Others generate negative PR about the potential take-over firm.

Better Due Diligence

Even major companies can experience rude awakenings after acquisitions. VeriSign won praise when it purchased the high-flying German company Jamba AG. Unfortunately, Verisign did not know that much of Jamba's revenue came from distributing pornography, or that it was the target of lawsuits, regulatory problems and bad publicity. This should have come out during due diligence, a serious step you must handle thoroughly and professionally. Rather than avoiding bad news that might derail a deal, work hard to discover any flaws so you can avoid a costly mistake.

> "All mergers and acquisitions should be based on a sound corporate strategy."

Analyze the macroeconomic and regional issues surrounding your M&A target and its industry, including relevant trends. Compare historical numbers to see if the forecast is realistic. If it predicts a sudden positive change, is the rationale sound? How does your target handle competition, innovation and industry changes? Beware of pending obsolescence. Investigate operations, profitability, cash flow, receivables, IT systems and R&D. Dig into legal issues facing the firm, and check its HR policies and turnover. What are its fixed assets? What intellectual property does it have and what is it worth? Does it have unsettled environmental issues? Investigate thoroughly. A bad deal is a bad deal. Find out before you write the check.

Deciding What It's Worth

Valuation has become its own field of study, with many books and articles examining the topic and its various techniques. When you pursue a publicly traded firm, you have the benefit of the market price as starting point. However, you have to do your own work to decide what it is worth to you. What can you do with the firm to increase its value? When you set out to buy a company, the price will rise because you have created new demand. In strategic purchases, you might need to offer a higher per-share price to persuade the present owners to sell control of the company.

> "M&A is a means to an end – not just an end in itself. Unfortunately, in many deals the focus is exclusively on completing the deal and not enough attention has been paid to...various organizational and people issues."

Specialized consultants can calculate the value of a firm in various ways, but also perform your own valuations to get a sense of their results. Never take the target's financial statements at face value. You will need to adjust certain aspects of their evaluation of assets, liabilities, income and cash flows to reflect the company's value to you. Valuing public firms is easier because these statements are available. To select a private firm as your target, you must estimate its value. Once you are engaged, have your experts carefully review the private company's financial statements and compare them to a realistic audit before a final valuation. If you are buying a struggling company, its liquidation value is useful. Book value clarifies a company's current position. Use comparative value to see the company in its competitive context. The most popular method of valuation is discounted future cash flows (DCF) because most of the value of any firm resides in its future earning power.

Getting to an Agreement

Even if you know you can add value to the target, buy it in a way that leaves that value in your pocket. You can gather intelligence about your prospective target and gain some measure of ownership without paying a premium. For example, buy a toehold (3% to 5%) to get more access to information. When you announce your decision to purchase, you will probably realize gains on these shares to help pay for the acquisition. You also can make a "bear hug" pitch to the board, a strategy that starts friendly, but carries a threat of hostile takeover. You might ignore the board, and make a tender offer for shares with conditions and prices that encourage people to act early.

> "Job losses – often as high as 5% to 15% of the employees of the combined organizations – go hand in hand with every merger or acquisition."

Your strategy depends on the kind of bid, the personalities involved and your intentions. Trying to wrench control of a target away from its management is complex because you must anticipate how it will resist. Where possible, a cooperative method is best and cheaper. You know what the target is worth to you, so use methods that capture its value. Hold your cards close, don't lead with your best price, don't change your price easily or often, and don't get forced to negotiate against your own interests. Document the process so you can always justify your actions.

Putting the Companies Together

The real work begins once you win the deal. Many M&A deals have faltered because the planning for actually merging the firms happened in an information vacuum and fell apart when it hit reality. These transactions fit four broad categories:

1. **"*Brave New World*"** – Both companies will disappear within a new entity. This option runs the highest risk and requires the most care.
2. **"Digestion"** – The acquiring firm swallows the target. Beware of culture shock.
3. **"Reverse takeover"** – The acquiring firm takes on the target's identity. Prepare your team for the shifts this requires and prepare the target firm for management changes.
4. **"Business as usual"** – Both companies carry on as usual with minimal integration.

> "High business risk should be matched by low financial risk, and vice versa."

Each of these contains real risk and mismatching your approach to the acquisition style will only magnify the dangers. Use this acronym to remember the keys to merger success: "LEARN CIA. Leadership, Engineer successes, Act quickly, Retain key employees, Nurture clients, Communicate, Integrate the two cultures, Adjust, plan and monitor."

What Did You Learn?

Apply intense after-action analysis to every merger or acquisition you attempt or complete to extract value from the experience. What worked? What disappointed your team? What surprised you? Why? How good were your estimates? If you plan on acquiring more companies, turn M&A into a center of strength with systematized resources. Create a process with a designated team. Look closely at the advisors on both sides. You might find someone talented to help you next time. Every M&A deal is different, just like every custom-tailored suit. But that doesn't mean each suit is utterly unique. The tailor uses a set of core principles to design, cut and assemble each one. Similarly, you can systematize acquisitions. Gather sound intelligence to avoid bad deals and to make good deals better. Apply it to more strategic moves. M&A is much more of an art than a science, but you can work it systematically. Be informed, thoughtful, strong and successful.

About the Authors

Scott Moeller runs Cass Business School's executive education program. He worked in academia and industry, and headed a venture capital fund. **Chris Brady**, dean of Bournemouth University's business school, completed his postgraduate studies in the Royal Navy.