Ace the Consulting Case Interview

Part 1. Structuring

Lecture 7. M&A cases (specialized)

Typical M&A cases for specialized M&A practices

01 **EY (M&A) (2020)**

Machine Co. which produces integrated systems for the oil & gas industry is looking into spinning off a polymer chemicals business (ChemCo) that it owns. What strategic considerations does it need to make for the divestiture?

02 **EY (M&A) (2020)**

Your client is a large global hardware manufacturer. They have two major product lines – hardware for laptops and for smaller devices (e.g. smartphones). They recently acquired an Asia-based hardware company. How would you assess this acquisition?

03 **EY (M&A) (2019)**

Your client is a wine producer that makes sustainably sourced boxed wine. They have decided to acquire a premium wine producer. Should they? Both companies are California based.

Typical M&A case prompt for specialized M&A practices

EY (M&A) (2019). Our client is a large retail chain. They are considering the acquisition of another retail chain. They brought your team in to rationalize this acquisition. How would you approach it?

1 Rationale

- Increase market share
- Capture synergies
- Expand to new market segments

2 Synergies

- Revenue synergies
- Cost synergies
- Balance sheet synergies
- Tax synergies

3 Barriers to synergies and dis-synergies

- Potential delays (e.g. due to poor operational execution)
- Cultural issues
- HR issues (e.g. improper talent retention)
- Legal issues (e.g. anti-trust, patent usage)

4 Governance framework

- IMO
- Pre- and post-Day 1 plans
- Operating models
- People-Process-Systems
- 30-60-90 day planning and progress monitoring

1 Rationale

Vs.

For Buyers

- Scale-up business, pursue inorganic growth, increase market share
- Get access to new technologies, best practices, and intellectual property (e.g. patents)
- Get access to new/better capabilities (e.g. expansion in production capacity, access to new sales/distribution channels)
- Get access to new markets (e.g. geography, customer segments)
- Get access to the key talent/team
- Move up or down in the value chain
- Capture cost and revenue synergies

For Sellers

- Respond to shareholder pressure
- “Unlock” working capital (e.g. free up cash to fund other M&As or R&D)
- Divest non-core business and increase management focus on the core
- Shed underperforming assets
- Meet legal requirements for other deals

2 Revenue synergies

- Cross-selling
- Accelerated geographical expansion given broader geographical footprint of a combined company

- More bundling options
- More pricing power given the higher market share

- Better product innovation given combined R&D forces
- Better customer experience given adoption of the best practices from each other
- More appealing value proposition given a wider range of products

- More efficient sales given exchange of the best practices
- Higher marketing ROI
- More appealing loyalty program due to wider opportunities to collect and spend points

2 Cost synergies

Fixed costs

- Decrease in overhead costs due to the consolidation of overlapping functions like IT, HR, marketing, finance, etc. (incl. headcount reduction, consolidation of purchasing products/services for overhead ops)
- Lower rent after the consolidation of the production facilities and closing some of them
- Lower maintenance costs due to
  - The exchange of the best practices
  - Consolidation of in-house maintenance services (e.g. headcount reduction)
  - Volume discounts for consolidated purchasing of spare parts, outsourced maintenance services, etc.
  - Freeing up some equipment following the higher utilization rate of the equipment
- More efficient marketing to avoid competition between two firms

Variable costs

- Decrease in raw material costs due to the volume discounts for consolidated purchasing
- Decrease in labor costs due to:
  - Increase in labor efficiency after exchange of the best practices in operations
  - Consolidation of the production facilities that might free up some labor
- Lower transportation costs due to:
  - Route optimization (in case of geographical footprint overlap)
  - Volume discounts for consolidated purchasing of outsourced transportation services, fuel, etc.
- Lower distribution and credit card fees given higher negotiation power (in case of similar distribution channels)

2 Other synergies

Balance sheet synergies

- Lower costs for borrowed capital
- Access to more financial resources
- Capex rationalization
- Improvement in accounts receivable (AR) and accounts payable (AP)
- Better inventory management

Tax synergies

- Optimized taxes (e.g. combined operating losses)

3 Barriers to synergies and dis-synergies

General barriers/ dis-synergies

- Disruption to the normal operations during the post-merger integration
- Diluted focus on the core during the post-merger integration
- Loss of customers due to brand issues
- Loss of suppliers due to conflicts
- Lower/delayed synergies (due to poor operational execution, financial reasons, incompatible IT systems, etc.)
- One-time costs (e.g. costs for consultants, onboarding costs for employees)

HR issues

- Normalization to higher compensation and benefits
- Key personnel departure
- Unmotivated people due to uncertain future
- Differences in cultures between two companies
- Lack of focus on hiring during post-merger integration

Legal issues

- Legal issues related to use of patent/tech
- Delays due to anti-trust compliance
- Legal issues related to head count reduction (in EU and China)

4 Governance framework

Steps and actions

- Set up integration management office (IMO)/separation management office (SMO) org structure, including role of functional areas
- Establish pre-Day 1 and post-Day 1 integration/separation plans
- Develop operating models (for each functional area) for future state based on vision of combined/separated companies
- Focus on "People-Process-Systems" framework
- Develop 30-60-90-day planning and monitoring of integration/separation

Terms

- Typical functional areas are HR, IT, Finance & Accounting, Supply Chain/Procurement, Ops, Sales & Marketing, Legal, R&D, etc.
- IMO/SMO (Integration/Separation Management Office) is a Program Management Office (PMO) established to run an integration/separation
- Day 1 is a date immediately following close of a deal
- Pre-/post-Day 1 Plans are detailed plans with timeline and checklist for operationalizing a deal post-close

Typical pitfalls in a M&A case structure (for specialized M&A practices)

Not knowing the vocabulary of the M&A case

Using alternative M&A framework

Next steps

01

Internalize the framework and learn the vocabulary

02

Get a deep understanding of each framework element: rationale, synergies, barriers to synergies, and governance framework