All to play for

Striving for post deal success

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Introduction

The Survey

This is the fifth of a bi-annual survey which plots the development of the M&A market over the last 10 years. Findings from this survey seek to address deal success, as measured by shareholder value, in the market peak immediately before the onset of the current 'credit crunch'. The challenging conditions being experienced in many sectors mean that failure to deliver value from these deals is likely to have a greater impact than before. The findings are as relevant as ever, both in providing insight into how to make recent deals more successful and improving the way M&A is done as the market returns.

By looking at the underlying trends post deal, we have sought to understand the impact of competition on deal success, how corporates and PE firms have fared in the current environment, what regional variations are present, and how the escalating challenges of integration are impacting the whole Boardroom.

Context

There has been an incredible change in the professionalization of M&A since KPMG International began producing this survey in 1999, a period spanning two cycles of record breaking highs and significant lows. Over time we have seen sellers with the upper hand over inexperienced buyers, then buyers improving their diligence to gain ground over sellers. The growth of Private Equity (PE) has raised the bar even further, approaching M&A with a professionalism that has threatened to eclipse more conservative corporates.

Corporate sellers have fought back using competitive auctions to extract higher deal prices. When we started researching this edition, we expected to find that the professional buyer was now matched by a professional seller and that a 'perfect' market was forming. This would mean that the buyer pays over a proportion of the upside while retaining the potential for further value realization. While we found that this was somewhat true, it is clear that acquirers are finding it challenging to deliver the full value post deal.

With higher purchase prices and more of the future synergies being paid over, post deal integration becomes much harder. Striking the deal is only the start of the game – value delivery is "all to play for".

Key findings

Deal success

- The proportion of deals that have reduced value has grown from 26 percent to 39 percent in the two years since our previous survey, *The Morning After*. This is the first deterioration we have seen in 10 years of monitoring post deal trends.

Pricing to win

- On average, 44 percent of future cost synergies/ performance improvements are included in the deal purchase price, reinforcing a message from the last survey.
- While growth was their primary reason for undertaking M&A, corporates generally did not build revenue synergies into their pricing or communicate these synergies to the market.
- PE firms are more aggressive on pricing, building in more upsides in order to price to win. They were also more focused on driving the revenue line rather than cost reduction after deal close.

Auction process

- Three quarters of PE acquisitions were won as a result of competitive bids compared to only 38 percent of corporate acquisitions.
- Corporates are less likely to enhance value when they win competitive deals.

Degree of integration

- Only half of corporates integrated their acquisitions fully. Acquisitions that were fully integrated were more than twice as likely to enhance value as those that were left as standalone entities.

Regional differences

- Increased competition for deals in Europe and the Americas appears to be one of the factors driving a marked deterioration in deal success there. In the Europe, Middle East and Africa region (EMA), 39 percent of corporates took part in competitive tenders while in the Americas the level was even higher at 45 percent of corporates.
- Deals in the Asia-Pacific region (ASPAC) appear to be increasingly more likely to enhance value at 36 percent; perhaps because of the higher economic growth rates in the region and the less competitive nature of its M&A market.
- Results in ASPAC show that their M&A market is rapidly maturing, catching up in terms of both professionalism and sophistication.

Post deal challenges for each Executive

CFO: Starting on the back foot

- Gaining control post deal took longer than expected in one third of deals.
- Competitive processes are limiting due diligence and forcing CFOs to focus on short term control issues after close, rather than driving deal value delivery.
- Only 19 percent of corporates had planned to reduce working capital post deal, compared to the majority of PE firms.

COO: Disconnect between pre and post deal targets

- 80 percent of respondents believed they had exceeded post deal targets, yet deals are not delivering value. This suggests that operational targets post deal were different to those set in the original deal model.
- Corporates are successfully meeting their targets for basic operational tasks, such as procurement savings. However, they are finding it challenging to meet more strategic goals such as operational efficiency improvements.

M&A Director: Pivotal post deal role

- 'M&A champions' are companies that consistently achieve their M&A objectives. These companies involve and get buy-in from a wide set of cross-functional operational management upfront.
- Nearly one third of companies surveyed sold non-core assets post deal, though 70 percent of these divestments were unplanned.

HR Director: Retain, reward and tackle culture

- Revising reward schemes and retaining key talent are the primary post deal objectives for HR. Corporates are leveraging incentive schemes to drive performance in the hope of achieving "PE style" motivation.
- Culture remains one of the top post deal challenges with companies continuing to link post deal HR challenges with cultural complexity. Companies that strive to understand where the hot spots are likely to occur, and actively develop plans to tackle them, are better positioned to overcome HR issues.

CIO: IT integration – no pain, no gain

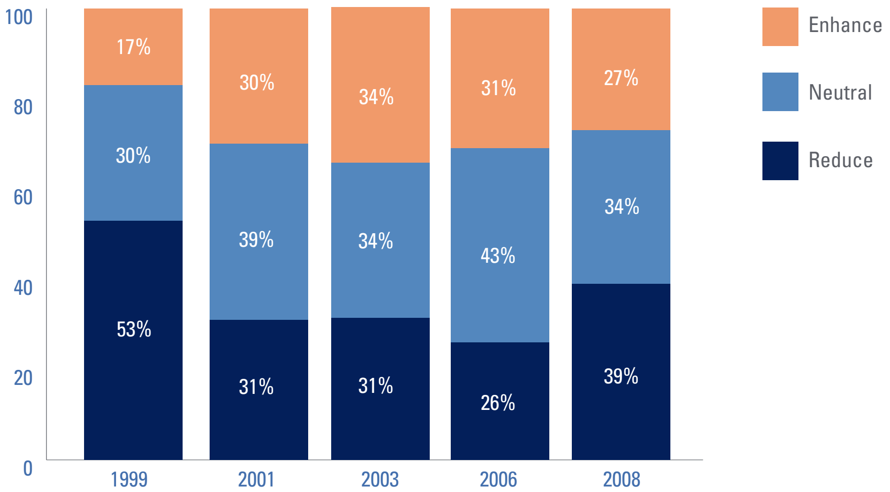
- Companies that fully integrated IT systems were 39 percent more likely to enhance shareholder value than those that took a partially integrated or standalone approach.
- 76 percent of respondents said their post deal IT programs were on or under budget. This could signal a lack of stretch rather than efficient IT management.

The deal environment

The competitive deal environment has led to a significant proportion of future value being included in the purchase price but this is not fully delivered post deal.

The proportion of deals that have reduced value has grown from 26 percent to 39 percent in the two years since KPMG International's previous survey, *The Morning After*. This is the first deterioration in performance that we have seen in 10 years of surveying post deal trends.

Value enhancement trend from 10 years of KPMG International's M&A surveys



Base: 100 percent of corporate respondents
Note: Measurement of value created is based on company share price movements relative to average industry sector movement during a two year period. Factors other than the deal may have affected share price movements over the period.
Source: KPMG International

Once again, there is a large perception gap between what corporates think they have achieved in their deals and what has actually been delivered using shareholder value as a measure. An overwhelming 93 percent of corporates believed the deal they had executed had created value for their organization. We are surprised that this gap has not narrowed in the last 10 years in line with rising standards of corporate governance and performance management.

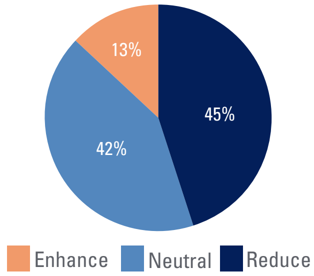
It appears that corporates are still not making an objective assessment of their performance post deal. In such a competitive market it is crucial that corporates track post deal performance and focus on delivering more than the value premium they paid to win the deal.

Corporates still losing out to more aggressive pricing from PE firms

We found that corporates were less likely to win a deal as a result of a competitive bid. Only 38 percent of deals completed by corporates were won as a result of a competitive bidding process, compared to 72 percent for PE firms. If their growth strategy is to be delivered through M&A, corporates need to be able to win auctions and deliver the value.

When corporates do win competitive bids they appear unable to balance the price paid with future synergies to create value. Only 13 percent of competitive bids won by corporates created value.

Do competitive corporate deals deliver?



Base: Corporate respondents involved in competitive tenders
Source: KPMG International

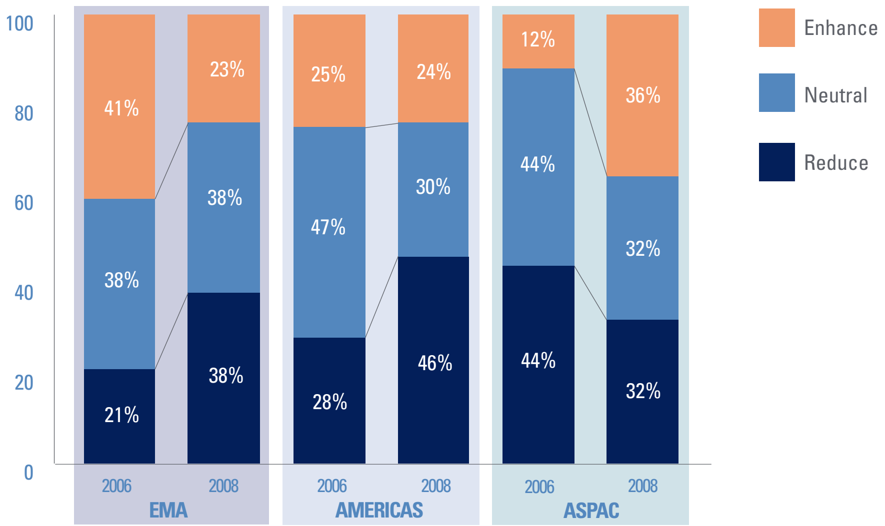
Regional comparisons

ASPAC deals appear to be increasingly more likely to enhance value

Corporates in the Americas and EMA have suffered increases in value reduction from deals since our 2006 survey. This has coincided with an increase in deal competition in these regions. Only 22 percent of corporates in ASPAC took part in competitive tenders compared to 39 percent in EMA and 45 percent in the Americas. ASPAC's less competitive M&A market and its higher economic growth rates may be among the reasons for the greater level of value enhancement from deals there, where 36 percent of companies had enhanced value.

"As the global manufacturer that we are, we felt that we needed a much bigger presence in Asia"

Have deals enhanced value in each region?



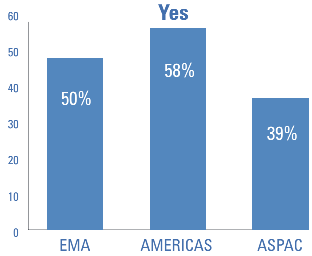
Base: 100 percent of corporate respondents
Source: KPMG International

Our findings show that the profile for value creation from deals in ASPAC is similar to the global profile for value creation from deals in our 2003 survey. Given the head-start that M&A markets in EMA and the Americas have had, ASPAC appears to be catching up rapidly in terms of professionalism and sophistication.

Do something different?

Honest reflection on deal performance is essential to learn lessons for the next time. Only half of EMA corporate respondents said they would do something different yet three quarters of deals did not enhance value. Respondents in the Americas are slightly more aware of their performance shortfalls in M&A delivery than corporates in EMA or ASPAC.

If you were going to do the deal again, do you think you would do anything differently?



Base: 100 percent of corporate respondents
Source: KPMG International

Findings by Executive

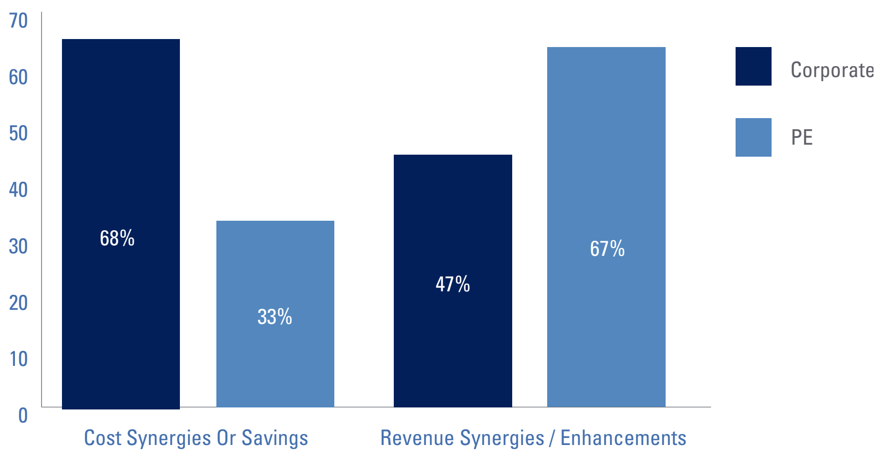
CEO: Integration as foundation for value/growth strategy

Competitive market demands future benefits to be included in pricing

We found that, on average, corporates included 44 percent of their synergy targets in the purchase price – a similar level to our last survey. Consequently, acquirers have to deliver nearly half the potential upside just to break even. However, they are often being given less information and tighter timescales to develop robust plans during the competitive auction process.

PE firms have a greater focus on revenue enhancement than cost reduction. They appear more confident in delivering revenue upsides and therefore factor them into their valuation.

Factors affecting price



Base: 100 percent of corporate and PE respondents
Source: KPMG International

Revenue Synergies

The main strategic objectives driving deals among corporates were market and geographic growth, yet they are less likely to include revenue enhancements in their purchase price.

This seems to be incongruous, if it is all about growth then why are revenue synergies absent in many corporate valuations?

At least part of the answer is market perception. Historically, markets tended to discount revenue synergies; consequently it is market practice for corporates to only quantify the cost reduction element. Revenue synergies were seen as challenging, with areas such as cross selling notoriously difficult to deliver. The survey findings suggest that corporates prioritize cost synergies at the expense of revenue synergies. We believe that the market has evolved and if better information on revenue synergies is available, the market could form a fuller view of the strategic rationale and therefore improve valuations.

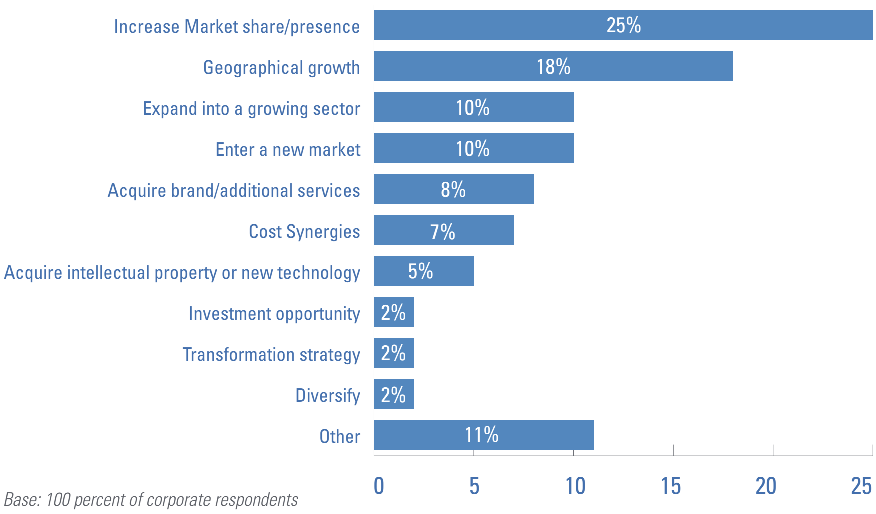
"If companies included revenue synergies we would incorporate them in our valuation models"

Equity Analyst

We believe that corporates should provide a more complete view of both revenue and cost synergies they hope to realize on integration. Moreover, equity analysts should expect revenue synergies to be part of corporates' deal announcements so they can include them in their company valuations.

Nearly all corporates believed the acquisition was the best way to achieve their strategic objectives despite the high proportion of deals failing to create value. While deals may not have enhanced value, three quarters of corporates said the deal enabled them to address current market conditions more effectively than if they had not done the deal.

Primary corporate deal rationale



Base: 100 percent of corporate respondents
Source: KPMG International

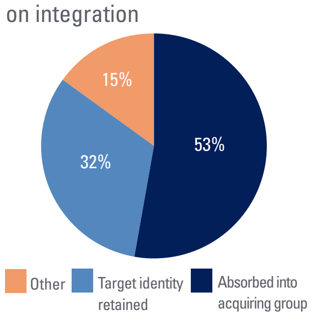
Half the acquisitions by corporates are not fully integrated

Surprisingly, corporates are evenly split on whether to absorb their acquisitions or retain separate identities.

Only 53 percent of corporate acquisitions had been integrated. Given that 44 percent of performance improvement upside is being factored into the price, this suggests there may be a gap between original plans for integration and post deal implementation.

'Light touch' integration is often used to describe a 'softly softly' program, yet this survey found a strong correlation between groups that fully integrated and those that enhanced value. Acquisitions that were fully integrated were more than twice as likely to enhance value as those that were left as standalone entities.

Corporate CEOs split on integration



Base: 100 percent of corporate respondents
Source: KPMG International

CFO: Starting on the back foot

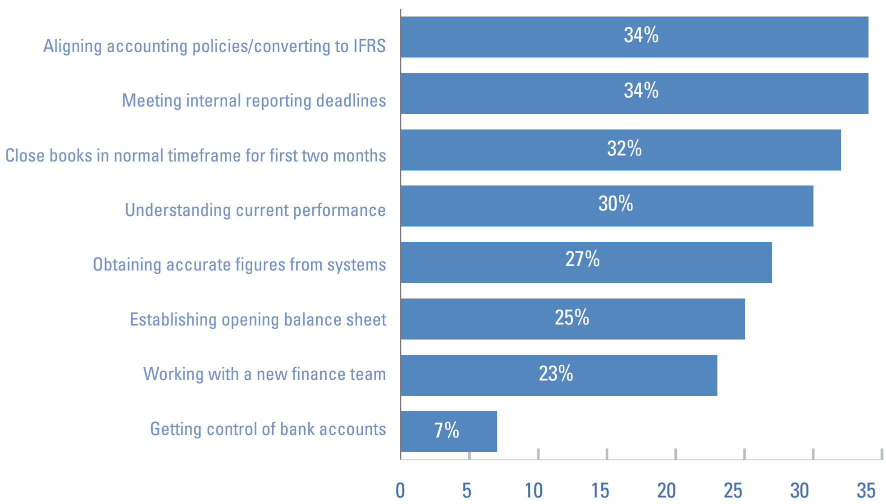
Gaining financial control takes longer than expected

The previous survey found that those who built robust synergy and post deal plans prior to executing the deal were more likely to be successful. With increased competition and even more pressure to reduce the scope of due diligence, the issue of reduced pre deal preparation has been exacerbated. This has impacted the CFO's ability to quickly understand and take control of the business. Buyers are reluctant to commit resources until victory is certain - this can be a costly decision.

In around one-third of deals surveyed it took longer than expected to understand the current performance, close the books and meet internal reporting deadlines.

"My expectations perhaps were a bit naive but I expected it to be done more quickly than it turned out."

What took longer than expected to control



Base: 100 percent of corporate respondents
Source: KPMG International

Finance functions are forced into short-term focus, on 'Day One' readiness and initial reporting, at the expense of broader issues affecting the business going forward. Basic tactical tasks, such as getting control of bank accounts, can distract CFOs from playing an active role in integration and impede their ability to take strategic control of the business quickly.

Working capital: why is cash not king for corporates?

Working capital is a vastly overlooked aspect of operational performance improvement for corporates – 81 percent had not planned to reduce working capital post deal. PE firms were more focused on cash, with the majority planning to reduce working capital post deal. We believe that there is an urgent need for corporates to develop a more robust approach to post deal cash management.

COO: Disconnect between pre and post deal targets

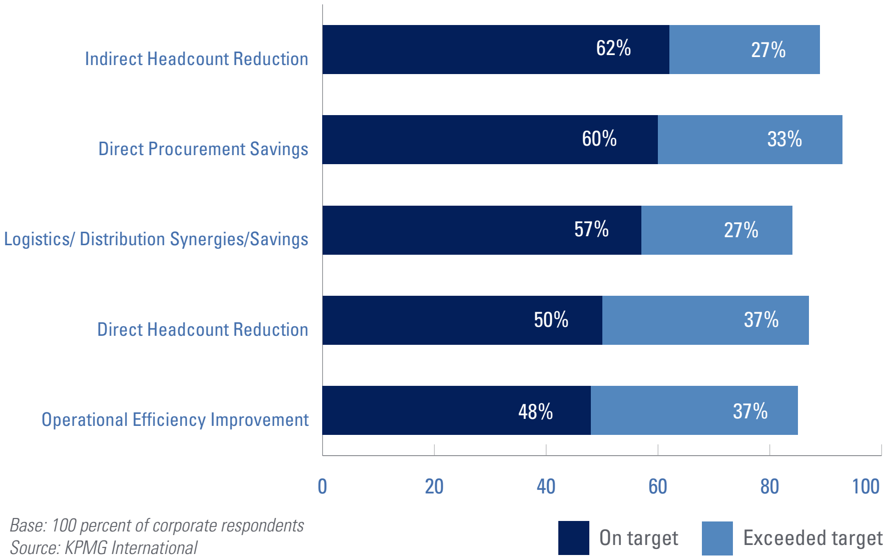
Reality versus targets

More than 80 percent of respondents believed they had met or exceeded their targets for post deal operational performance improvement as illustrated below. Yet, a significant proportion of these deals failed to create value against KPMG's measure. It may be that the operational targets set post deal were not the same as upside targets included in the deal model and therefore factored into the price paid. Clearly there are a number of factors that impact post deal value creation such as business as usual, strategic decisions, unfreezing opportunities or pursuing various other synergies.

It is crucial that the COO believes in the operational upside targets pre deal and is closely involved in operational due diligence. Furthermore, accurate translation of these upside targets into post deal operational plans increases the chances of deal success. Previous survey findings show that those who set stretch targets were more likely to be successful.

> "Driving out the synergies between the two was quite tough because you must create an acceptance on the other side and explain the need for them to change for the better..."

Percentage of respondents meeting or exceeding operational targets



Base: 100 percent of corporate respondents
Source: KPMG International

Corporates focused on 'quick win' operational targets

Corporates are successfully meeting their targets for basic operational tasks, such as procurement savings. However, they are finding it challenging to meet more strategic goals such as operational efficiency improvements. Respondents cited the need to focus on day-to-day management of the business as the main reason they failed to deliver their targets. Often these pre deal targets are expressed as 'x percent margin improvement' and lack specific actions or analysis to underpin them.

M&A Director: Pivotal post deal role

Developing the platform for value creation post deal

Drawing relevant cross-functional stakeholders into the deal team, such as the COO and CIO, increases buy-in to the deal rationale and performance targets. Greater deal visibility for these executives can also make the post deal transition phase smoother and may increase the chances of value creation.

Planning is the key to successful M&A

Companies that have successfully achieved their post deal strategic objectives have developed a systematic approach to M&A. KPMG's survey *Doing Deals in Tough Times* highlights five attributes that these 'M&A champions' incorporate to help meet acquisition goals in successive deals. M&A Directors should consider these attributes when planning post deal acquisitions or divestments.

KPMG's attributes of 'M&A Champions'

1. Use due diligence to examine a wider range of business issues
2. Use corporate development teams to monitor post deal results
3. Dedicate the right people to the integration team (with the right commitment)
4. Use a Project Management Office (PMO) to manage cross-functional interdependencies
5. Focus on 'stabilizing' the organization post-close

Source: 'Doing Deals in Tough Times, KPMG International, 2008

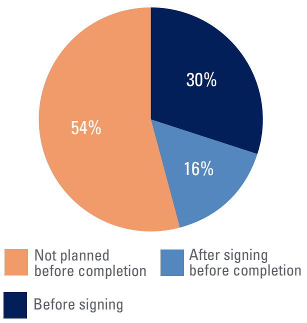
Divestments often become necessary after the deal

As well as the central rationale for a deal, many acquisitions result in the sale of non-core assets. However, these are rarely planned for, with 70 percent of acquirers failing to plan for a subsequent divestment prior to signing the deal.

In our view, it is much better to identify and plan for divestment prior to completion. That way the non-core assets can be sold off faster, while avoiding a 'fire sale'. This may also prevent distraction, allowing focus to stay on the remaining business and enabling management to provide clarity on its strategy to stakeholders.

The ad hoc nature of the majority of post deal divestment programs appears to have some impact on the length of the divestment process. Over a quarter of the divestments took longer than originally anticipated.

When divestments were planned



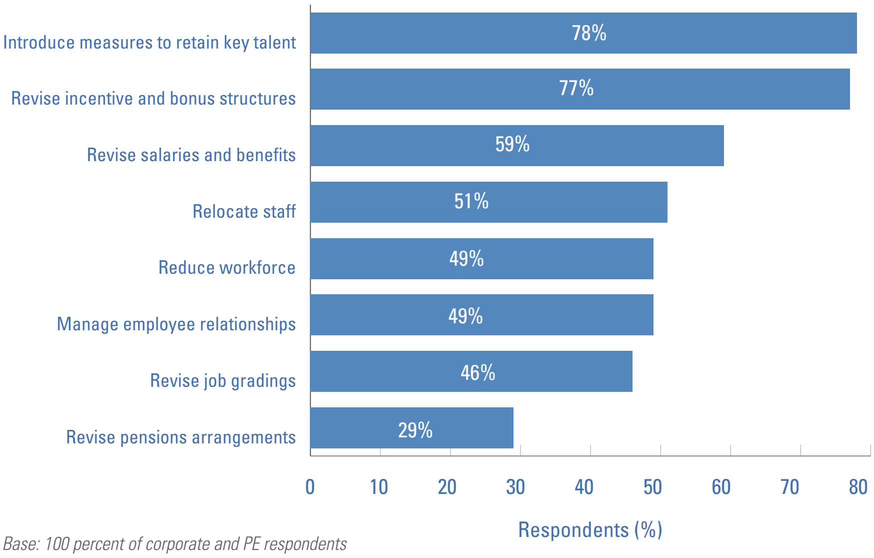
Base: 31 percent of corporate and PE respondents
Source: KPMG International

HR Director: Retain, reward and tackle culture

Driving staff performance post deal

Retaining talent remains a key post deal HR objective; however, the approach to retention has shifted. Rather than simply relying on bonuses, the focus has moved to revising reward schemes in order to incentivize staff to stay post deal. We found that 78 percent of corporates and 72 percent of PE firms revised their reward schemes post deal. This appears to indicate that corporates are adopting a similar approach to driving staff performance as PE firms.

Planned for the following HR objective



Base: 100 percent of corporate and PE respondents
Source: KPMG International

PE firms focus less on reducing the workforce than corporates. This is surprising given the negative press associated with post deal staff reduction following PE acquisitions.

Cultural differences still in top three post deal challenges

The growing number of cross-border deals is further increasing the cultural complexity of integration. Our findings show that cultural differences continue to be a major post deal issue since our last survey. Companies often link post deal integration issues with cultural variation and complexity.

Rather than blaming cultural differences for problems experienced during post deal integration, organizations should preempt these issues. Respondents noted that recognizing and understanding cultural differences and clear communication were effective strategies. By identifying and analyzing cultural variance upfront and proactively addressing potential hot spots early on, companies can begin to forge a workable, if not fully common, culture quickly post deal.

CIO: IT integration – no pain, no gain

Further potential to drive savings and synergies

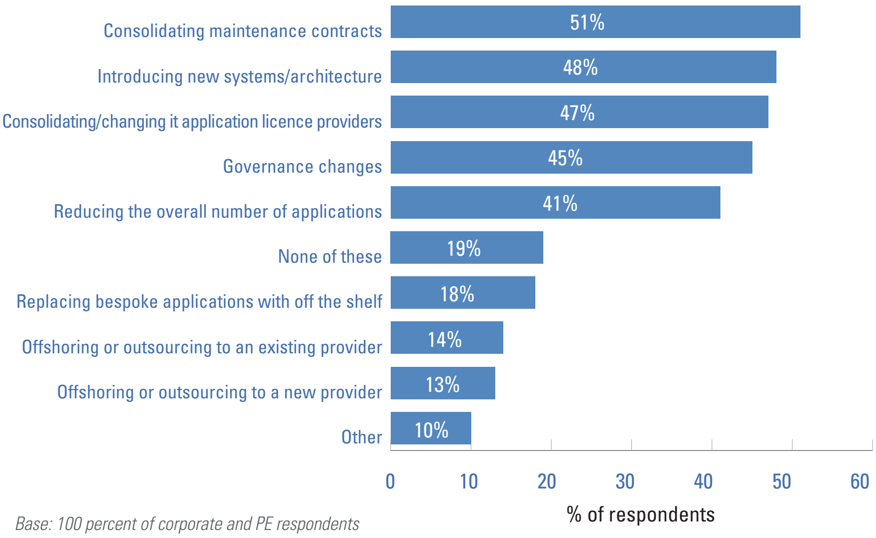
On the face of it, IT performance indicators appear positive with 76% of respondents on or under budget and 68% on or ahead of schedule with their post deal IT implementation plans.

However, dig a little deeper and it is evident why. Post deal IT programs lack stretch. Only 46% of companies planned to fully integrate IT services with the remainder choosing a hybrid or standalone solution.

Furthermore, a significant number of respondents did not plan to undertake post deal IT initiatives which could provide significant savings, for example replacing bespoke with off-the-shelf applications and revising off shoring arrangements.

> "The original model was far too ambitious and complicated so we decided not to disrupt the existing model."

Changes to IT systems post deal



Base: 100 percent of corporate and PE respondents
Source: KPMG International

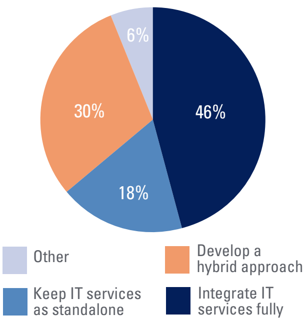
The lack of intent shown towards IT cost savings may partly explain the fact that in deals where post deal IT programs were either on or under budget only 20% were found to create shareholder value.

Are CIOs playing it safe?

IT integration is complex, time consuming and can be painful. It can lead to costs running over budget, but it is generally worthwhile. There is a strong correlation between deals that were found to create shareholder value and those that fully integrated their IT systems. Whilst fully integrating IT systems is not always the right answer we found that companies that took a fully integrated approach to IT integration were 39 percent more likely to enhance shareholder value than those that took a partially integrated or standalone approach.

CIOs are getting better at maintaining IT functionality and playing it safe but are shying away from the enabling projects required to deliver the full merger benefits.

Post deal IT strategy



Base: 100 percent of corporate and PE respondents
Source: KPMG International

Survey methodology

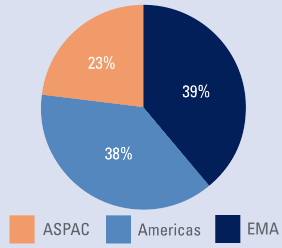
KPMG International extends its thanks to all the companies and PE firms who have taken the time to participate in this survey.

This is the fifth survey on major global M&A deals with this release building on the 2006 report The Morning After: Driving for post deal success. Our objectives were to ascertain the proportion of deals that enhanced shareholder value and understand experiences and processes undertaken by corporates and PE firms related to post deal management.

The fieldwork was conducted by RS Consulting between April 2008 and July 2008 via telephone interviews. The 101 corporate participants were taken from a global sample of companies who had conducted deals worth over US$75 million between 2006 and 2007. 18 PE firms agreed to participate and self-selected the deal they discussed from deals completed at least 12 months earlier.

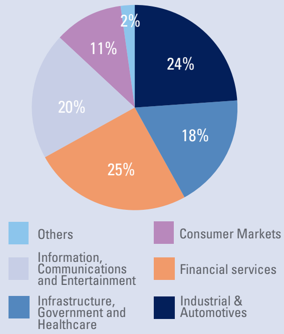
Further research was conducted using share price information supplied by Evalueserve. Each deal was categorized as having enhanced, reduced or left shareholder value unaffected. For each deal, a relative measure of change in the acquiring company's share price was taken one year pre deal announcement and one year post deal announcement. This share price information was then compared with the overall trend in the relevant industry segment. To preserve the confidentiality and anonymity of survey respondents (and in accordance with standard market research guidelines) analysis of the survey findings was carried out by RS Consulting and not by KPMG International or KPMG member firms.

Geography of survey respondents



Base: 100 percent of corporate respondents
Source: KPMG International

Corporate respondents by sector



Base: 100 percent of corporate respondents
Source: KPMG International

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Across KPMG's international network of member firms, our years of experience tell us that clients' challenges typically fall into three main areas – growth, performance and governance. It is here that KPMG has positioned its expertise to work with you as you restructure and expand. Our Advisory practice combines specialist skills around the world to tackle your challenges, providing objective advice and execution to help preserve and maximize value.

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Related publications

We have produced a variety of publications to help provide insight into some of the key questions that businesses involved in M&A may be asking and lead the way in addressing areas of concern.

To receive electronic copies or additional information about any of the publications below please e-mail: advisory@kpmg.com

The Morning After

Driving for post deal success – the fourth study on Major Global M&A deals examining the proportion of deals that enhanced shareholder value and processes undertaken by corporations and PE Firms related to post deal management.

Doing Deals in Tough Times

This new white paper from KPMG's Advisory practice examines the most significant characteristics and best practices of acquirers that seem to continually succeed at M&A even during challenging market conditions.

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Designed and produced by KPMG LLP (U.K.)'s Design Services
Publication name: All to play for
Publication number: RRD – 102660
Publication date: October 2008
Printed on recycled material.