

Mergers and Acquisitions: an Introduction

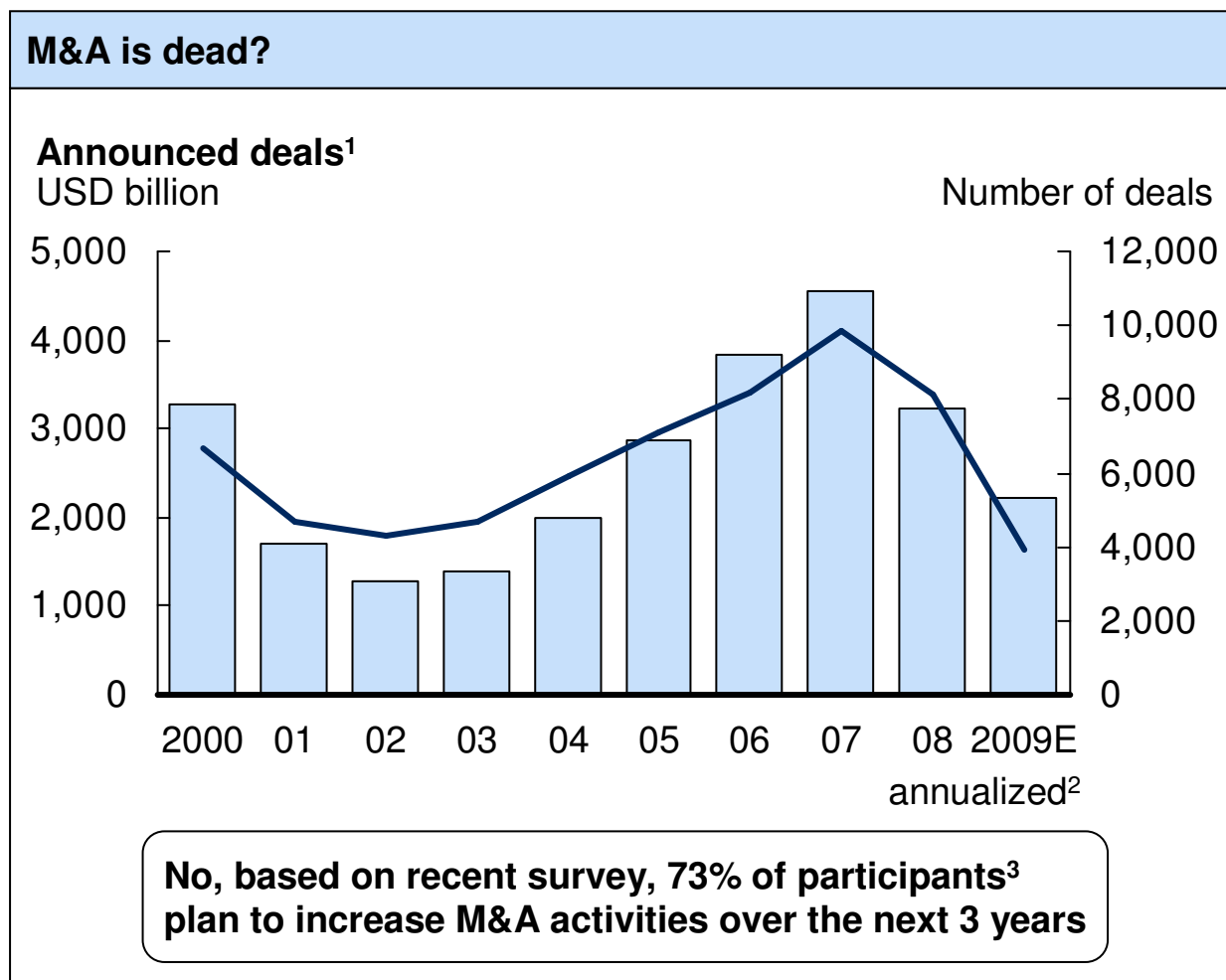


Discussion document
January 14, 2010

CONFIDENTIAL AND PROPRIETARY
Any use of this material without specific permission of McKinsey & Company is strictly prohibited

After a significant drop in M&A during 2008 and 2009 a revival is expected

■ Value
— Number of deals



“M&A is and will continue to be a key pillar of our investment strategy”
– CFO of a leading consumer goods player

“We continue our strategy by doing small transactions as recent business”
– Head of M&A of a large multinational bank

1 Includes deals of more than USD 25 million only

2 Based on same multiple of deal value for full year/deal value until March as 2008

3 Based on “Excellence in M&A” database

In its broadest sense, M&A refers to a change of ownership; the various types of M&A can be characterized on several dimensions

Key dimensions	Implications for deal process
Approach to target <ul style="list-style-type: none"> ▪ Friendly ▪ Hostile 	<ul style="list-style-type: none"> ▪ In a friendly deal, discussion with target management and (limited) exchange of data possible ▪ In hostile bid, the target's management actively opposes the transaction (while respecting their fiduciary duties)
Target ownership <ul style="list-style-type: none"> ▪ Public (listed) company ▪ State-owned ▪ Privately held 	<ul style="list-style-type: none"> ▪ For publicly held and state-owned targets process defined in takeover regulations ▪ Privately held target allows for more customized process
Transaction structure <ul style="list-style-type: none"> ▪ Merger of equals ▪ Acquisition ▪ Divestiture ▪ JV/Alliance 	<ul style="list-style-type: none"> ▪ Deal type has consequences for legal/structuring aspects of the deal ▪ Implications for negotiation intensity and tightness of process
Transaction process <ul style="list-style-type: none"> ▪ Controlled auction ▪ Negotiated transaction 	<ul style="list-style-type: none"> ▪ Auction: deadlines set by seller ▪ Negotiated sale: process is mutually agreed upon by both parties
Type of consideration <ul style="list-style-type: none"> ▪ Cash only ▪ Shares or cash and shares ▪ (Partially) deferred 	<ul style="list-style-type: none"> ▪ Acquirer must secure financing for cash consideration ▪ Dilution must be considered in shares considerations ▪ Deferred consideration is effectively debt from seller

Common types of transaction processes

- Friendly private acquisition in controlled auction
- Friendly public acquisition in a negotiated transaction
- Friendly private divestiture in a negotiated transaction
- Friendly public merger of equals in a negotiated transaction

M&A is frequently driven by differences between actual price and potential value

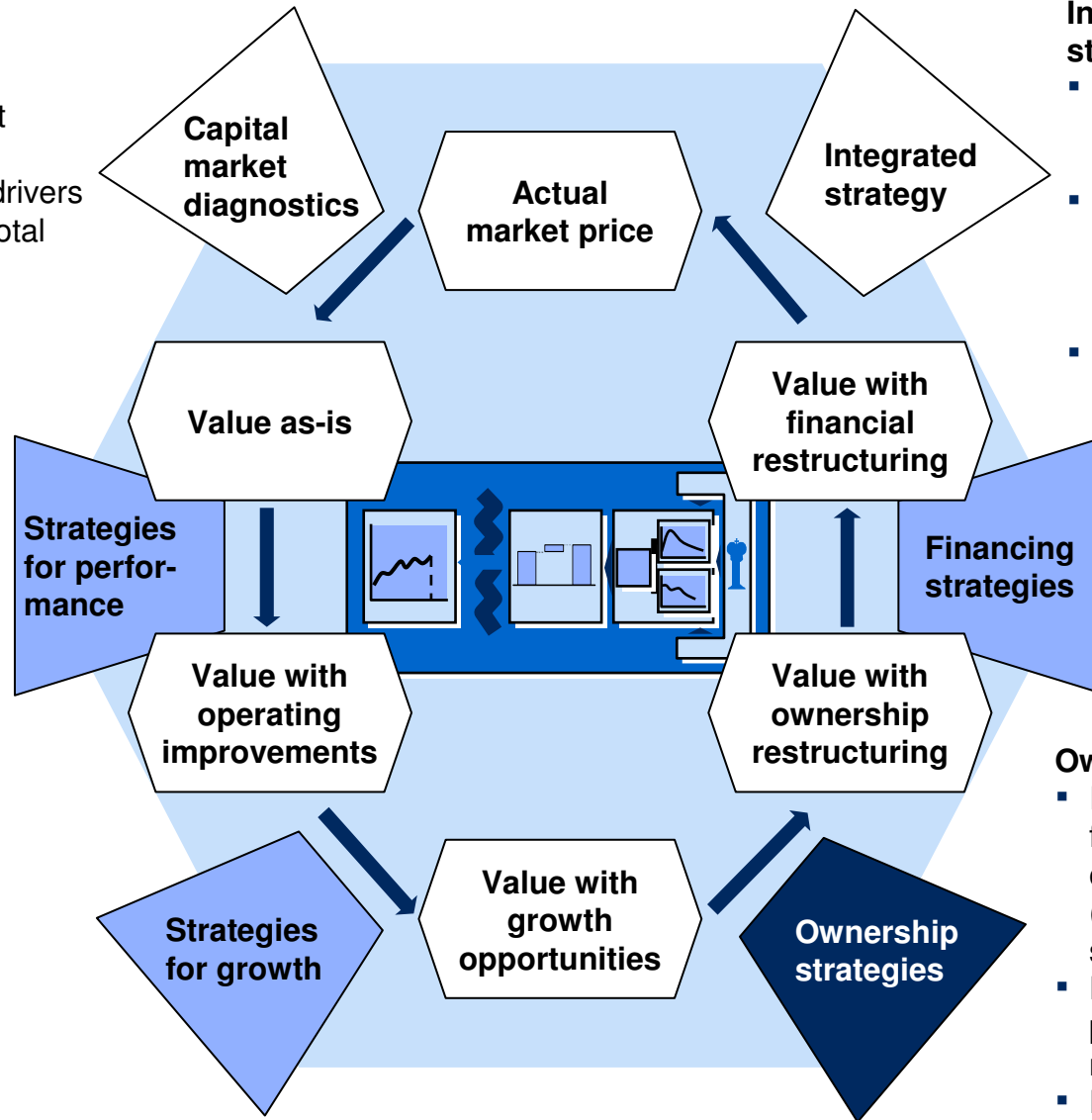
- M&A as enabler
- M&A a core lever

Capital market diagnostics

- Understand current market value
- Identify key value drivers
- First estimates of total value creation opportunities

Business strategies

- Identify operating improvement opportunities
- Identify growth opportunities
- Estimate value creation potential of business strategies
- Formulate action plans



Integrated value creation strategy

- Analyze interdependencies among strategic opportunities
- Design most effective integrated strategy for corporation (make iterations if needed)
- Formulate integrated action plan

Financing strategies

- Identify opportunities for financial/capital restructuring
- Estimate value creation potential
- Formulate action program

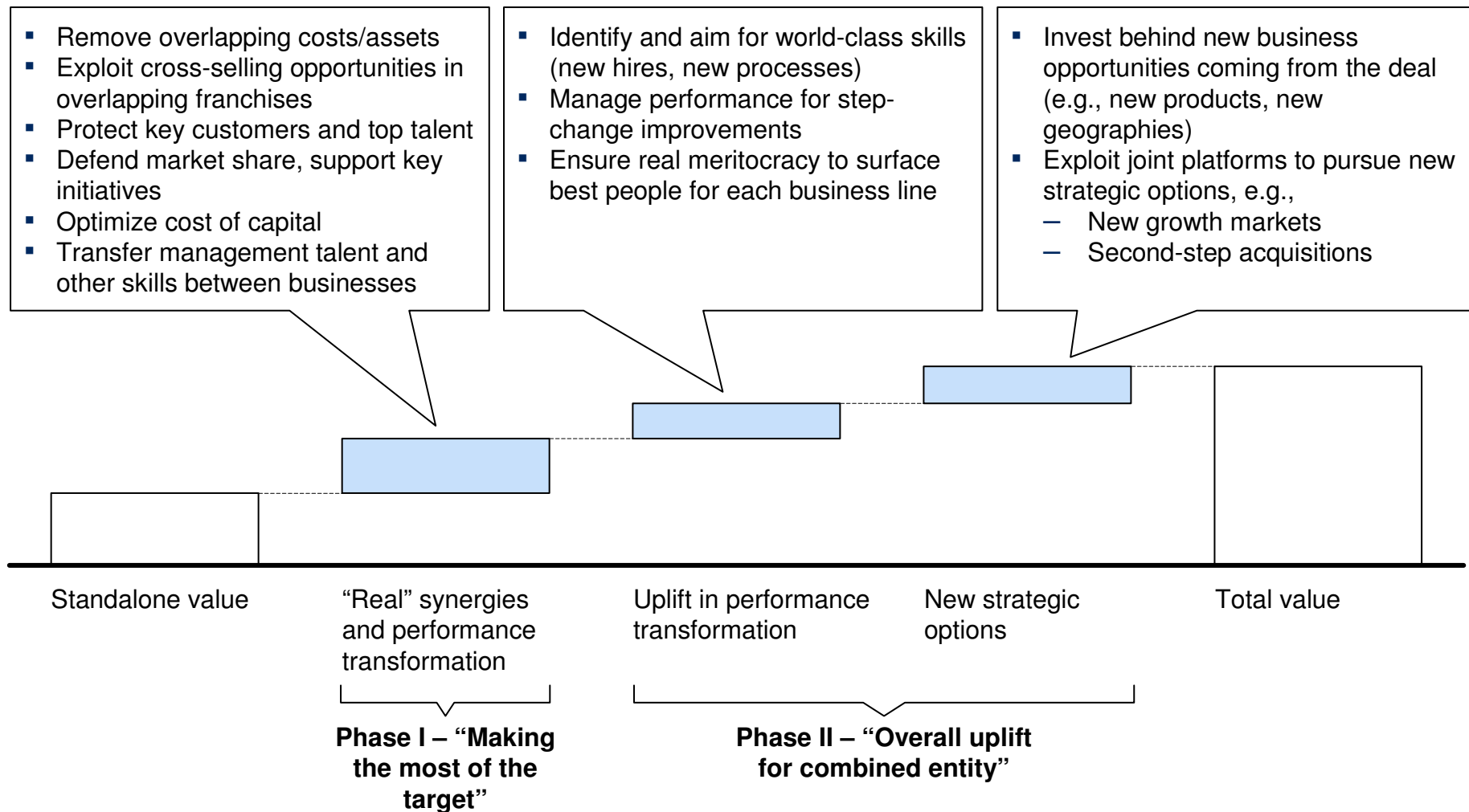
Ownership strategies

- Identify opportunities for ownership restructuring of corporate portfolio (acquisitions/divestments/spin-offs etc)
- Estimate value creation potential from ownership restructuring
- Formulate action plan

Synergies: value created by the combination of two companies above and beyond what each company could reach on a standalone basis

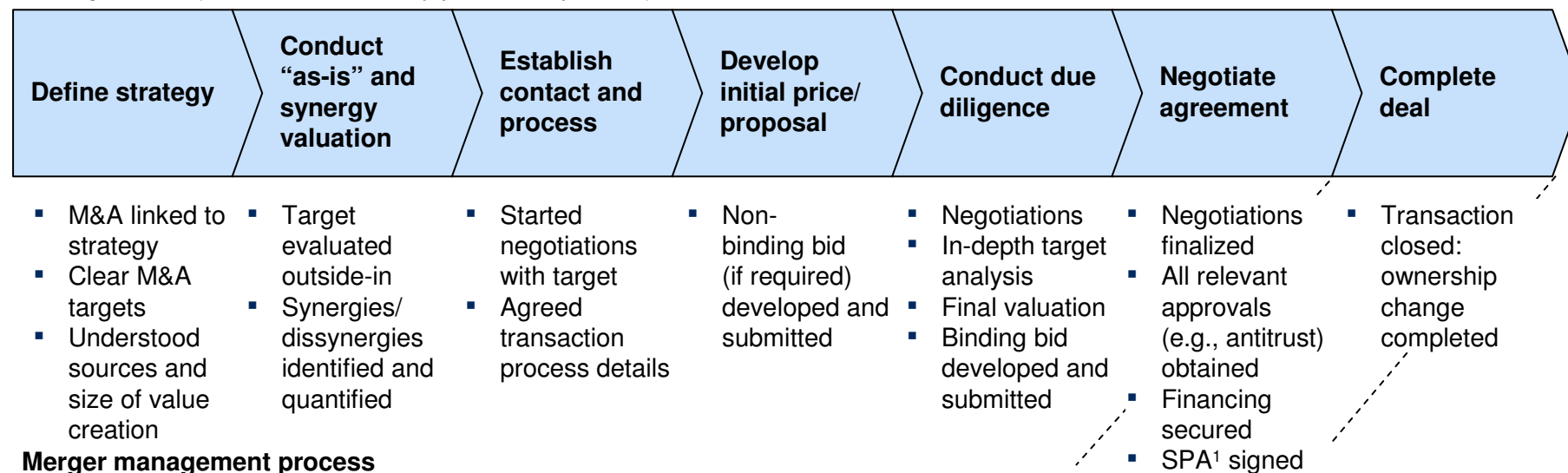
EXAMPLE

NOT EXHAUSTIVE

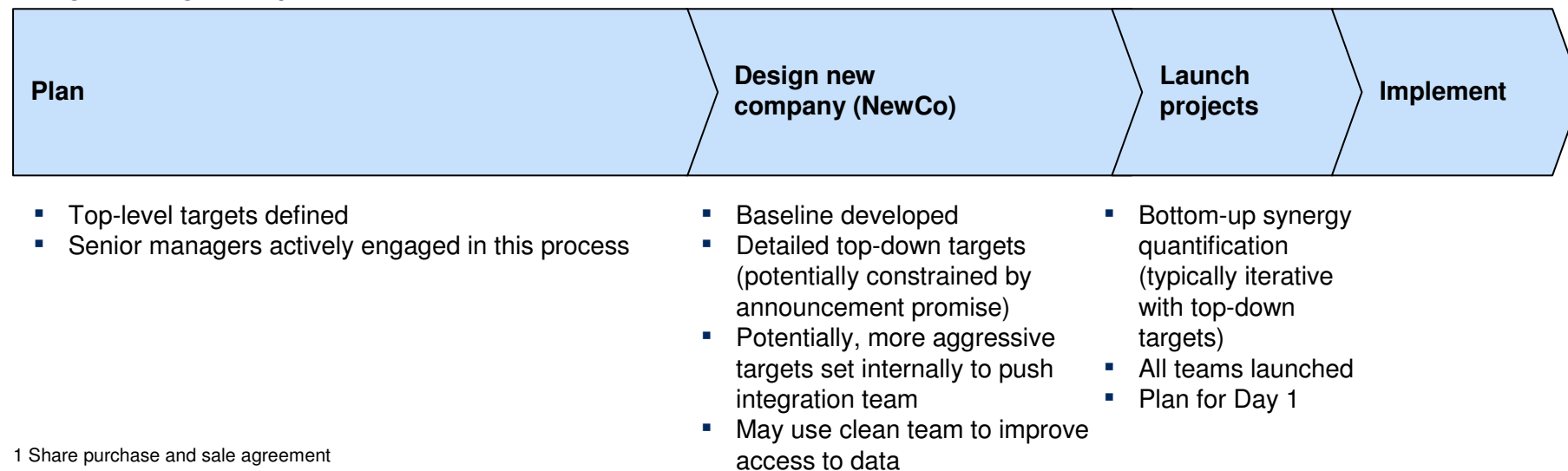


Transaction processes vary depending on the type of M&A and must be linked to merger management

M&A process (indicative for friendly private acquisition)



Merger management process



¹ Share purchase and sale agreement

Excellent M&A players rely on 5 principles

Tailored approach



Strict M&A governance

- Clear responsibilities
- Transparent decision procedures and criteria
- Controlling of M&A targets

M&A linked to strategy

- Link to corporate strategy
- Clearly defined M&A targets
- Programmatic M&A approach
- Deep understanding of value drivers



Clear M&A processes

- Proactive sourcing
- Stage-gate process
- “Learning” M&A function



M&A enablers in place

- Tailored playbook
- “Best-in-class” toolbox
- Management incentive schemes



High-performing M&A organization

- Integrated M&A function
- Multifunctional deal team
- People/capabilities

Indicators of successful M&A

- Grow faster
- Create more value
- Not too many “misses”
- No disasters
- Effective and efficient processes



I Best-practice players have clear strategic guidelines

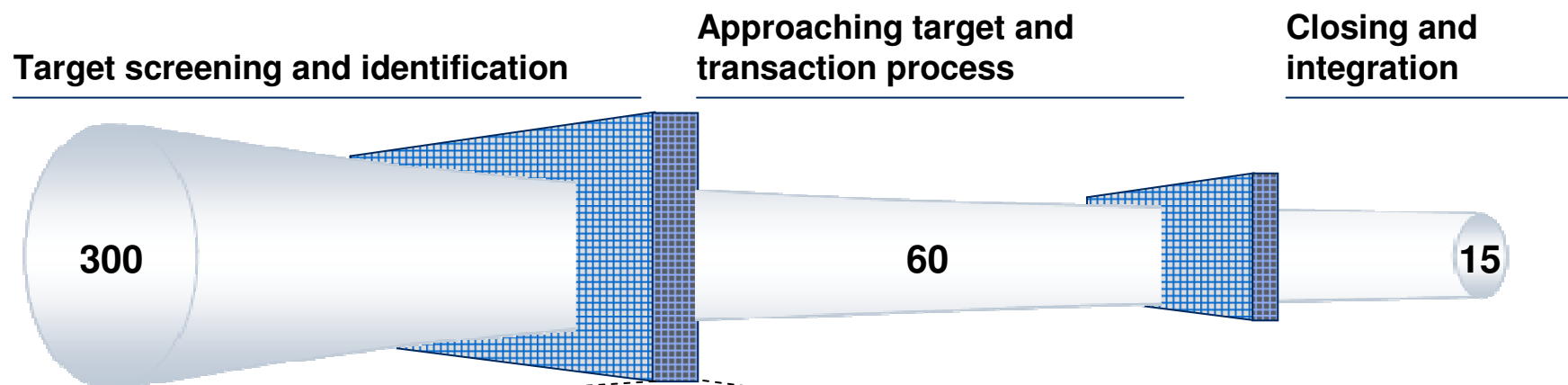
PARTICIPANT EXAMPLE

- No M&A for this BU
- M&A limited possibility
- M&A part of strategy

	Right to M&A	Required capabilities	Frequency Number of deals in 3-5 years	Size EUR million
Corporate		<ul style="list-style-type: none"> ▪ R&D efficiency ▪ Distribution 	1 5-10	>5,000 50-500
BU 1		<ul style="list-style-type: none"> ▪ R&D products and pipeline 	2-3	50-500
BU 2		<ul style="list-style-type: none"> ▪ N/A 	0	N/A
BU 3	Divest	<ul style="list-style-type: none"> ▪ N/A 	5	50-500
BU 4		<ul style="list-style-type: none"> ▪ R&D products and pipeline ▪ R&D skills 	(2-3) (2-3)	5-20 5-20
BU ...		<ul style="list-style-type: none"> ▪
Total transactions			18-25	

- M&A program derived from corporate and BU M&A planning
- Prioritization of targets done on corporate level given strategic priorities and M&A capacity
- Clear financial criteria for M&A transactions

II “Killer” criteria defined based on past experience and rigorously implemented at an early stage



Standardized one-page for initial go-ahead

Target profile

- Market, prospects, strengths, weaknesses, etc.
- Preliminary financial evaluation

Strategic rationale

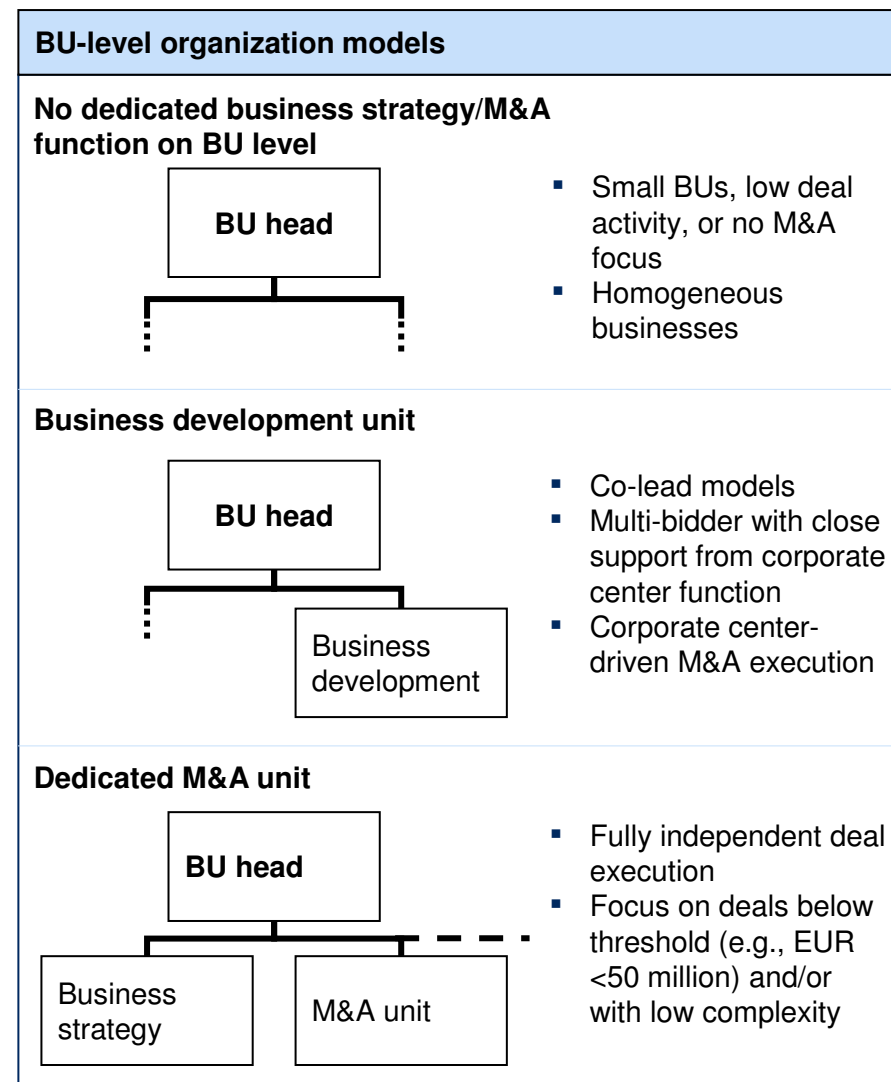
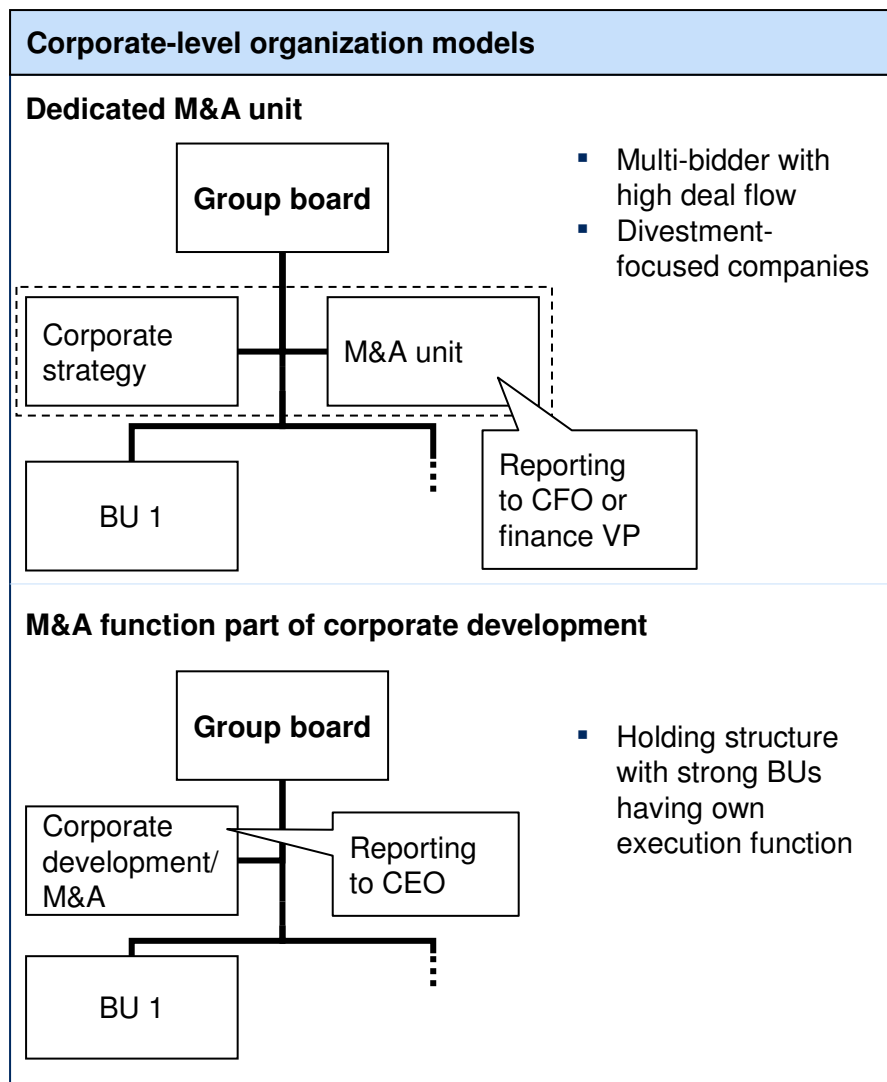
- Deal story

Killer criteria

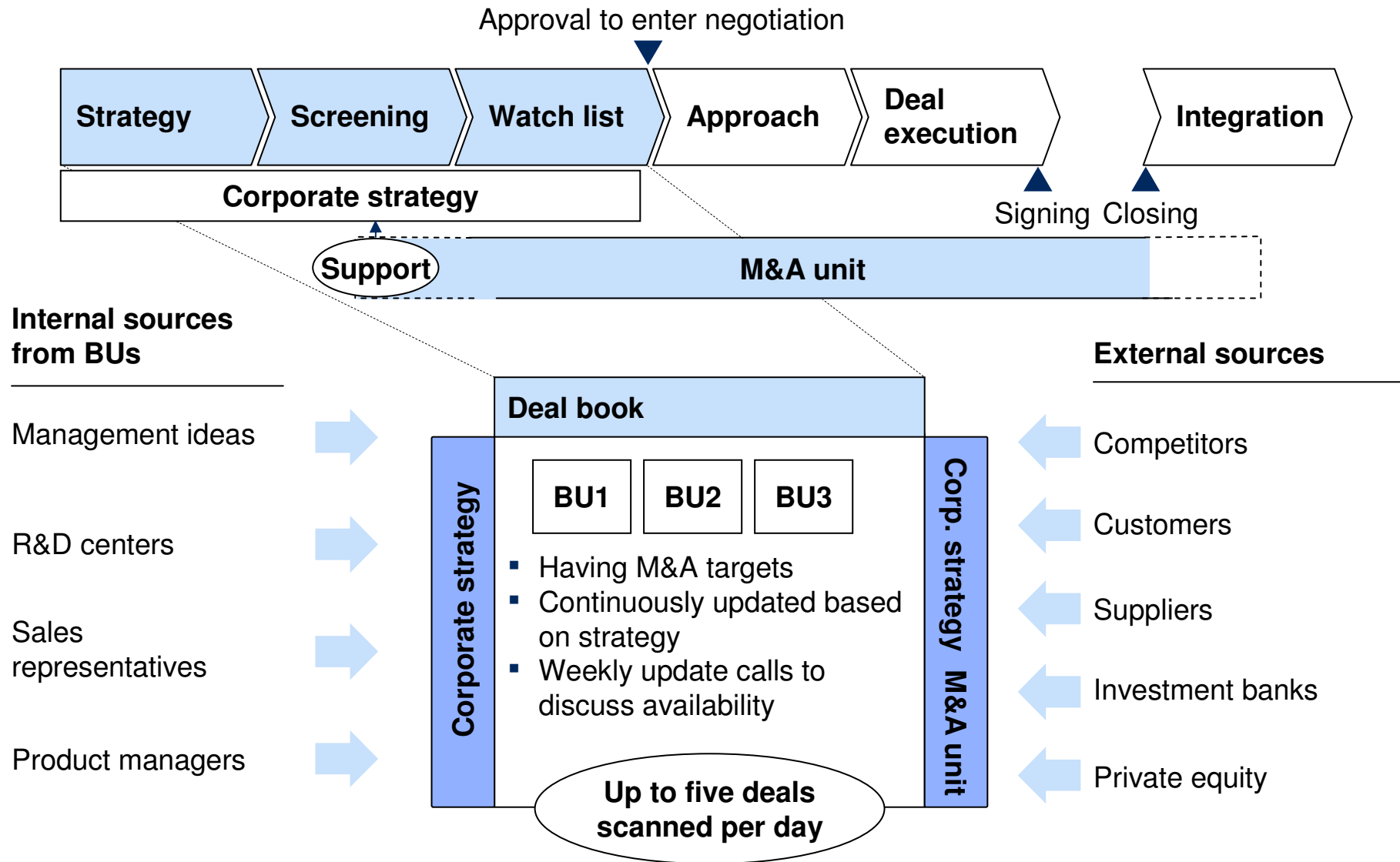
- Killer criteria to be addressed
 - BU buy-in
 - Financing capacity
 - Regulatory approval
 - Feasibility of deal execution and integration

- **Killer criteria** defined based on historic experience
- **First approval to go ahead** considered **key driver** for subsequent deal **success rate**
- Striving for a **DD-to-closing conversion rate of 4 to 1**

III Best-practice acquirers strongly link M&A and corporate development and have BU-centered capabilities on top of corporate capabilities



IV Actively managing deal book with high top management attention



V Systematic high-volume acquirers possess an M&A playbook EXEMPLARY

I M&A strategy	Gap analysis 	Planning process 	Hurdle rates/targets
	Decision processes 	Deliverables 	No-go criteria
II M&A governance			
III M&A organization	Deal team setup 	Team charters 	Gatekeepers
IV M&A processes	Process description 	Company databases 	DD checklists
	Synergy cockpit 	Valuation model 	Postmortem analysis

Continuous improvement of M&A function

- Institutionalized postmortem deal process reviews
- Update of toolbox
- Assignment of responsible team member to manage and update playbook and tools

Playbook available to all parties involved in the process