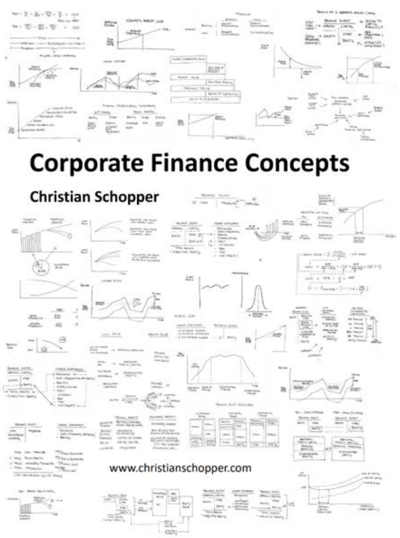
M&A MECHANICS

2019

For more concepts click on:



CorpFinCE
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Distinction between Merger and Acquisitions

- A merger is a transaction to unite two existing companies into a new one
- An acquisition is a transaction whereby a company buys most – usually 50+% - of another firm's ownership stakes to assume control
- Differentiation between mergers and acquisitions has become increasingly difficult

Reasons for M&A

- **Integration**
  - Horizontal / lateral integration
    - Same customer, same product
    - Geographic expansion
  - Vertical integration
    - Acquisition of suppliers
    - Acquisition of customers
- **Diversification**
  - Product / technology expansion
    - Different products / technology
    - Same customers
  - Conglomerate
    - New products, new customers …
  - Financial sponsors
- **Defensive**
  - Acquisition of direct competitors
    - Enlarge company size
    - Anticipate competitors´ move
- **Synergies**
  - Value and performance of the companies combined will be greater than the sum of the separate individual parts
  - Growth, cost, financial, operational…
- **Economies**
  - Access to economies of scale or scope or provide greater market power because of lesser competition
- **Asset Consolidation**
  - Consolidating resources that could be physical, patents, human resources or intellectual property
- **Value Unrelated**
  - Dominant logic of the management, which could just be for diversification or personal incentive

Available Process Typology – Driven by Seller

	Pros	Cons
Private negotiation	■ Perfect in presence of a "preferred" bidder ■ Guarantee of exclusivity ■ Easy to control ■ Relatively easy to be interrupted	■ Lower probabilities to maximize the price ■ It could need more time than expected ■ Lower seller's negotiation power because of lack of competition
Few parallel private negotiations	■ It introduces competition in the process ■ High level of uncertainty on the status of the process ■ It allows to maintain confidentiality ■ Relatively easy to be interrupted	■ Lower seller's negotiation power because of reduced competition ■ Management of different bidders, who ask exclusivity, could result difficult to achieve ■ Still low seller and advisor's negotiation power because of lack of competition

Available Process Typology – Driven by Seller (cont´d)

	Pros	Cons
Private auction	■ Perfect in case of numerous potential bidders ■ Good chance to maximize value ■ High control by the seller in negotiating terms of the agreement ■ Rapid process	■ Process difficult to be interrupted ■ Risk of information leakage
Public auction	■ Open to all potential buyers ■ Highest probability of price maximisation ■ High perception of "fairness"	■ Risk of damaging business's reputation if the sale is not successfully completed ■ Lack of flexibility to interrupt the process

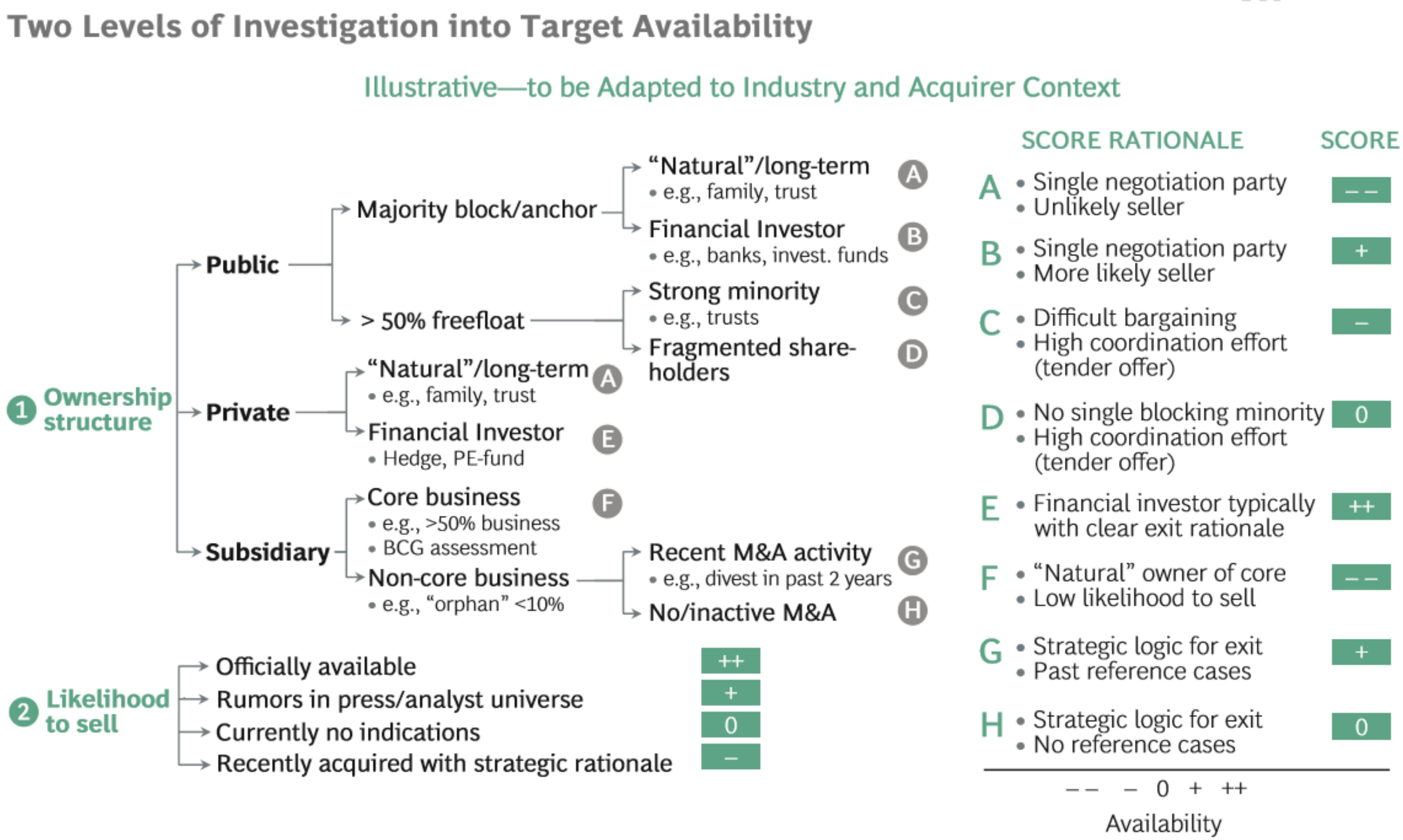
Available Process Typology – Driven by Buyer

	Pros	Cons
Unsolicited Offer (Friendly)	▪ Negotiations efforts with only controlling counterpart/s ▪ Price offered previously agreed with controlling shareholders	▪ Execution risk - bidder may not reach optimum control threshold (i.e. debt push down) ▪ If target is public an unconditional mandatory offer could be required ▪ Certainty to acquire an identified stake of target
Unsolicited Offer (Hostile voluntary offer)	▪ Price solely fixed by Buyer on the basis of its objectives ▪ Possibility of conditional bid ▪ Certainty of acquiring desired control threshold (debt push-down) ▪ If successful likely probability of take-private or free float restoration	▪ Poison Pills ▪ Risk of interlopers and counterbids ▪ Uncertainty of results until the end of the bid period ▪ Delicate to be executed

Principle Steps

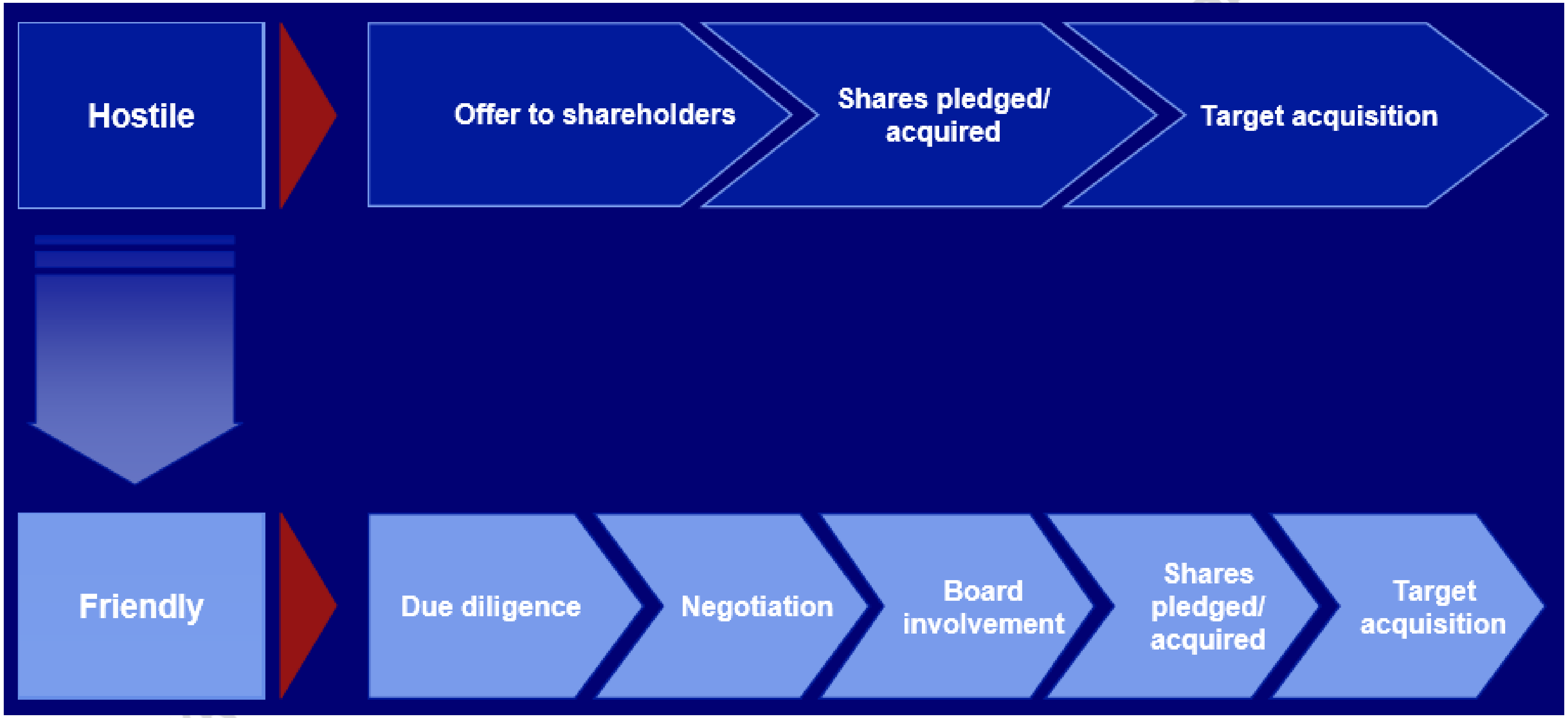
- Identification of potential targets
- Capability and Fit assessment
- Valuation of the target
- Arranging financing and Investment Bank Advisory
- Making a formal approach
- Due Diligence
- Signing
- Approvals
- Closing
- Post merger integration

Target Availability



http://image-src.bcg.com/BCG-The-Art-of-Successful-Acquisition-Oct-2015_tcm9-18798.pdf

Hostile vs Friendly Target Approach



Buy Side

Market analysis	Establishing targets	Documentation / Valuation	Due Diligence	Negotiation	Closing
1-2 months	1-2 months	1-2 months	1-2 months	1-2 months	
• Detailed definition of target • Market screening ("Long List") • Target identification ("Short List")	• Target prioritization and definition of time-line • Contacting targets on an anonymous basis to check potential sale attendance • First meeting with management and shareholders	• Short documentation of targets • SWOT Analysis including statement regarding a potential buy • Indicative valuation as basis for price-range • Structuring of transaction process	• LOI negotiation reg. parameters of transaction • Additional management meetings • Preparation and Coordination of the Due Diligence (Legal, Commercial, Financial, HR)	• Purchase Price negotiation • General negotiations (e.g. Milestones) • Warranties, Guaranties, Decision making • Final purchase agreement negotiation • Signing • Monitoring	

Sell Side

Preparation
1-2 months

- Structuring of the process
- Market screening
- Defining the ideal investors profil
- Data room setup and preparation of management presentation
- Documentation of the company including budget planning
- Research of potential investors („Long List")

Contacting and Preselection
1-2 months

- First contact (anonymous) with potential investors
- Exchange of non-disclosure agreement
- Handover of Information – memorandum (IM) and first discussion with management
- Obtaining indicative offers
- Selection of suitable investors for the Due Diligence („Short List")

Due Diligence
1-2 months

- Coordination of the Due Diligence process (legal, commercial, etc.)
- Management meetings, side visit
- Obtaining binding offers including proof of financing
- Letter of intent (LOI) negotiation regarding transaction parameters
- Selecting suitable investors for negotiations

Negotiations
1-2 months

- Purchase price negotiation
- General negotiations (e.g. Milestones)
- Warranties, guaranties
- Decision finding
- Negotiation of the final purchase agreement

Closing

Legal Themes & Topics

- Confidentiality Agreement
- Letters of Intent
- Exclusivity
- Auction Process and Indications of Interest
- Due Diligence
- Possible Transaction Structures
- Acquisition Agreement
- Commercial Terms / Economic Provisions
- Holdbacks, Escrow, Earnouts
- Representations and Warranties
- Pre-Closing Covenants
- Post-Closing Covenants
- Closing Conditions
- Indemnification
- Anti-Sandbagging
- Indemnification Procedures
- Dispute Resolution
- Fiduciary Duties

Legal Themes & Topics (cont´d)

Representations and Warranties:

- Assertions made by the seller to the buyer about what they are buying
- Seller makes specific promises, for example
  - Accuracy of financial statements
  - Any lingering environmental or legal problems
- The seller then "indemnifies" the buyer
  - That means, the seller promises to pay up if problems pop up

Indemnity Escrow Amount:

- Portion of the purchase price held in escrow to serve as a fund to satisfy indemnification claims against the seller
  - Typically calculated as a percentage of the purchase price
  - For technology companies this can range from less than 5% to greater than 15%; current market conditions generally put this in the range of 10% to 15%.

Indemnity Escrow Period

- Can be less than a year to greater than two years, but currently runs between 12 and 18 months

Legal Themes & Topics (cont´d)

Reps & Warranties Survival Period:

- Length of time after closing during which a party may make claims for breaches of reps and warranties
  - Between 12 and 18 months
  - Also known as the "general survival period."

Carve Outs to General Survival Period:

- Certain reps and warranties may be carved out and be extended for a longer period of time
  - Broker's fees, employee benefits, intellectual property, taxes owed, capitalization, title to assets and due authority to make the sale in the first place

Indemnity Basket Type:

- Indemnifiable losses a party must incur before it can seek indemnification
  - True deductible basket means that basket serves as a deductible, and the indemnifying party is responsible for all losses exceeding the basket amount
  - Tipping basket means that the indemnifying party is responsible for all losses, once those losses reach the basket amount

Indemnity Basket Size:

- Calculated as a percentage of the purchase price
  - Can range anywhere from 0.025% to greater than 1.5%

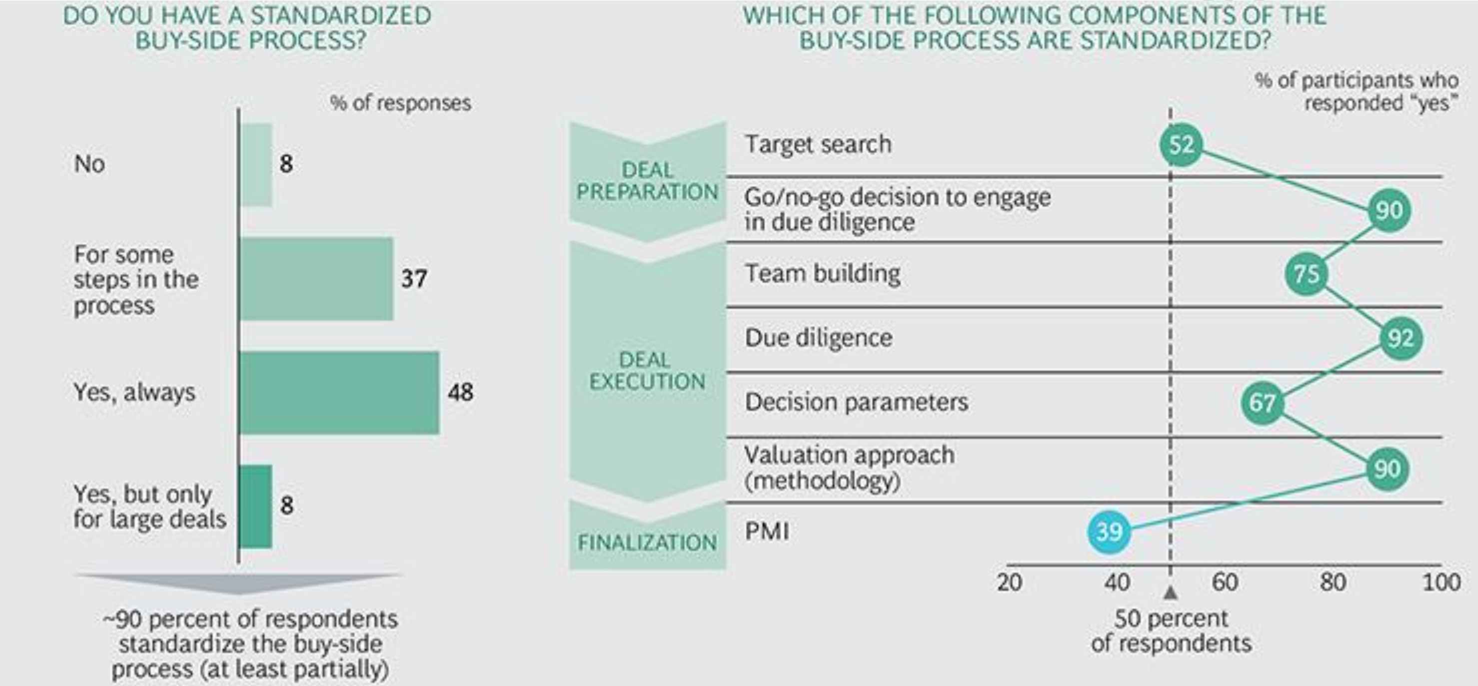
Why M&A Frequently Fails

- Only 47 percent of all deals produce a positive relative total shareholder return one year after the transaction date

- The four most cited reasons for deal failure are:
  - poor integration,
  - higher than anticipated complexity,
  - difficult cultural fit, and
  - synergies that did not materialize

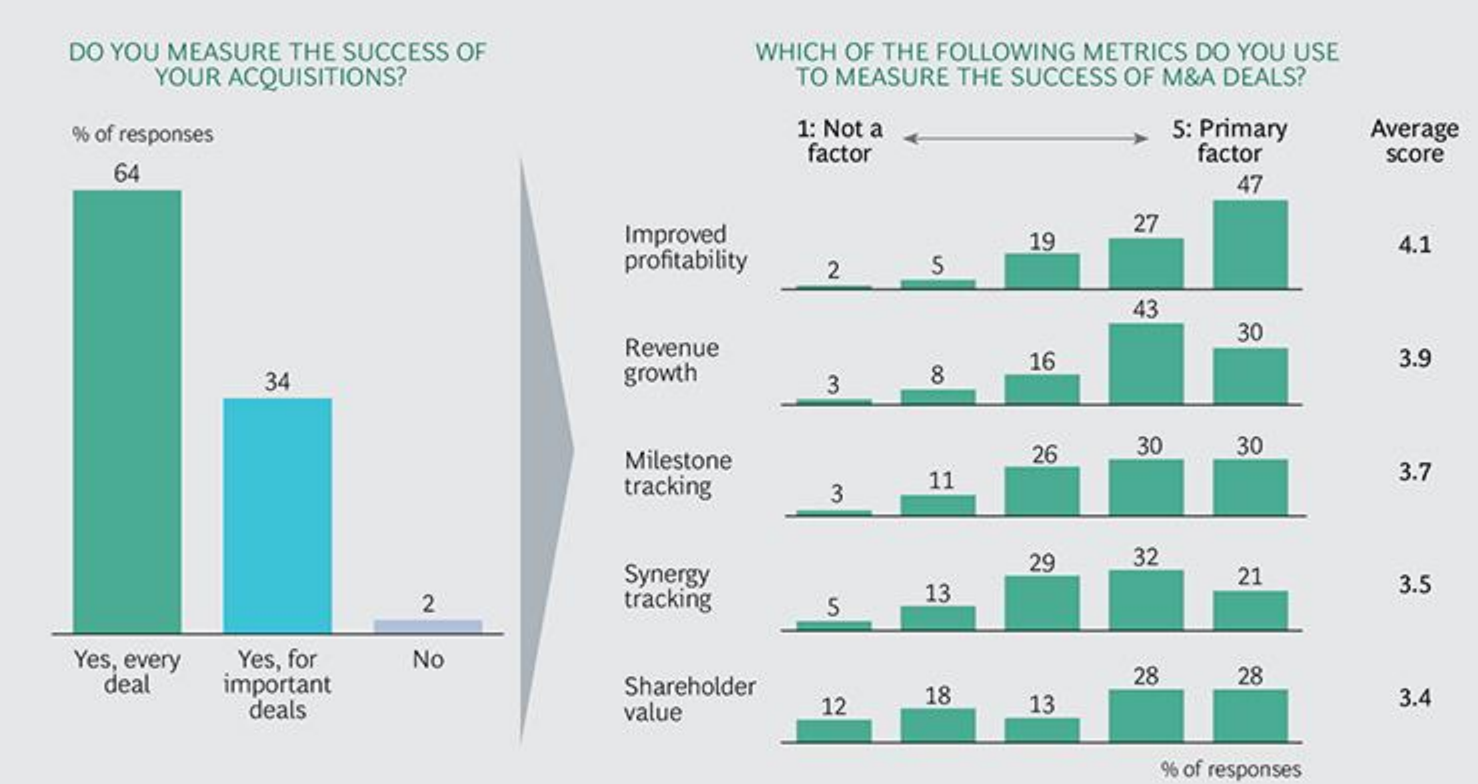
- Measurement of success (or lack thereof) may be a bigger culprit. Less than two-thirds of corporate leaders said they measure the success of every deal they do, and just over one-third said they only track the success of “important” deals.

Most Companies´ Standardised Deal Processes Overlook Post Merger Integration



Sources: BCG 2015 Corporate Leaders M&A Survey; BCG analysis.
Note: A total of 65 corporate leaders responded to this survey question. Because of rounding, the percentages in the left-hand graphic do not add up to 100.

Profitability Outranks Value Creation in Gauging M&A Success



Sources: BCG 2015 Corporate Leaders M&A Survey; BCG analysis.
Note: A total of 64 corporate leaders responded to this survey question. Because of rounding, not all percentages add up to 100.

Post Merger Integration

Successful M&A integration

1. Follow the money
2. Tailor your actions to the nature of the deal
3. Resolve the power and people issues quickly
4. Start integration when you announce the deal
5. Manage the integration through a "Decision Drumbeat"
6. Handpick the leaders of the integration team
7. Commit to one culture
8. Win hearts and minds
9. Maintain momentum in the base business of both companies-and monitor their performance closely
10. Invest to build a repeatable integration model

The Decision Drumbeat in practice

Focus on the fundamentals.

Coordinate decisions.

Assign decision rights and roles.

Stick to the timetable.

McKinsey&Company

There are 12 best practices in merger integration.

Focus on value creation	1 Anchor integration architecture and approach in deal rationale 2 Look beyond due diligence and open the aperture to exceed traditional synergies 3 Selectively transform parts of the business 4 Protect business momentum to avoid typical loss of revenue
Prepare well	5 Define a comprehensive, tailored integration approach—and stick to it 6 Empower a value-added integration-management office that attracts top performers and line leaders 7 Don't underestimate culture; use a scientific approach to identify issues and intervene as needed 8 Build momentum by making critical decisions well before close and completing key activities within 100 days
Execute rigorously	9 Don't make day one bigger than it needs to be 10 Track activities and operating metrics in addition to traditional financial measures 11 Overcommunicate, with messages tailored to every stakeholder group 12 Build capabilities for future deals

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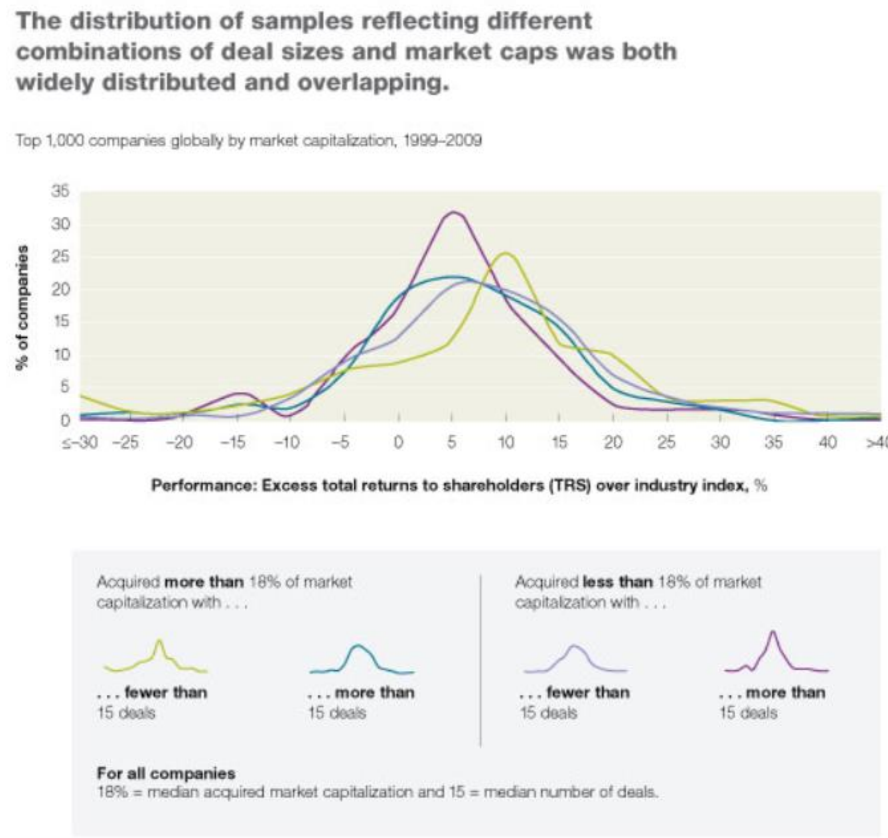
The size and frequency of deals matter less than how companies execute them

- It seems not to matter much whether companies completed one large deal, many small deals, or few deals
  - In statistical parlance, the distribution of samples reflecting different combinations of deal sizes and market caps was both widely distributed and overlapping
- From a value-creation perspective, this finding means that the size and number of deals matter less than the discipline with which they are identified, priced, integrated, and managed



Growing Through Deals: A Reality Check (cont´d)

McKinsey&Company

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Top 1,000 companies globally by market capitalization, 1999–2009

Acquired **more than** 18% of market capitalization with . . .

- **. . . fewer than** 15 deals
- **. . . more than** 15 deals

Acquired **less than** 18% of market capitalization with . . .

- **. . . fewer than** 15 deals
- **. . . more than** 15 deals

For all companies
18% = median acquired market capitalization and 15 = median number of deals.

McKinsey&Company

There is no magic formula to make acquisitions successful

- Like any other business process, they are not inherently good or bad, just as marketing and R&D aren't
  - Each deal must have its own strategic logic
  - Acquirers in the most successful deals have specific, well-articulated value creation ideas going in
  - For less successful deals, the strategic rationales—such as pursuing international scale, filling portfolio gaps, or building a third leg of the portfolio—tend to be vague
- Empirical analysis of specific acquisition strategies offers limited insight, largely because of the wide variety of types and sizes of acquisitions and the lack of an objective way to classify them by strategy
- What's more, the stated strategy may not even be the real one: companies typically talk up all kinds of strategic benefits from acquisitions that are really entirely about cost cutting …

The Five Types of Successful Acquisitions (cont´d)

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There is no magic formula to make acquisitions successful

- An acquisition's strategic rationale should not be a vague concept like growth or strategic positioning, but must be translated into something more tangible
- Furthermore, even if your acquisition is based on one of the archetypes below, it won't create value if you overpay

Five Archetypes

- Improve the target company's performance
- Consolidate to remove excess capacity from industry
- Accelerate market access for the target's (or buyer's) products
- Get skills or technologies faster or at lower cost than they can be built
- Pick winners early and help them develop their businesses

Harder strategies

- Roll-up strategy
  - Consolidate highly fragmented markets where current competitors are too small to achieve scale economies
- Consolidate to improve competitive behavior
  - Consolidation to lead competitors to focus less on price competition
- Transformational merger
- Buy cheap

Taking a Longer-Term Look at M&A Value Creation

McKinsey&Company

Companies that do many small deals can outperform their peers—if they have the right skills

- **But they need more than skill to succeed in large deals**

- Long-term returns vary significantly by deal pattern and by industry
- The implication is that across most industries, companies with the right capabilities can succeed with a pattern of smaller deals, …
- … but in large deals industry structure plays as much of a role in success as the capabilities of a company and its leadership

The excess shareholder returns of the world's top 1,000 nonbanking companies reveal distinct patterns of deal making.

Global 1,000 nonbanking companies, 1999–2010 (ie, 639 institutions for which data are available through 2010)

Source: Dealogic; McKinsey analysis

Taking a Longer-Term Look at M&A Value Creation (cont´d)

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Taking a Longer-Term Look at M&A Value Creation (cont´d)

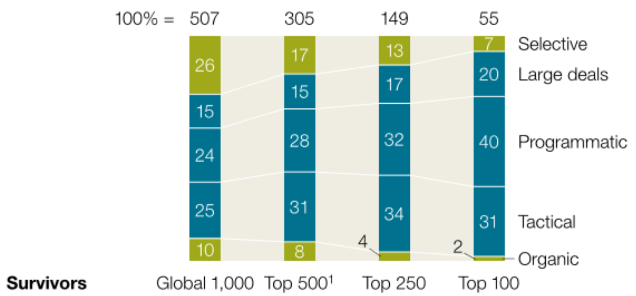
McKinsey&Company

Long-term returns to M&A

- The larger companies get, the more they rely on M&A to grow
  - A majority of these companies complete many smaller deals, with no large ones
  - This finding makes sense, since large deals tend to be hit or miss
- The only companies that had, on average, negative excess returns were those that did large deals
  - The odds of positive excess returns were slightly better for shorter time frames after specific deals, with about half generating positive excess returns within two to five years of the deal

The larger companies get, the more they use M&A to grow.

Distribution of survivors (companies that were in the global 1,000, top 500, top 250, or top 100 in both 1999 and 2010), %



Minimum market cap as of Dec 31, 1999, $ billion	5.0	6.9	13.9	40.2

[1]Percentages do not sum to 100%, because of rounding.
Source: Dealogic; McKinsey analysis

McKinsey&Company

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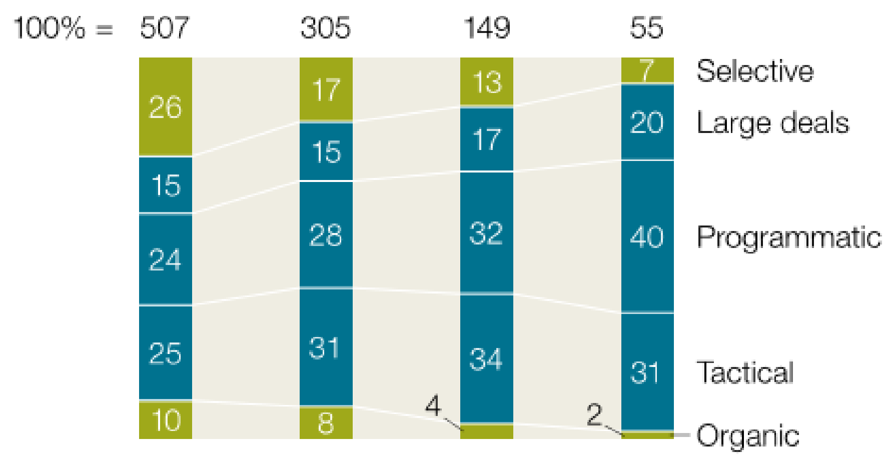

Survivors	Global 1,000	Top 500[1]	Top 250	Top 100
Minimum market cap as of Dec 31, 1999, $ billion	5.0	6.9	13.9	40.2

[1]Percentages do not sum to 100%, because of rounding.

Source: Dealogic; McKinsey analysis

Companies using a programmatic strategy are the most successful.

Global 1,000 nonbanking companies, %

● Average
— 95% confidence interval

	Median excess total returns to shareholders (TRS),[1] Dec 1999–Dec 2010	Probability of excess return greater than 0	Excess TRS, difference between 25th and 75th percentile in percentage points
Programmatic	2.8	64	9
Selective	2.0	64	10
Organic	2.0	58	14
Tactical	1.3	61	8
Large deal	–1.7	44	12

[1]Outperformance against global industry index for each company.

Source: Dealogic; McKinsey analysis

Taking a Longer-Term Look at M&A Value Creation (cont´d)

McKinsey&Company

The importance of industry specifics

Should an individual company in a specific industry at a given time should engage in M&A?

- Most relevant details seem to be industry structure, the match of an asset with a well-articulated strategy, and the execution capabilities required to realize value

Returns by M&A approach are widely distributed and can obscure individual results, but they roughly indicate the top strategies by industry.

Global 1,000 nonbanking companies, median excess total returns to shareholders (TRS), Dec 1999–Dec 2010, %

■ Top strategies in industry

Top strategies	Industries: Consumer discretionary	Telecom	PMP[1]	High tech	CPG[1] and retail	Materials	Manufacturing, other industrials	Insurance and related
Programmatic	4.2	4.5	3.1	–1.2	3.2	4.5	0.7	0.1
Selective	2.0	1.3	6.4	–2.6	2.5	–1.5	4.8	1.7
Tactical	0.4	0.7	N/A[2]	1.2	2.6	–3.0	1.8	2.6
Large deals	–2.8	–0.9	2.0	–6.7	3.8	–0.3	3.5	4.0
Organic	–4.2	N/A[2]	N/A[2]	–2.0	1.4	N/A[2]	–5.2	9.8

[1]PMP = pharmaceutical and medical products; CPG = consumer packaged goods.
[2]Data not shown where category contained <5 companies.
Source: Dealogic; McKinsey analysis

McKinsey&Company

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Industries

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Programmatic	**4.2**	**4.5**	**3.1**	**–1.2**	**3.2**	**4.5**	0.7	0.1
Selective	**2.0**	**1.3**	**6.4**	–2.6	2.5	–1.5	**4.8**	1.7
Tactical	0.4	0.7	N/A[2]	**1.2**	2.6	–3.0	1.8	2.6
Large deals	–2.8	–0.9	2.0	–6.7	**3.8**	**–0.3**	**3.5**	**4.0**
Organic	–4.2	N/A[2]	N/A[2]	–2.0	1.4	N/A[2]	–5.2	**9.8**

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Source: Dealogic; McKinsey analysis

Taking a Longer-Term Look at M&A Value Creation (cont´d)

McKinsey&Company

Large deals

- Companies are more successful with large acquisitions—those worth more than 30 percent of the acquirer's market capitalization—in slower-growing, mature industries
  - Here, there is great value in reducing excess industry capacity and improving performance, and a lengthy integration effort is less disruptive
- In contrast, large deals in faster-growing sectors have been less successful

Programmatic deals

- Companies across a variety of industries do well using the programmatic approach
- In addition, there is a volume effect: The more deals a company did, the higher the probability it would earn excess returns
- Evidence shows that executing a high-volume deal program requires certain corporate capabilities but not necessarily a specific industry structure

Taking a Longer-Term Look at M&A Value Creation (cont´d)

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Tactical deals

- Companies using a tactical approach to M&A also do numerous small deals, but those deals do not, combined, make up a large portion of the acquirer's market capitalization
  - Tech companies were significantly more successful with this approach than with the others: they used M&A as part of an innovation and capability-building strategy, buying options and adding functions
  - Industrial companies in this segment seem to use tactical M&A to fill gaps in products or channels

Selective deal making

- Many companies do deals occasionally but don't appear to have an M&A capability or a proactive M&A strategy
  - Total shareholder returns are in all likelihood driven more by an organic-growth tailwind than by M&A strategy

Winning M&A Strategies Across Life Cycle Phases

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	Build	Expand	Operate	Reshape
M&A Objective	Assemble the business model	Replicate across products and markets	Stay focused on efficiency/cost 'sweet spot'	Improve industry structure
	Creation			
Acquisition strategy	• Many small bets • Generation of own deal flow • Specialization	• Numerous midsize bolt-ons to cross-fertilize products/ markets	• Poorly operated products and brands	• Roll-ups • Disintegration & reintegration of the value chain
Divestiture strategy	• Frequent review of bets • Divestiture of completed business models	• Divestiture when efficiency trumps growth	• Divestiture when cost advantage not sustainable	• Divestiture to operator if structure restored • Else, divestiture to LBO for "harvest"
Critical M&A skills	• Deal flow screening • Creative structuring	• Deal structure and managerial integration to capture synergies	• Operational integration	• Insight to spot trends • Deal structuring

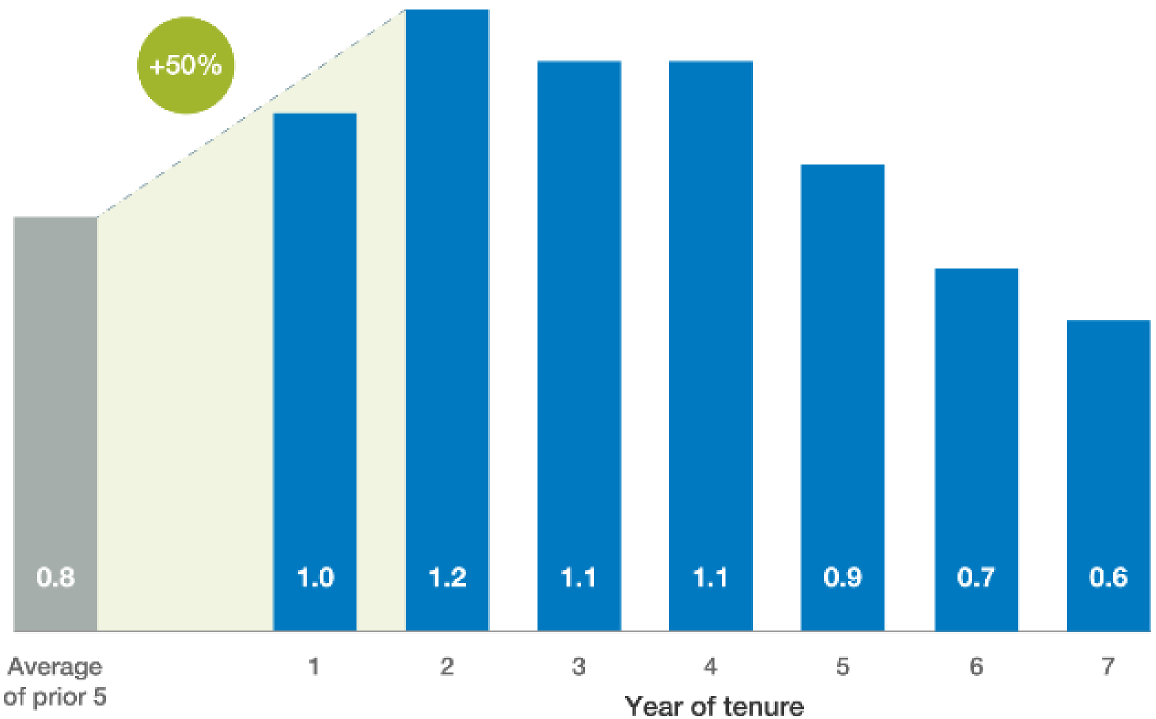
Source: McKinsey analysis

A Deal-Making Strategy for New CEOs

McKinsey&Company

New CEOs are under pressure to move early and conduct more M&A deals sooner than later in their tenure.

Number of deals per year by year of tenure



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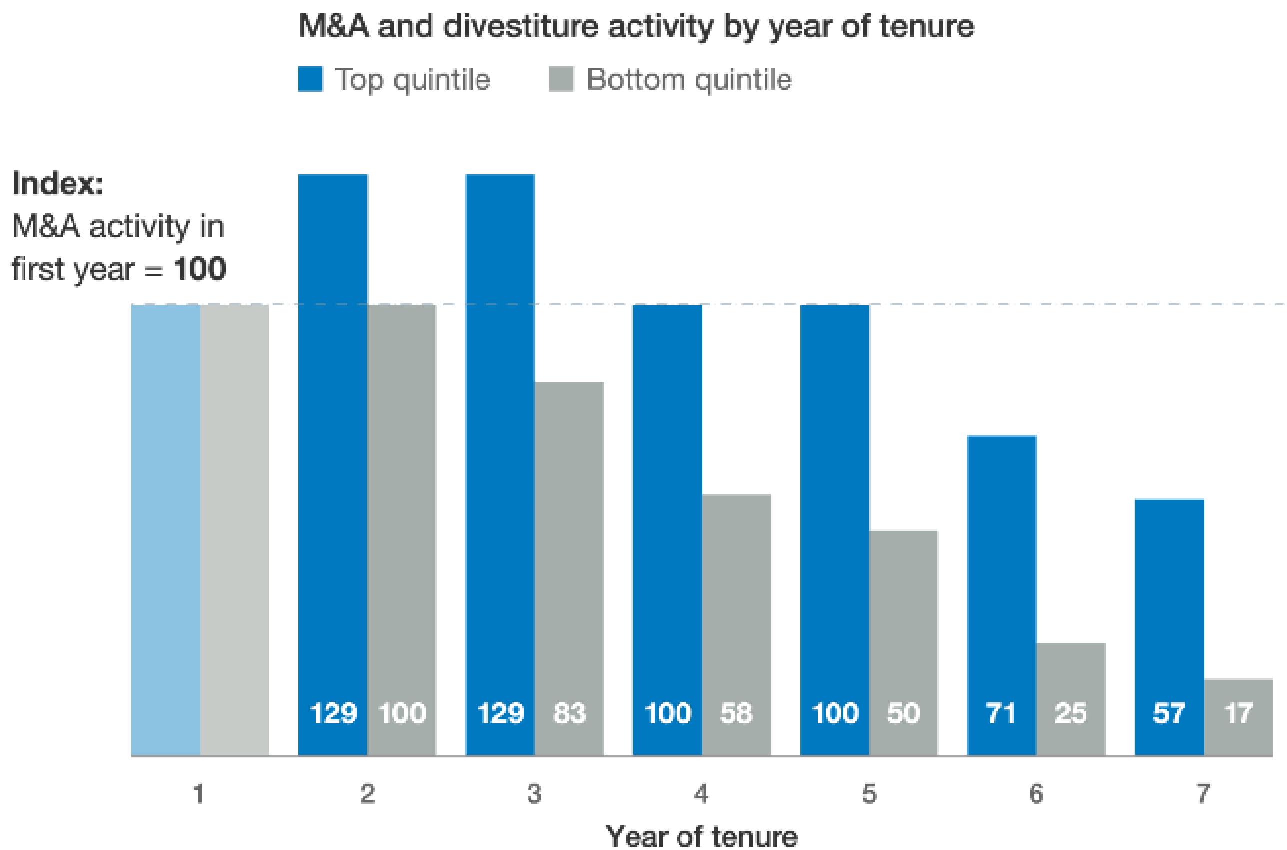
A Deal-Making Strategy for New CEOs (cont´d)

McKinsey&Company

Top-quintile CEOs are more aggressive early on and experience less of a drop-off in M&A activity over time.



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The Value Premium of Organic Growth

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At comparable total growth levels, companies with more organic growth outperform those with more growth from acquisitions.

[1]Excludes banks, insurance companies, extraction companies, and cyclical commodities.

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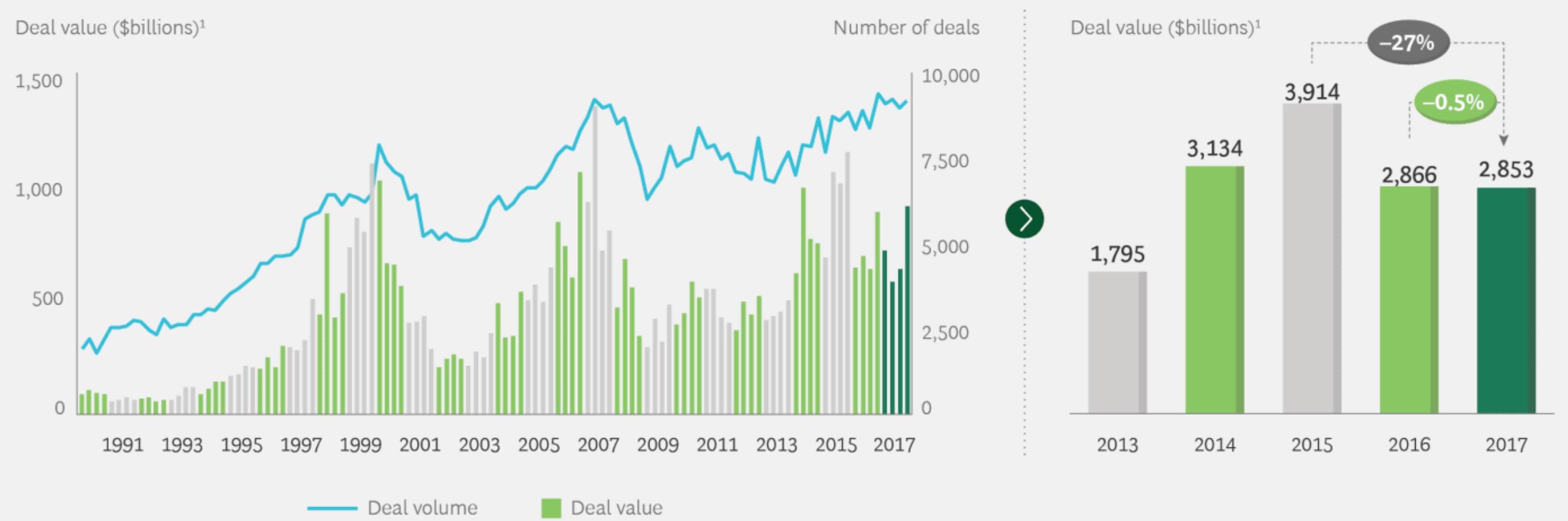
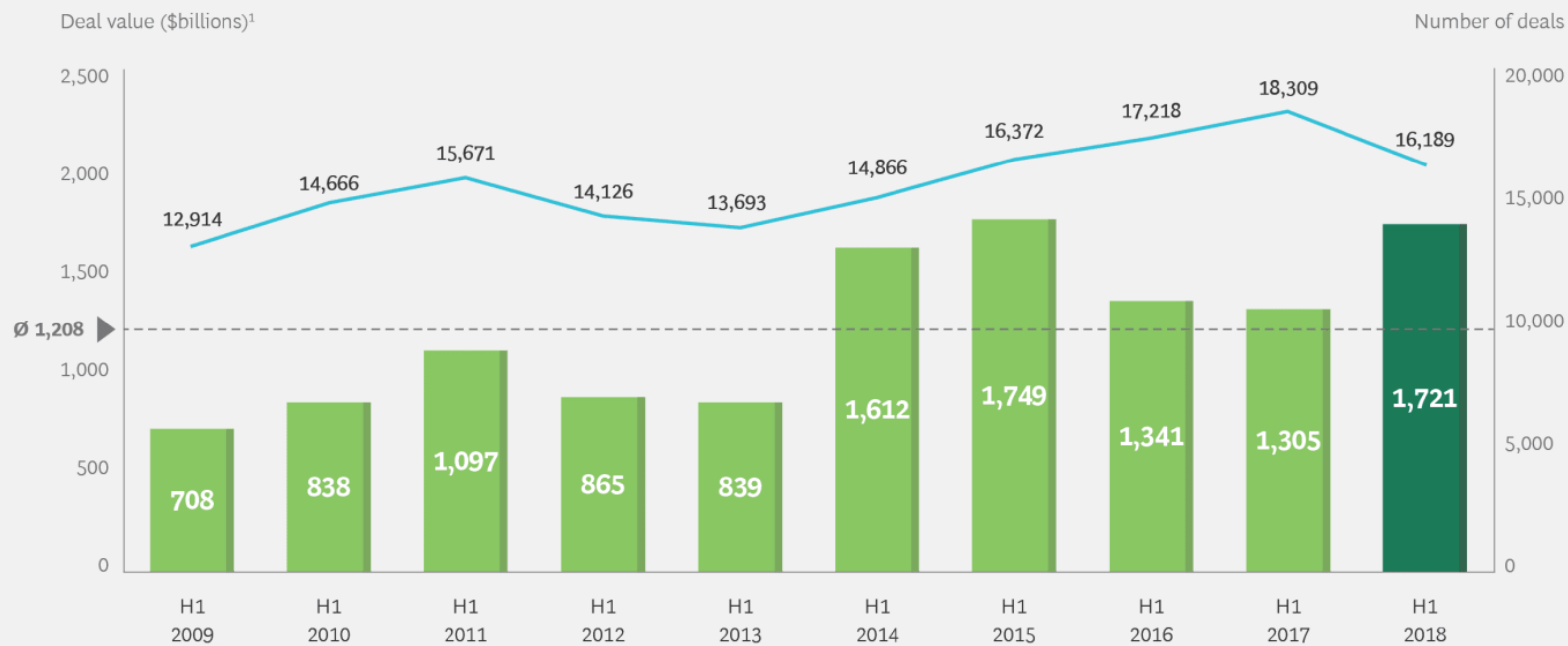
Global M&A Trends & Observations

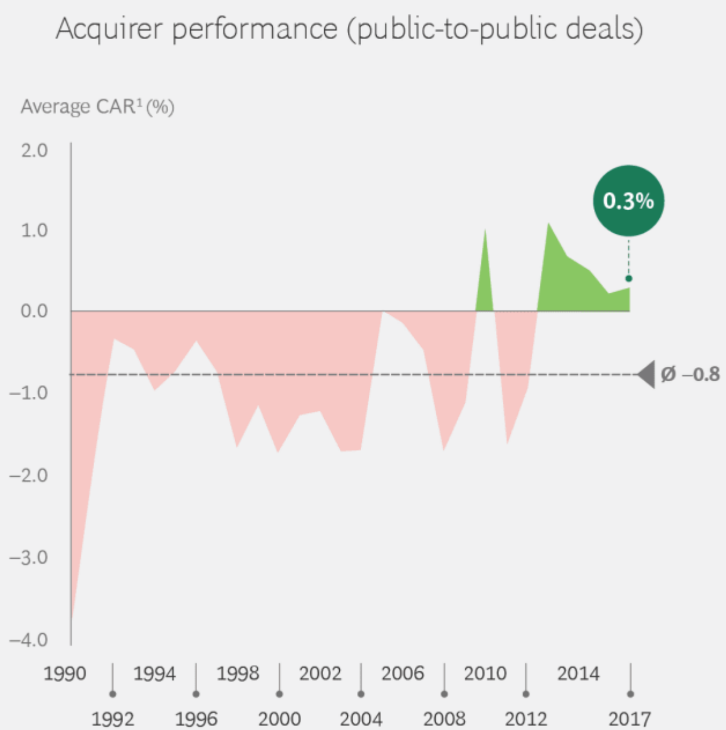


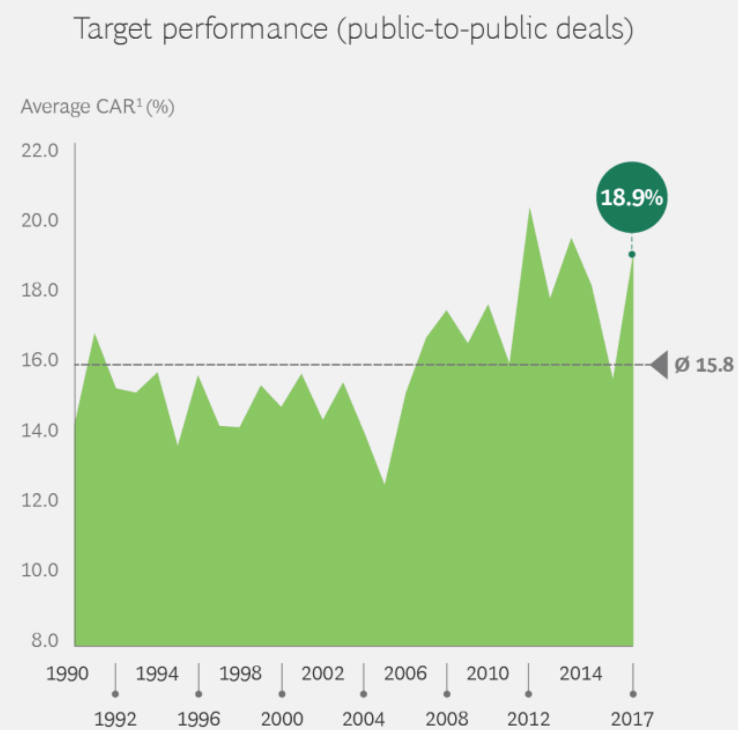
Sources: Thomson ONE Banker; BCG analysis.
Note: The total of 686,709 M&A transactions comprises pending, partly completed, completed, unconditional, and withdrawn deals announced between 1990 and 2017, with no transaction-size threshold. Self-tenders, recapitalizations, exchange offers, repurchases, acquisitions of remaining interest, minority stake purchases, privatizations, and spinoffs were excluded.
[1]Deal value includes assumed liabilities.

Global M&A Trends & Observations (cont´d)



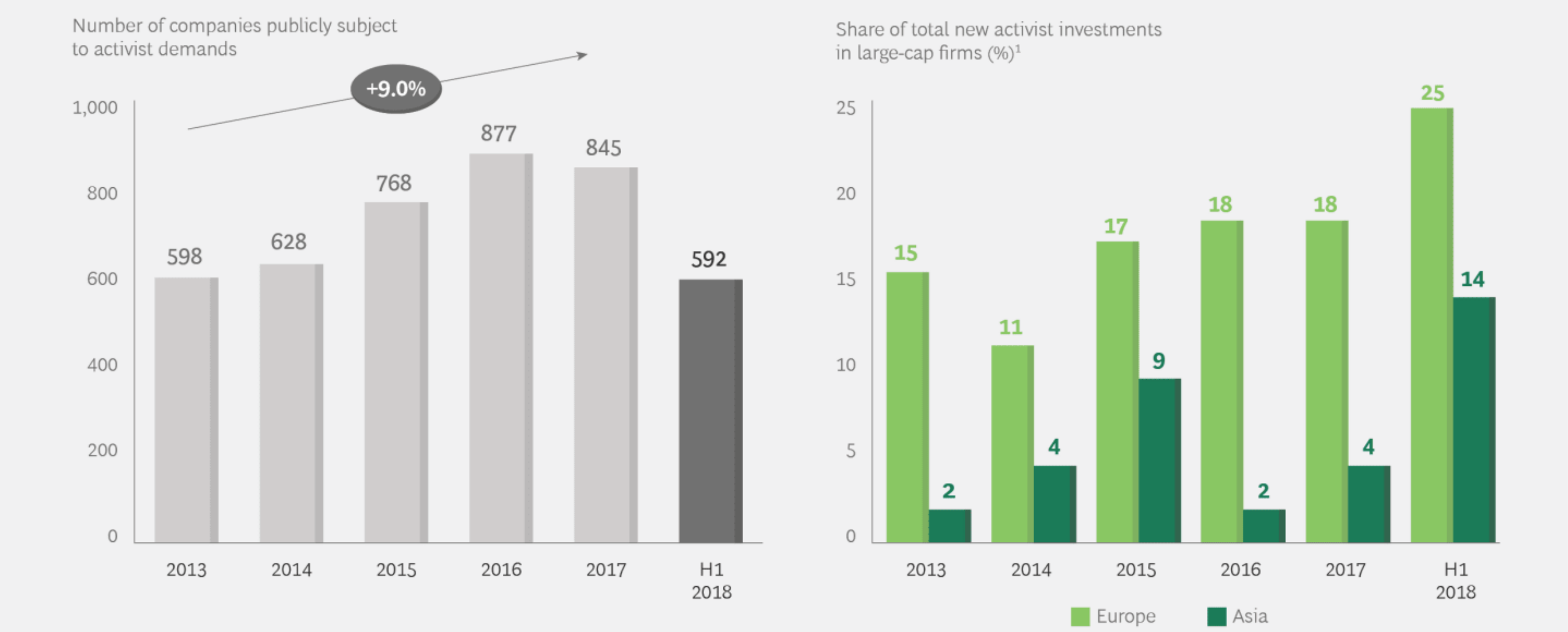
Sources: Thomson ONE Banker; BCG analysis.
Note: The total of 154,024 M&A transactions comprises pending, partly completed, completed, unconditional, and withdrawn deals announced between 2009 and June 30, 2018, with no transaction-size threshold. Self-tenders, recapitalizations, exchange offers, repurchases, acquisitions of remaining interest, minority stake purchases, privatizations, and spinoffs were excluded.
[1]Deal value includes assumed liabilities.





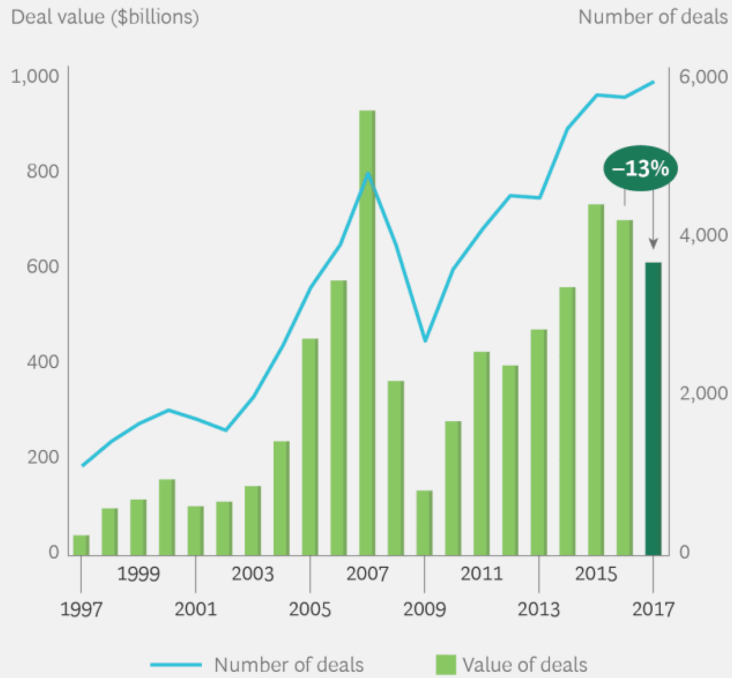
Sources: Thomson ONE Banker; BCG analysis.
[1]CAR = cumulative abnormal returns calculated over a seven-day window centered on the announcement date (+3/-3).

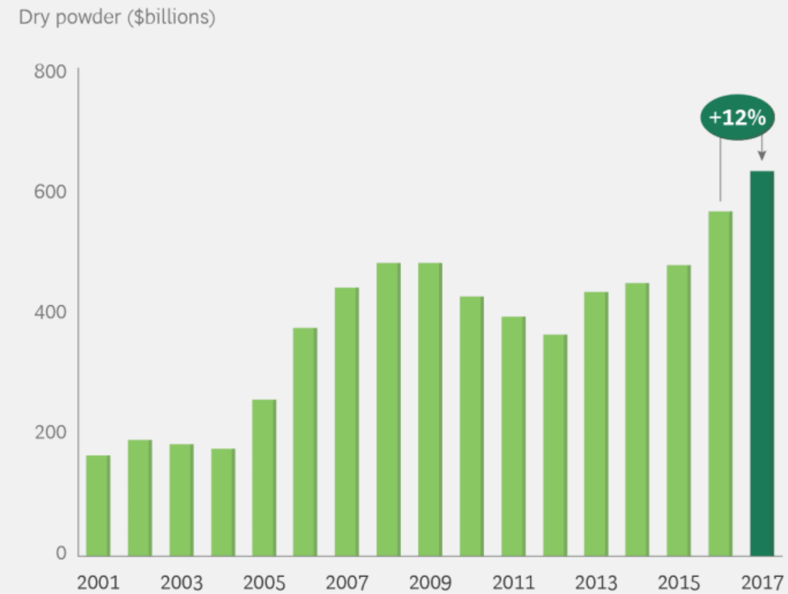
Global M&A Trends & Observations (cont´d)



Sources: Activist Insight; BCG analysis.
[1]Large cap refers to companies with market cap above $10 billion.

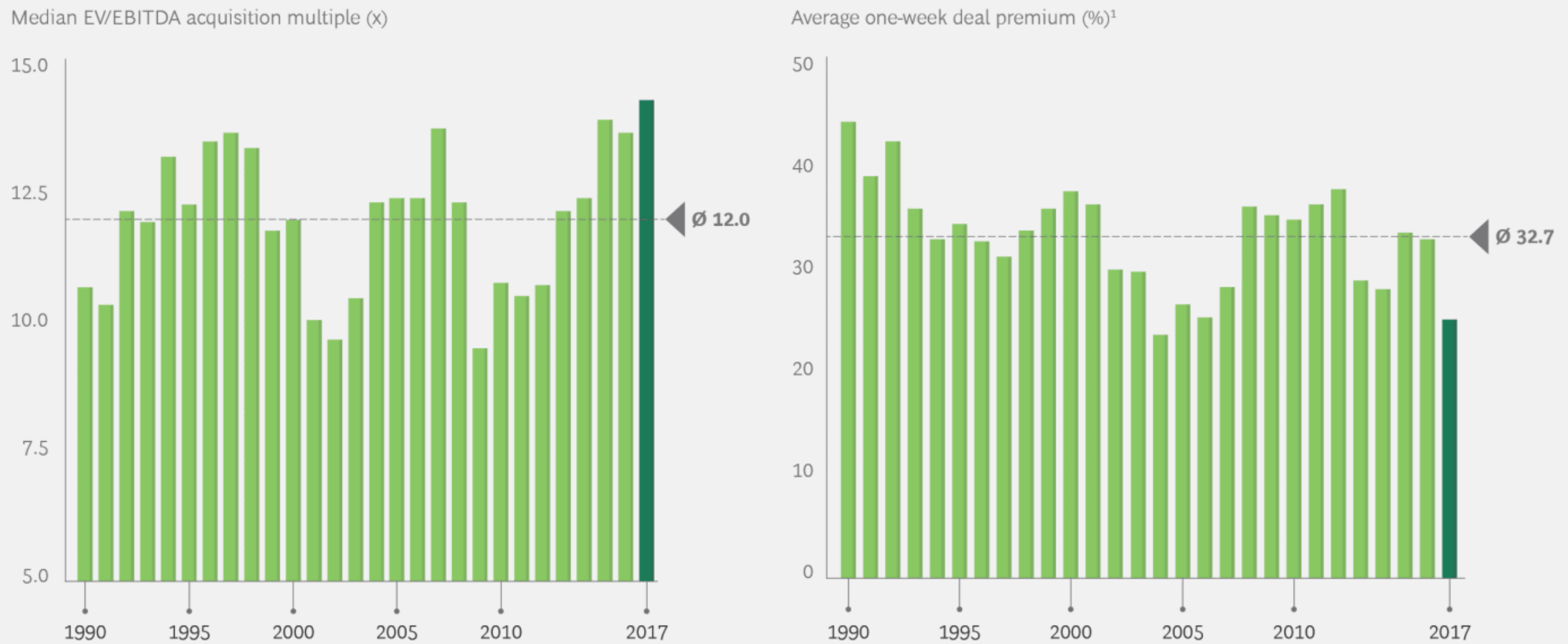
Global M&A Trends & Observations (cont´d)





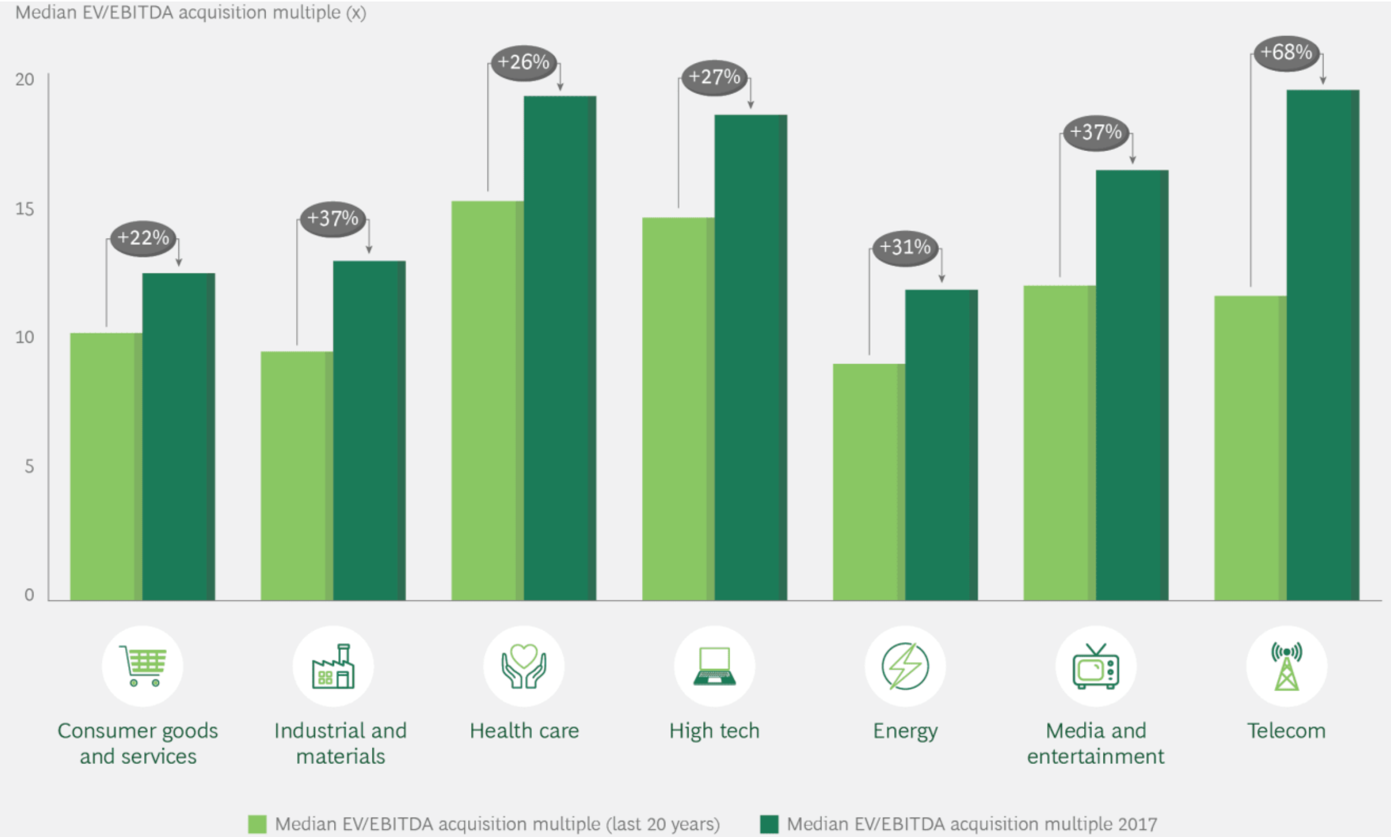
Sources: Thomson ONE Banker; Preqin; BCG analysis.
[1]The total of 70,689 private equity transactions comprises completed and unconditional deals announced between 1997 and 2017 involving private equity sponsors with at least 75% of shares acquired or divested. Self-tenders, recapitalizations, exchange offers, repurchases, acquisitions of remaining interest, minority stake purchases, privatizations, and spinoffs were excluded.
[2]Buyout funds only.

Global M&A Trends & Observations (cont´d)



Sources: Thomson ONE Banker; BCG analysis.
Note: The total of 18,493 M&A transactions comprises completed, unconditional, and pending deals announced between 1990 and 2017 with transactions of at least $25 million and at least a 75% share transfer. Self-tenders, recapitalizations, exchange offers, repurchases, acquisitions of remaining interest, minority stake purchases, privatizations, and spinoffs were excluded. Only deals with a disclosed value were considered.
[1]The acquisition premium is the amount by which the target's offer price exceeds its closing stock price one week before the original announcement date; the top 2.5% of deals were excluded to reduce distortion by outliers.

Global M&A Trends & Observations (cont´d)

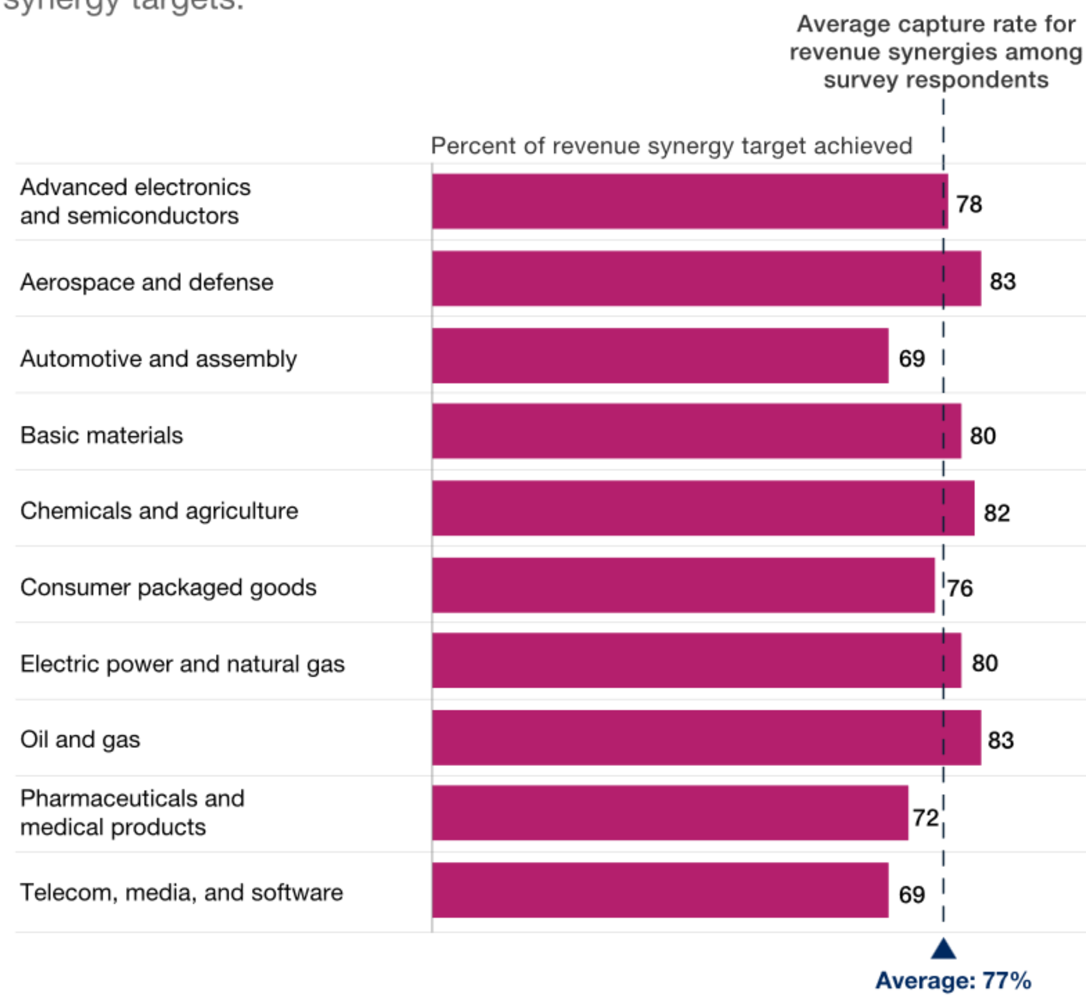


Sources: Thomson ONE Banker; BCG analysis.
Note: The total of 15,586 M&A transactions comprises completed, unconditional, and pending deals announced between 1998 and 2017 with transactions of at least $25 million and at least a 75% share transfer. Self-tenders, recapitalizations, exchange offers, repurchases, acquisitions of remaining interest, minority stake purchases, privatizations, and spinoffs were excluded. Only deals with a disclosed value were considered.

Thoughts on Revenue Synergies in M&A

McKinsey&Company

Across industries, companies consistently undershoot their revenue synergy targets.



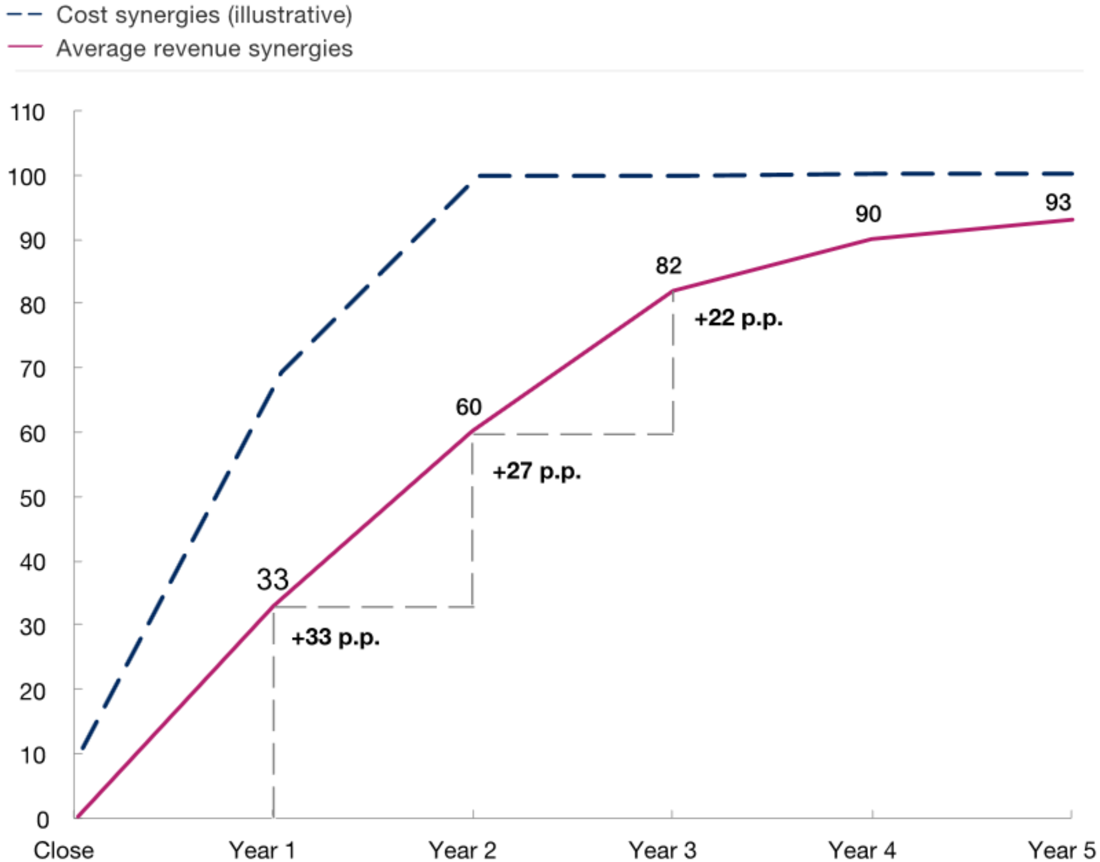
McKinsey&Company | Source: McKinsey survey of 200 M&A executives

Thoughts on Revenue Synergies in M&A (cont´d)

McKinsey&Company

Revenue synergies take longer to capture than cost synergies.

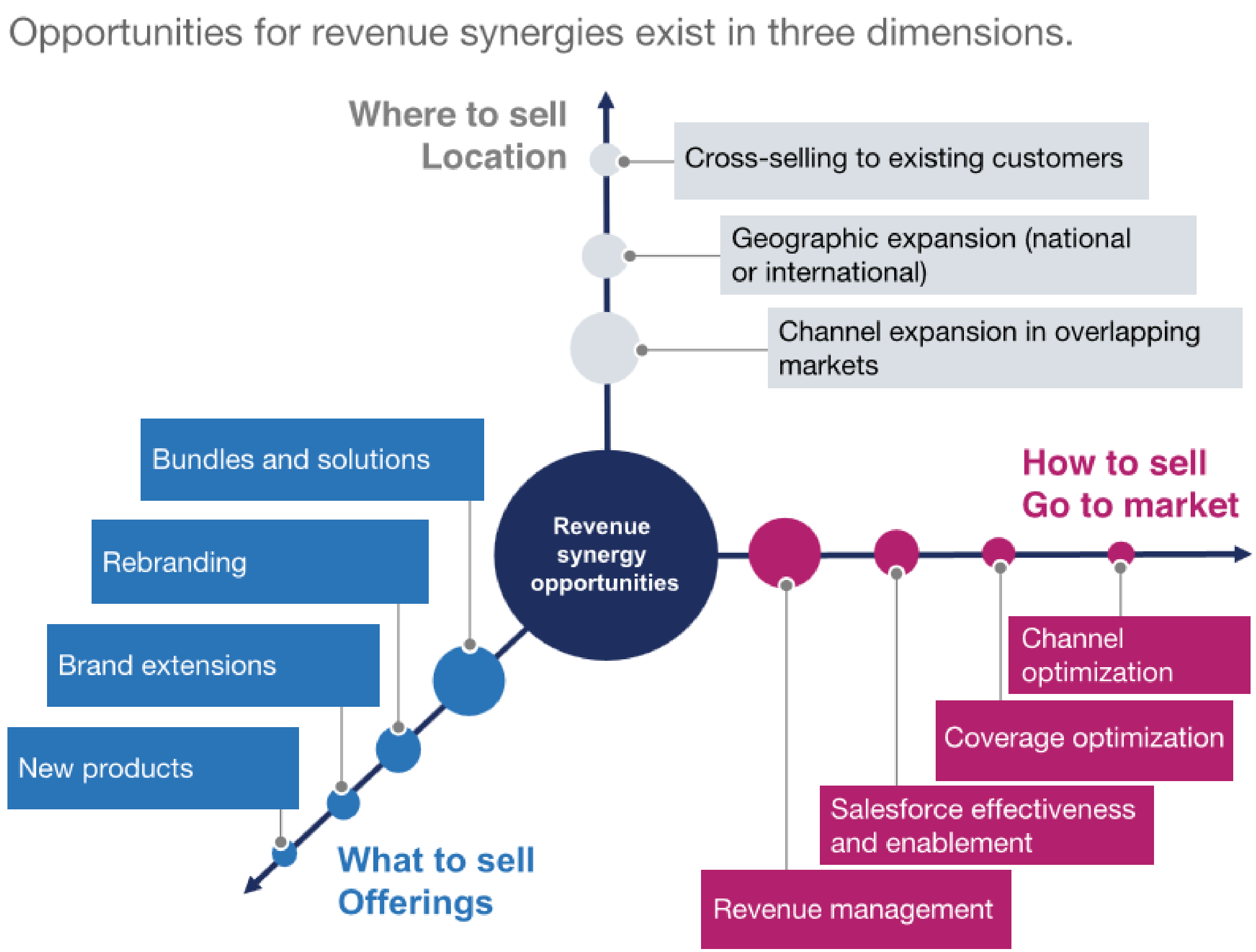
Percent of total synergy target captured by the end of each year after deal close



McKinsey&Company | Source: McKinsey analysis

Thoughts on Revenue Synergies in M&A (cont´d)

McKinsey&Company

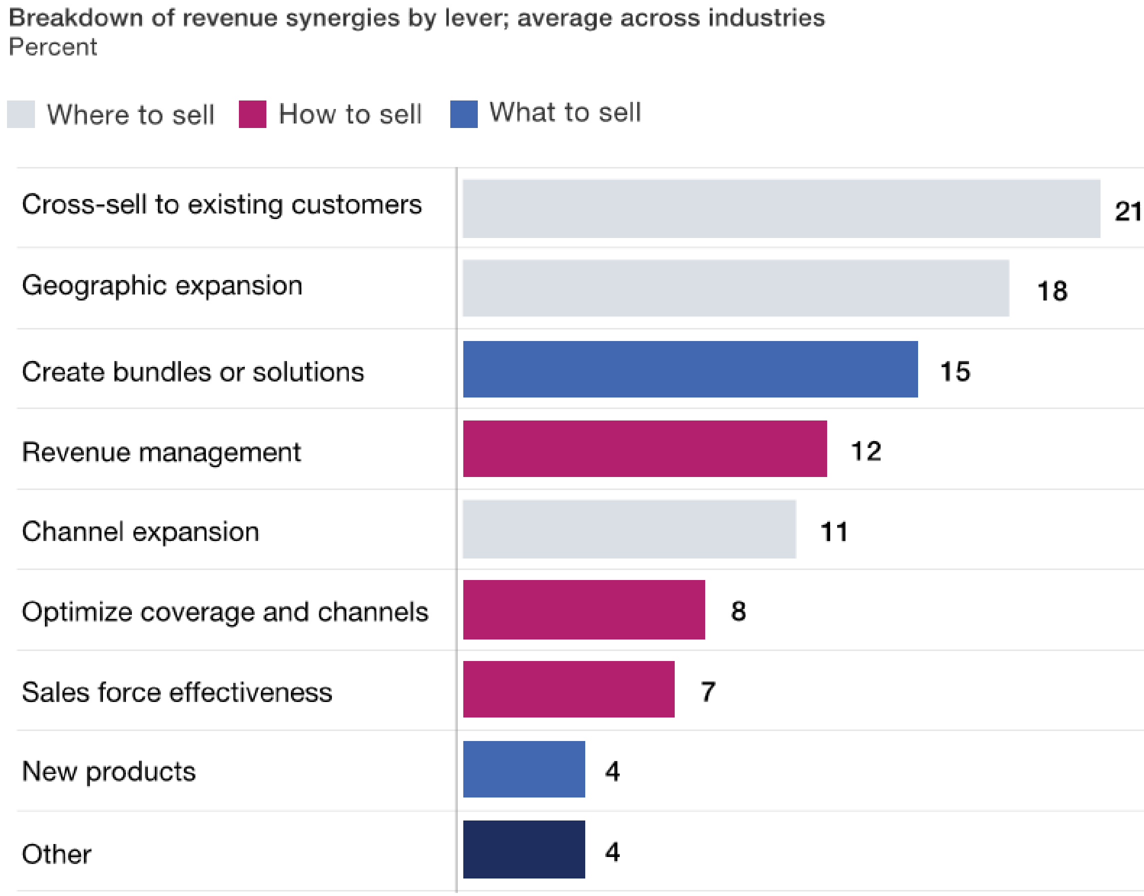


McKinsey&Company | Source: McKinsey analysis

Thoughts on Revenue Synergies in M&A (cont´d)

McKinsey&Company

Opportunities exist in all three dimensions, with “where to sell” the leading source of value.



McKinsey&Company | Source: McKinsey analysis

Eight Basic Beliefs About Capturing Value in a Merger

McKinsey&Company

- Due diligence is not the be-all and end-all foundation to maximize value
- Revenue and capital synergies are as important as cost synergies
- Desire to perfect the baseline should not compromise implementation planning
- Stretch synergy goals should be ambitious but not too aggressive
- Synergy planning cannot succeed without strong links to financial planning
- The first 12 months postclose are the most critical for capturing synergies
- The IT blueprint is critical to delivering synergies
- Achieving synergies requires understanding their one-time costs

Contact

Christian Schopper

Private: christian.schopper@aon.at

Business: christian.schopper@corpfince.com

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