

The Advanced M&A Approach: Increasing Success with Enterprise Planning & Optimization

by Carlos Centurion



"Specifically to M&A, EO is useful for anyone involved in the process.

But I can tell you as a former CEO, this is the first position that should latch onto this software because it's miraculous in its ability to view all dimensions pre and post-merger and provide a roadmap for realizing the synergies expected in the acquisition.

And for the CFO, well, EO is a best friend for this role – no other solution provides the accuracy on the numbers with any scenario or consideration. With EO, management can make a good acquisition a great acquisition by optimizing the opportunity in the shortest period of time."

- **John Beletic** (Involved with more than 25 corporate M&As)
Executive Chairman of Fiber Tower and River Logic Board Director
Venture Partner with Oak Investment Partners



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A River Logic White Paper

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INTRODUCTION

Visit the M&A section of just about any consulting firm or MBA school's website and you'll find research-backed assertions indicating that "50-80% of M&A transactions fail to deliver shareholder value."⁽¹⁾

Invariably, the authors of these studies point to two factors as the main culprit of the transaction not delivering the anticipated value: lack of proper planning—either before committing or during pre-close—, and not addressing the culture issues. This paper focuses on proper planning.

Despite significant planning according to textbook or consultant recommendations, M&A deals continue to fall short of delivering their potential. Why?

One example involves a large M&A transaction that resulted in a company with sales over \$50 billion and more than 100,000 employees. The "Value Capture" team of nine full-time people drove the target setting, planning and monitoring of all synergy capture for approximately a year, including eight months pre-close and four months post-close. The companies did everything as well as they could:

- Planning started well in advance of close date
- The best talent was brought to the table, including top employees from each company, as many as 500 people
- Expert consultants from the top consulting firms were hired to support the planning process
- Senior management dedicated significant attention to the transaction
- The new organization was promptly announced
- Communications about the merger were excellent, both internally and externally

This merger is considered a success in the public eye because the company over-delivered on its synergy commitment to the Street by more than 40%, and many articles were subsequently published in the press about the transaction's well planned execution.

When compared against potential, however, this merger fell short. It should have delivered at least 80% over Street commitment in a compressed timeframe. Additionally, it should have delivered significant revenue upside. How does a merger that does everything right fall short of potential?

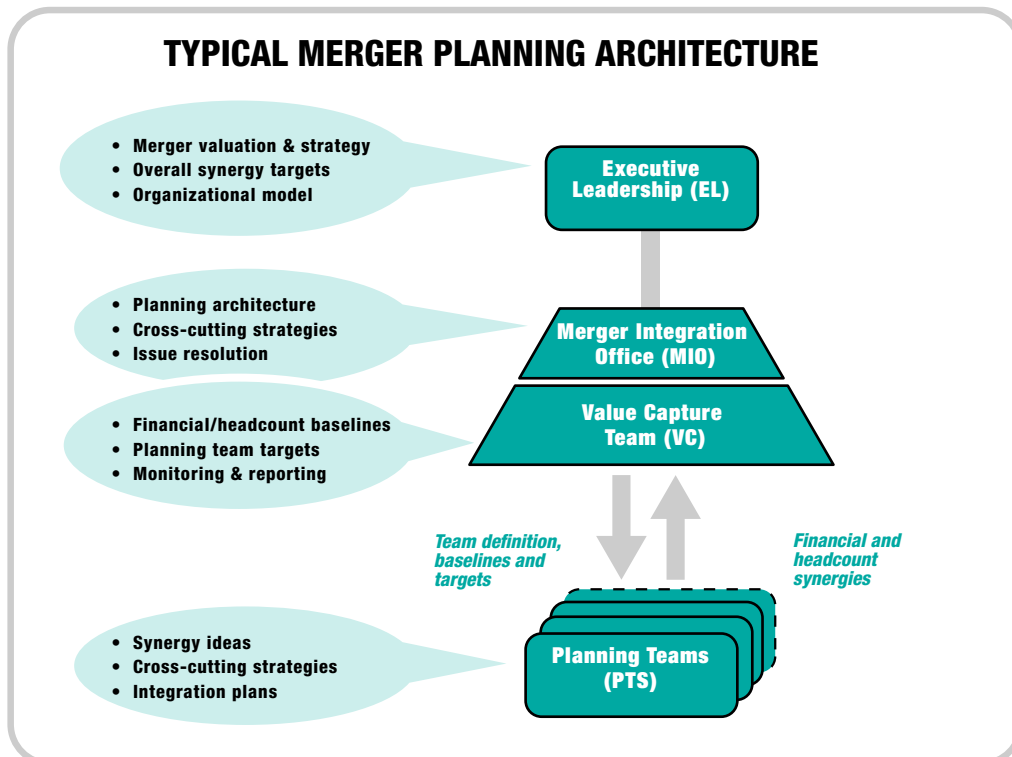
The reason lies in the supporting technology. A planning force of 500 employees, an army of consultants and the well-staffed Value Capture team, all armed with Excel, simply did not have enough agility and analytic capabilities to deliver the best plans. They couldn't quantify or understand the true impact of synergy ideas on the organization, let alone evaluate all the combinations of cost-cutting ideas and investments that would result in the best, most flexible plan.

Enterprise Planning & Optimization (EP&O) is an approach combining new methodology with the latest planning and modeling technology to identify the sources of value—even before a merger is agreed to. EP&O finds the optimal synergy plans and enables maximum capture faster during post-merger integration. The result is a dramatic increase in mergers that delivers positive value to shareholders.

River Logic's Enterprise Optimizer® (EO) is the Planning & Optimization system underpinning the Enterprise Planning & Optimization approach. EO creates a holistic model of a business to identify the synergies with the highest financial impact on the entire company. EO considers processes, operations, constraints and pricing scales to represent costs, profits and balance sheet metrics as they are incurred by the business.

UNDERSTANDING THE LIMITATIONS OF TODAY'S M&A APPROACH

The shortcomings of current M&A planning and integration are best illustrated by explaining the current methodology. A typical merger has the following structure:



Executive Leadership (EL): The senior executives who will manage the new company provide strategic direction, establish company targets, define the organizational model and resolve conflicts as they arise.

Merger Integration Office (MIO): A committee of senior executives that manages the overall effort, including team structures, target setting by team, cross-cutting strategic analyses and progress monitoring.

Planning Teams (PTs): Business unit and functional teams charged with generating revenue and cost synergy plans. The average Fortune 1,000 merger has 10-16 such teams depending on the number of business units or divisions in each company.

Value Capture Team (VC): Composed primarily of financial analysts and responsible for producing cost and P&L baselines, setting synergy and P&L targets, monitoring progress of the synergy planning process and producing pro-forma financials.

Planning starts with the Merger Integration Office, which establishes the overall structure of the merger planning effort. This includes establishing the Planning Teams (PTs), the boundaries of what each team owns and influences and the team leaders. This initial step is guided by the organizational structure announced by the Executive Leadership (EL).

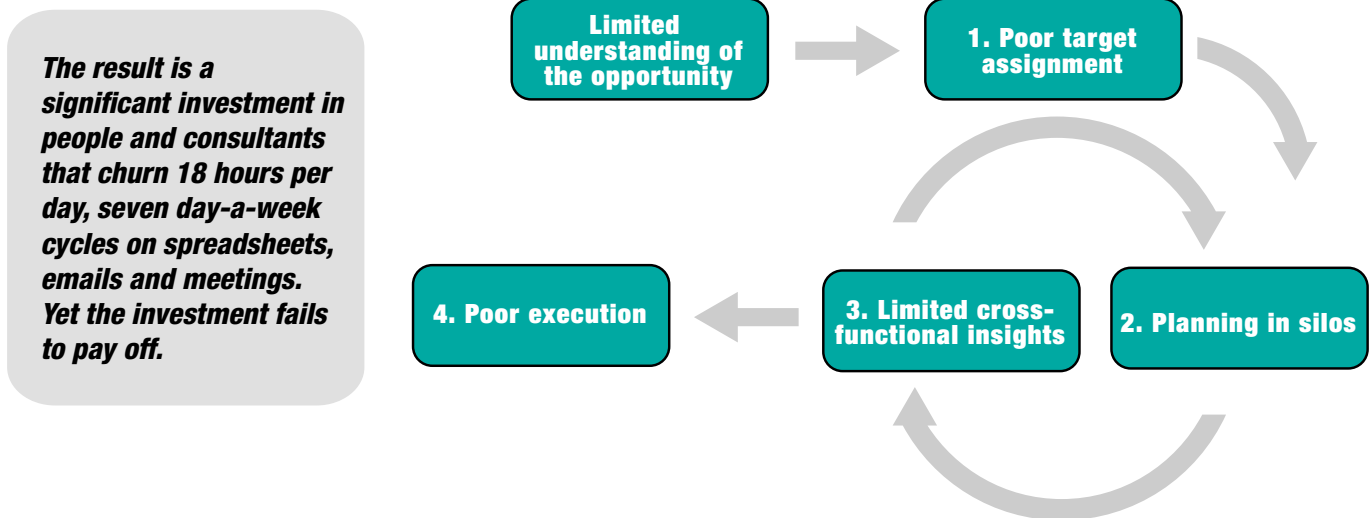
The Value Capture Team (VC) then creates cost, personnel and P&L baselines both for the entire company as well as for each Planning Team as defined by the Merger Integration Office (MIO). The VC team works with the MIO and the EL to establish P&L, cost and head-count reduction targets for each planning team (P&L targets are given only to some teams).

Once teams and targets have been established, pre-close planning focuses primarily on building the strategic and tactical integration plans that would maximize the company's competitive position and synergy capture after close.

Every week each team must report the latest synergy plans and corresponding financials to the Value Capture team, which provides a holistic picture to the integration office and the executive leadership teams. The Value Capture team is responsible for ensuring plans and financials are properly integrated across teams.

While the approach makes sense given the timing and tools available to companies and their consultants, it leaves significant potential on the table. ***Not only are strategies informed by limited or often incorrect insights, but as much as half the potential synergies are missed—No wonder so many studies denounce mergers for failing to deliver adequate returns to shareholders!***

Poor results are driven by the limitations of today's approach:



1. ***Synergy and headcount targets are not aligned with opportunity, forcing outcomes below potential.*** Targets are assigned based on financial and headcount baselines created by the Value Capture team and adjusted by the Merger Integration Office and Executive Leadership. ***Targets ignore true potential because opportunities and constraints are not properly quantified.*** For example, take a company that assigns a 15%-30% headcount reduction target in a somewhat “peanut-butter spread” approach across teams whereas there could be a team that should actually increase headcount due to new opportunities, while another team should reduce headcount by more than 30%.
2. ***Planning Teams act in silos, producing sub-optimal and often infeasible plans.*** In a typical merger, Business Unit teams worry about which products to phase out and which to invest in; Operations managers re-design the supply chain; Marketing selects target segments; Sales defines the coverage model; and Procurement determines which materials to buy. Each team evaluates the best plan within its silo, but has no time or ability to coordinate with other teams to understand the enterprise-wide impact and feasibility of each silo’s plan. ***The reality is that each team’s plans affect the impact of other teams’ plans, and the inability to evaluate cross-company plans significantly reduces the potential.*** Sometimes constraints are unaccounted for, resulting in delays and/or infeasibilities that cost the company additional resources and precious time.

3. **Value Capture acts primarily as a process watchdog and is unable to drive cross-team strategies and insights.** The Value Capture team spends most of its time every week integrating dozens of spreadsheets with synergy and headcount reduction input from each team. Furthermore, the VC team is unable to drive cross-functional insights because its baselines and information provided by teams is only at the financial and headcount levels. The lack of operational and KPI (key performance indicator) information means the VC team does not understand how Planning Teams' decisions impact other teams.

4. **Poor linkage to execution.** While each team has a realistic view of execution feasibilities within its own silo, the Planning Teams cannot plan feasibilities that take into account other teams' plans. **For example, a business unit might evaluate increasing production of a certain product, but it does not know that the supply chain team is planning on increasing synergies by reducing resources used to produce the product.** This results in either lost synergies or infeasible strategies. In addition, the post-merger integration effort is delayed.

There is a better way, one which would result in significantly stronger integration planning and execution.

M&A WITH ENTERPRISE PLANNING & OPTIMIZATION (EP&O)

Companies and consultants should move towards a more comprehensive methodology that maximizes synergy capture and enables merging companies to quickly attain a stronger competitive position. With Enterprise Planning & Optimization, companies and consultants create enterprise-wide, optimized and aligned integration plans. The benefits of moving to this approach include:

- **A clear understanding of the merger opportunity**, including investment requirements, feasibilities and timing. This not only provides the most robust valuation for the target company, but it also enables the Executive Leadership to establish maximum yet achievable synergy targets during pre-close planning.
- **P&L, cost and headcount baselines move beyond financials to include operational metrics and key performance indicators (KPIs)** for a more accurate and insightful view of owned, allocated and influenced revenues and costs. This allows the Merger Integration Office and Value Capture team to establish the appropriate Planning Team structure and to allocate synergy targets to each Planning Team that are aligned with the opportunity.
- **One enterprise-wide model of all merger synergies**, including financials, operations and constraints. This model delivers:
 - Accurate financial, headcount and operational impact from synergy ideas on the entire enterprise
 - Evaluation of multiple, interdependent ideas to find the combination with the best impact
 - Fast assessment of cross-functional strategies
- **Direct link between integration planning and execution**, resulting in faster implementation and a dramatic reduction of unpleasant surprises.

Current Methodology

“50-80% of M&A transactions fail to deliver value to shareholders⁽¹⁾”

Enterprise Planning & Optimization

“90%+ of M&A transactions deliver shareholder value above expectations”

Pre-merger Valuation

Significant number of acquisitions over-valued



Accurate merger valuations that create opportunity for positive shareholder returns

Pre-merger Planning

- Target setting not aligned with opportunity
- Synergy plans made in silos
- Significant “cycles” lost in meetings, emails and preparing spreadsheets



- Stretch, yet achievable targets aligned with opportunity
- Optimal combination of plans with accurate synergy impact
- Efficient planning frees up time to evaluate strategic and innovative alternatives

Post-merger Implementation

- Execution requires significant re-adjustment of plans
- Infeasible ideas cause time delays & unnecessary employee friction



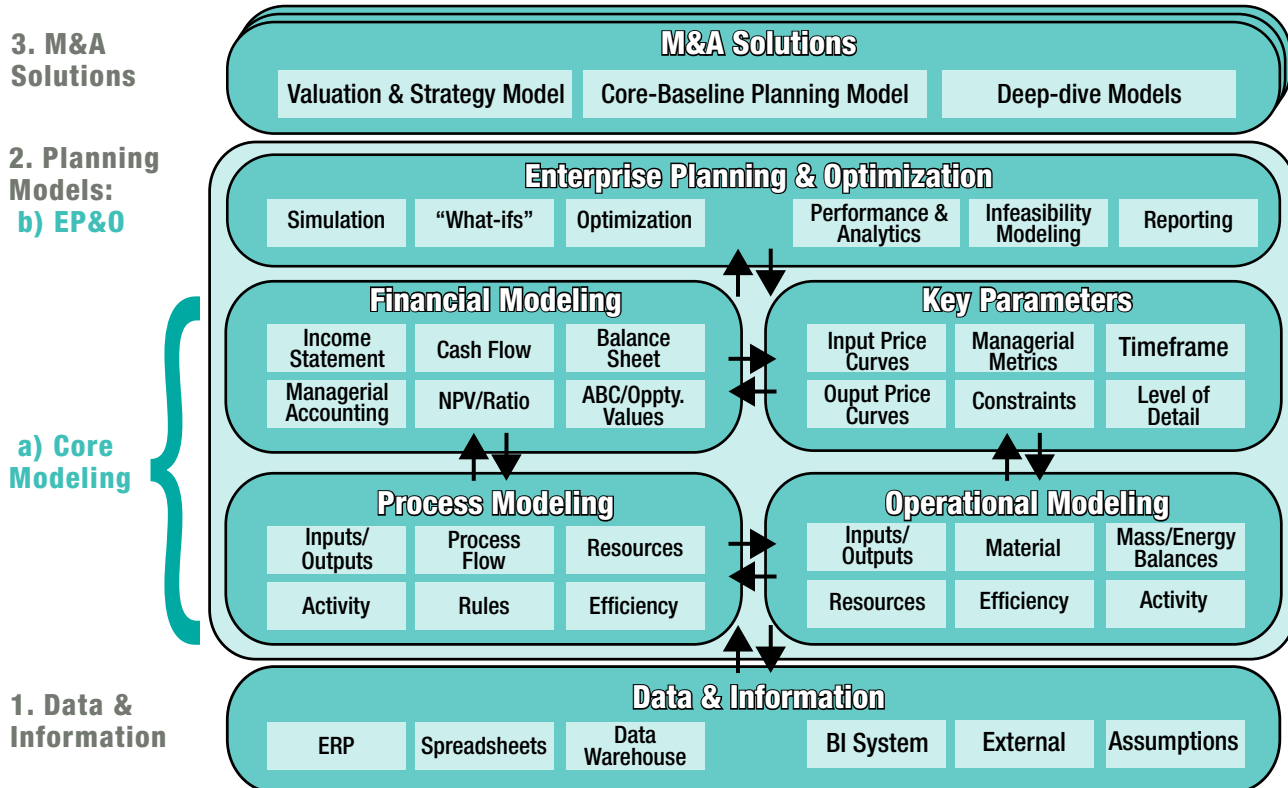
- Smooth, fast transition from planning to execution
- High visibility and predictability of merger results

The Enterprise Planning & Optimization approach typically yields at least 50% higher synergy capture at a much faster pace than current approaches.

RIVER LOGIC'S ENTERPRISE OPTIMIZER® (EO) -- THE DRIVER OF VALUE

Enterprise Optimizer® (EO) radically changes the way companies identify and evaluate M&A targets, plan for synergies and conduct post-merger integration activities. With EO, companies optimize M&A planning and integration because they can now find the optimal course of action at every level of decision. EO combines enterprise-wide process, constraint and financial modeling simultaneously to provide the most accurate representation of costs, profits and balance sheet metrics as they are incurred by a business.

Enterprise Optimizer® M&A System



The M&A Enterprise Planning & Optimization system has three primary components:

- 1. Data & Information:** At the ground level as indicated by the graph above, this component ensures all the correct data is fed into the system and that it is clean, accurate and from the right source to support the required M&A planning and integration decisions. Data from any system is adequate including ERP, data warehouses, desktop applications and the web.

2. Planning Model(s): These models are the core engine of the EP&O system and run on a laptop in a single application. They have two primary components:

- a. **Core Modeling** components enable the users to set the key parameters of the system and to model any process, operations and financials simultaneously. It is important to highlight that, while they are part of one simultaneous solution, each component is independent of the others. This means the user does not need all three to use or maximize the system. For example, some M&A planning models might only require financial and headcount information, such as the models that support organizational structure decisions.
 - Process modeling includes any type of process including those that are purely digital. Examples include product design, IT services, customer billing and order management.
 - Operational modeling includes any physical operation such as manufacturing, logistics, purchasing and inventory management.
 - Financial modeling includes P&L, balance sheet and cash flow statements as well as NPV and core financial ratios.
 - Key parameters enable users to establish the core design inputs for the model, such as the timeframe (e.g., how many time periods? How long?), the level of detail required, the pricing scales or elasticity curves, key managerial metrics (i.e., market share) and constraints (e.g., physical, regulatory, financial, managerial).

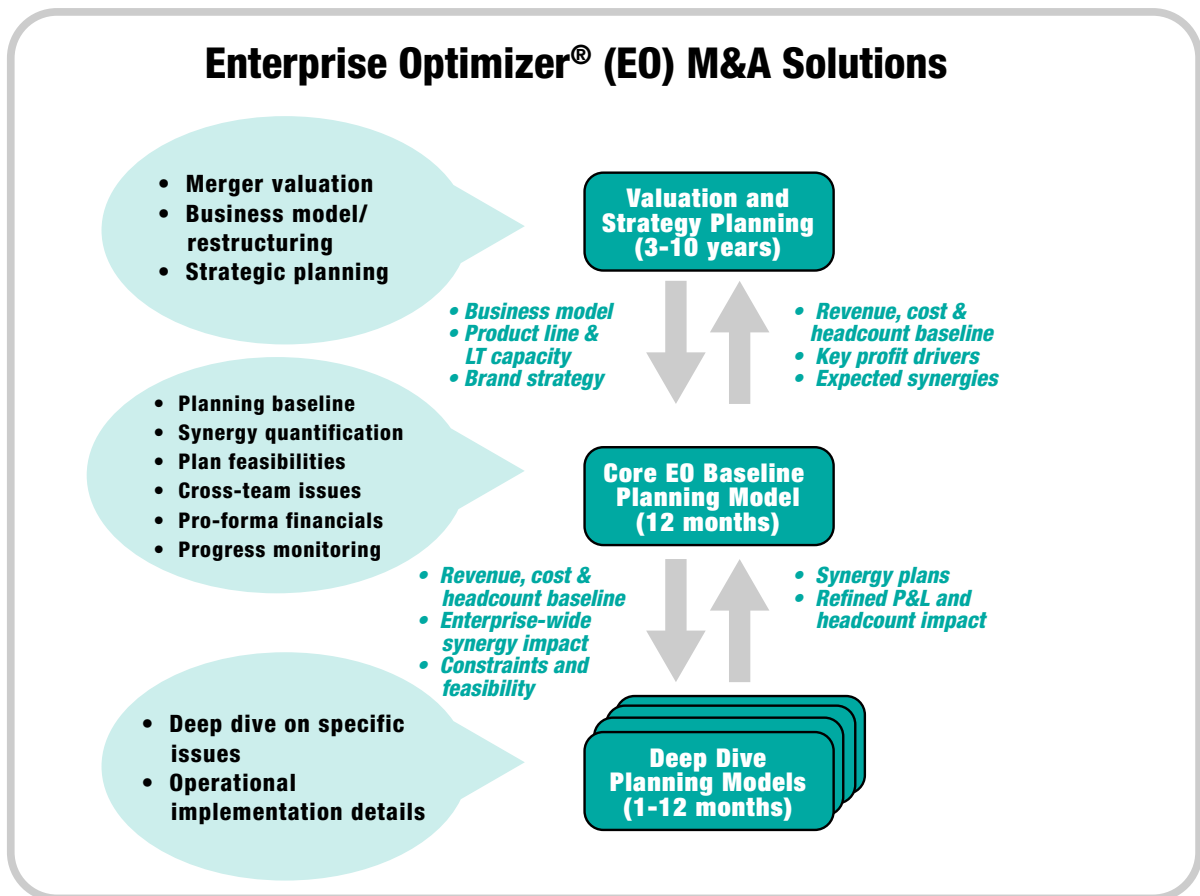
- b. **Enterprise Planning & Optimization** enables the user to find the optimal plan, implement feasible decisions and analyze performance. The system has a series of planning capabilities that include:
 - Forward-looking simulations that project a scenario forward to understand the impact of the situation on performance. For example, this feature can be used as a baseline to compare the performance of the two companies should they remain independent.
 - “What-if” scenario analyses evaluate the impact of changes to the model, such as additional capabilities, open/close decisions and product phase-outs associated with a merger.
 - Optimization finds the best solution for any given scenario and provides a clear view of marginal opportunities by evaluating the net value to the company of an additional unit sold, an extra customer of a given type or an extra hour of a resource while taking into account all marginal and opportunity costs. It is very useful to identify the best enterprise-wide combined solution across Planning Team silos.
 - Performance & Analytics dives deep into the drivers of profit and cash flow to identify the core drivers of future performance. This feature enables the MIO to identify the right metrics and set the appropriate targets for the merger planning and integration effort.

- **Infeasibility Modeling** identifies scenarios that are not feasible under “hard” or “soft” constraint situations and provides the “next best alternative” to the modeled scenarios when “hard” constraints are present. Planning Teams and Value Capture use these capabilities to flag and resolve inconsistent plans across teams.
- **Reporting** produces any type of performance report required ranging from purely financial reporting—useful for auditing and financial planning—to detailed costing and opportunity cost assessments. Reporting not only acts as a “bridge” system between the two companies to provide pro-forma financials and synergy capture projections, but also enables better organizational model and synergy capture decisions by quickly identifying the costs, revenues and headcount owned under different organizational model and Planning Team configurations.

3. M&A Solutions: The solutions enable the Executive Leadership, MIO, Value Capture and Planning Teams to interact with the system directly while limiting IT support requirements to data queries and clean-up. Three types of solutions are typically used:

- a. **Valuation & Strategy Model.** The main purpose is to establish a valuation range for the new company that would result in positive shareholder return. This model covers enough financial and operational detail over a multiple-year timeframe to identify the synergy opportunity and enable outside-in “what-if” analyses under different market and competitive scenarios. The Valuation & Strategy Model calculates the impact of the merger at different company valuation levels on shareholder value. The model is often used further during pre-close to evaluate strategic issues. For example, the MIO might want to determine the impact of alternative market evolution scenarios on the company by evaluating the business model under different business unit and value chain configurations.
- b. **Core Baseline Planning Model** tracks all full financials, all major processes & operations, important business constraints and all the headcount of the merging organizations. The model quickly identifies owned and allocated costs, producing full financial and headcount reports under different organizational structure alternatives within minutes. It usually covers a period of 6 months of actuals and 6 months projected forward. The model is first used by the MIO and the Value Capture teams to establish the financial and headcount baseline and to inform organizational model decisions made by the Executive Leadership. As the pre-close planning gets under way, the model is used by Value Capture to identify the overall opportunity, assign team targets, evaluate impact of cross-team issues and monitor overall progress. This model also drives the transition from pre-close planning to post-merger implementation and ensures important strategies, financials and operational detail are perfectly aligned.

- c. **Deep Dive Planning Models** enable the Planning Teams to focus on specific issues by adding or subtracting detail from the Core Baseline Planning Model. For example, the Supply Chain team might evaluate in detail which plants to close and the sales/marketing teams might want to dive deeper into customer profitability and pricing opportunities. These models are typically shorter-time frame and include finer detail such as individual resources, customers and SKUs. They are anchored on the data and assumptions from the Core Baseline Planning Model, which ensures not only that the analysis can be traced back to reliable synergies but also that Value Capture can assess the impact against the entire company model, thus breaking down the Planning Team silos.



Capturing the opportunity from EO requires a slightly different merger planning process that leads to full Enterprise Planning & Optimization.

THE ADVANCED M&A APPROACH

The Enterprise Planning & Optimization approach requires the following changes from today's approaches:

1. Prior to the merger agreement, the **Executive Leadership should build an EO Valuation Model** to accurately establish the merger potential and determine a valuation that ensures positive shareholder returns. This model takes 1-2 weeks to build and populate with data.
2. **The MIO and Value Capture team should build a Core EO Baseline Planning Model** that includes a complete, system-wide view of the two organizations. This model will act as the basis for pre and post-close planning:
 - a. **Planning baseline.** The financial, operational and headcount baseline that acts as the starting point for the overall planning process. The baseline is validated to a past period and tracks ownership of costs, P&Ls, assets and headcount.
 - b. **Organizational model.** The baseline model can easily produce P&Ls, costs and headcount ownership associated with the organizational model. Within minutes, these reports can be changed by simply changing the reporting structure in the model. The Executive Leadership and MIO can quickly view the financial, operational and headcount impact of potential organizational model decisions.
 - c. **Target setting.** A few scenarios, combined with the output from the Valuation Model provide a very accurate estimate of the total potential from the merger. The MIO can then break up the opportunity into synergy targets that are assigned to each Planning Team based on the organizational model established by the Executive Leadership as well as the team structures set up by the MIO.
 - d. **Synergy quantification.** Each Planning Team can see the impact of their ideas on the entire organizational financials. In addition, the model identifies scenarios that are not feasible either currently or because of assumptions from other teams. This process enables Value Capture to cut across Planning Team silos to identify the company-wide plans that would maximize synergy capture.
 - e. **Progress monitoring.** Value Capture can easily monitor progress of synergy plans against target by team, by area and by sub-components by comparing the expected company-wide impact of plans to the targets.
 - f. **Reporting.** The model provides audit-quality financials and acts as the bridge reporting system for pro-forma financials and synergy capture during pre-close.

3. The ***Value Capture team assumes a stronger leadership role*** in driving the synergy planning process. The Value Capture team builds on the initial Valuation Model to develop a Strategic Planning Model to support the definition and evaluation of cross-team strategic options. In this position, the Value Capture team is able to:
 - a. Identify high-impact strategic options.
 - b. Jointly with the relevant Planning Teams, accurately model and quantify the financial impact and operational requirements of each option.
 - c. Quickly translate decisions into synergy actions and assess the impact on Planning Team synergy plans and targets.

4. ***Planning Teams*** use the Core EO Baseline Planning Model and the Deep Dive Planning Models to ***identify the plans with the highest synergy impact on the entire enterprise and shift focus away from building excel spreadsheets.*** Planning teams increase coordination with other teams and move from analyzing a few scenarios within each silo to evaluating hundreds of enterprise-wide scenarios. Deep dives into each silo are evaluated in alignment with the overall merger model held by the Value Capture team.

5. ***The Value Capture Team uses the Core EO Baseline Planning Model to drive post-merger implementation and progress monitoring.*** The richness of financial, operational and headcount information in the model becomes the integration master-plan during post-close implementation. The model easily translates financial and head count reduction targets into KPIs and operational results, enabling teams to clearly see a path to execution that remains aligned with company strategy. At this point the EO model transitions to become part of the CFO organization under Strategic Planning & Analysis. The CFO organization assumes responsibility for post merger integration monitoring.

M&A CASE STUDY WITH ENTERPRISE OPTIMIZER® (EO)

The case study in the graph below describes the use of Enterprise Planning & Optimization in a Valuation scenario by a top-tier Management Consultant:

“The real power of EO is its ability to model a business from a system-wide perspective to rapidly produce financial improvement scenarios taking into account the operational aspects of the business, which ensures synergy ideas can be implemented”

Senior Partner – Management Consulting Firm

SITUATION

- Two large manufacturing companies announce merger
- Combined network of dozens of facilities (including plants and distribution centers) and assets (i.e., raw material sources) spread across multiple regions
- Announced synergies relatively modest
- Consultant partner approaches River Logic to model merger opportunities

SOLUTION

- EO model built in a week, encompassing all business units and supply chain assets
- Data was obtained from a River Logic data-provider partner
- Joint brainstorming and structuring of profit improvement and asset reduction opportunities with consultant partner

IMPACT

- Significant profit improvement identified, more than tripling Street commitment and doubling internal targets
- Asset reduction opportunities could yield an additional \$500 million in cash without hurting profits within 18 months
- New insights on how to structure the merger to drive maximum capture of opportunities

Despite the significantly higher synergy capture, the most important impact is the insights the new organization gets from the EO-based Enterprise Planning & Optimization approach. The insights go deep into the organization, gaining employee commitment and aligning everyone in the pursuit of the company strategy and the top opportunities. Significantly less time is spent with disparate spreadsheets, emails and unproductive meetings.

CONCLUSION

Consultants, academia and industry experts correctly point out that most mergers destroy value today. The main reason is inadequate or improper planning which points to the wrong strategies and synergies, and alienates company employees in the process.

With River Logic's Enterprise Planning & Optimization approach and EO software, a new methodology is now available that delivers stronger and faster synergy capture. When properly implemented, companies should see more adequate company valuations plus a significant increase in the number of mergers that deliver positive returns to shareholders.

Footnote:

((1) "Why do so many mergers fail?"; Knowledge@Wharton, March 30th, 2005, page 1.

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