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Effective Implementation of Cross-Border Mergers and Acquisitions

Acquisitions of US Companies by European Buyers

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Purpose
This paper will summarize practices used for effectively implementing cross-border mergers and acquisitions (M&A), with a specific focus on the acquisition of US companies by European buyers. The findings of this paper are based upon guidance from and interviews with three European multi-national corporations that have been active acquirers of US companies. This report will be especially useful for European companies interested in gaining a US presence through an acquisition, as well as for a US company that is considering a merger, sale or divestiture to an organization based in Europe.

Executive Summary

Cross-border acquisitions of US companies have become increasingly common over the last decade, and European buyers have represented a considerable portion of this cross-border activity. However, successful deal making across borders today requires more than expertise in the laws, economic conditions, cultural differences and social issues affecting the target company. The difficult and competitive environment in the current marketplace requires knowledge of the distinctive and sometimes complex characteristics of deal terms and structures, international financing techniques, regulatory and government issues, human resource issues and tax, valuation and accounting issues.

There are many potential benefits of mergers and acquisitions, and other business combinations such as joint ventures or alliances. M&A activity can boost revenues, profits and shareholder value in many ways — through economies of scale produced by increasing market share, through the expanded use of an existing distribution network by the acquisition of new product capabilities, through the extension of a strong product capability into new markets and through the diversification of product and market risks. In today's global marketplace — characterized by consolidation, convergence, the competition for talent and technology, and the increasing importance of such intangible assets as knowledge, skills and customer relationships — mergers and acquisitions are an essential tool of corporate development.

Unfortunately, in practice, these benefits can be elusive. Numerous studies over the years have documented the relatively low success rate of mergers at increasing shareholder value. For example, a 2001 study of 700 companies by KPMG indicated that only about 30% of these companies were successful at creating shareholder value as a result of their M&A deals (this was up from 17% in a 1999 study).

If they are poorly carried out, M&A transactions can be disruptive, costly and emotionally draining experiences to management and employees of both the buyer and seller. There are many reasons for unsuccessful M&A efforts, including inadequate due diligence, lack of a compelling strategy, unrealistic expectations of synergies, overpaying (especially where two or more prospective acquirers are bidding on a takeover target and have created an auction environment), conflicting corporate cultures, failure to move quickly and the lack of a well-developed post-merger integration strategy.

This report gathers the experience of three financial executives with European-based multinational firms that can fairly be described — by virtue of their size, financial performance and long track record of acquiring foreign companies — as employing best practices in cross-border mergers. These leading corporate M&A practitioners have implemented cross-border transactions that have significantly contributed to shareholder value. The report will examine practices these executives employed in pre-acquisition planning, M&A execution and post-closing integration of US companies on behalf of their European parent companies.

Background and Study Participants

This study was prepared by interviewing the three executives and ascertaining the lessons learned from value-added mergers and acquisitions. Importantly, this study focuses solely on acquirers from continental Western European countries. This study did not target buyers from the United Kingdom, primarily since there has been a long tradition of UK investment into the US. While there are certainly some cultural differences between the US and the UK, the differences are far greater when discussing continental Europeans.

This report is not intended to be a scientific study. Yet the author and FERF believe that the companies represented here have displayed skill in carrying out mergers and that the information the executives provide can be useful to companies evaluating their merger strategies.

We sought out senior practitioners at three Western European multi-national corporations — Siemens AG, Solvay SA and AEGON NV — and asked them to share their experiences, opinions and strategies. The practitioners at each company represented a spectrum of functional specialties involved in merger planning, execution and integration processes. Our interviews were built around a consistent set of questions that are included in Appendix 1. While the interview questions were intended to elicit discussion with our study participants, some financial executives may find the questions to be a valuable checklist of issues for any company to consider as it embarks upon a merger strategy.

There was a fundamental theme that emerged from the financial executives interviewed in the course of researching this report. Companies that implement effective merger and acquisition strategies understand that a successful deal is not an event — it is the end result of a rigorous and well-planned process that spans the spectrum from strategy to integration. Each and every business unit of a successful acquirer needs to establish and continuously update its strategy, identify target acquisitions if M&A is a part of the strategy, conduct due diligence, develop and execute an integration plan (ideally beginning during the due diligence phase) and address the multitude of issues that inevitably arise during a transaction. This process, by necessity, is a fluid and dynamic procedure that must evolve and adjust during the life of the deal. For example, a preliminary integration plan may be modified as additional synergies and value drivers are identified throughout the course of its due diligence efforts.

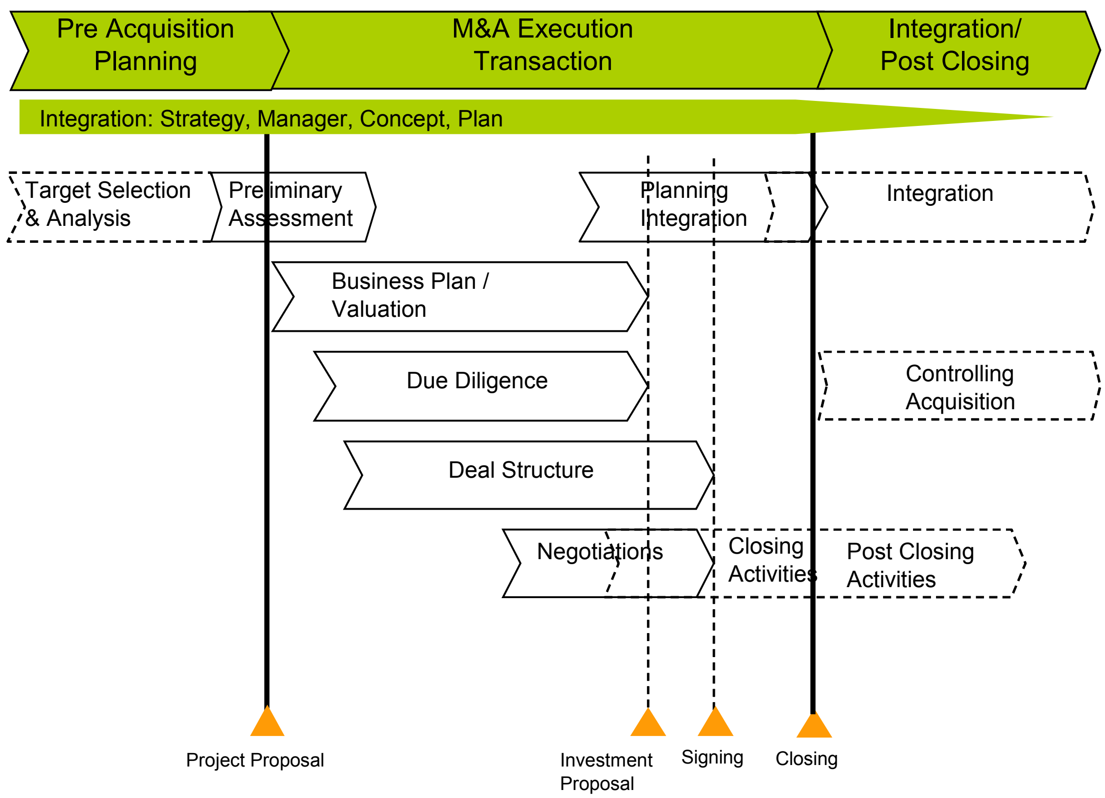
The theme of M&A as a process was reflected in the interviews of every participant. The following executives were interviewed as a part of this study.

Ms. Christina M. Stercken is Managing Director of Mergers & Acquisitions at **Siemens AG**. Siemens, based in Munich, Germany, is a global company with more than 400 manufacturing sites located in 190 countries and with a focus on electrical engineering and electronics. Siemens business units are divided among several segments including Information and Communications, Automation and Control, Power, Transportation, Medical Solutions and Lighting. Global revenues for fiscal year 2002 were about $77.8 billion and US operations contributed about $18.7 billion in revenues in 2002 (or about 21.5% of the total).

Siemens was an active acquirer of US companies throughout the 1990s and early 2000s. Over the past 10 years, Siemens has acquired 16 companies either in the US or with a strong US presence, representing a total equity investment of about 21.5 billion euros. Siemens' acquisitions included many well-known US companies, including Sylvania and Westinghouse. Other recent acquisitions have included firms such as ATECS and Acuson.

Ms. Stercken commented, "Siemens has a long history in the United States. Our business is built around several operating companies, but these companies have evolved through acquisitions over the last 30 or 40 years. Siemens has developed their market position in the US primarily through acquisitions."

Siemens has developed a comprehensive approach to planning, executing and integrating its M&A transactions. Ms. Stercken indicated that for "each and every individual business unit, there is a strict and tight process for considering M&A, which begins with the strategic evaluation." Siemens' M&A activities follow a rigorous "internal process with regular meetings in the Corporate Executive Committee," which is the company's primary decision making body. The diagram below illustrates Siemens' acquisition process.



When reflecting upon the obstacles in the M&A process, Ms. Stercken said, "The major challenges are selecting the right target and proper integration. Finding a target that is consistent with the strategic direction of the company can be difficult. Proper integration is critical to the success of an acquisition. Although execution is always important as well, it is often not as much of a challenge as the first two issues."

Mr. Guy H. Mercier is Vice President of Finance and Administration at Solvay Pharmaceuticals, a subsidiary of **Solvay SA,** an international chemical and pharmaceutical group with headquarters in Brussels. It employs more than 30,000 people in 50 countries. In 2002, its consolidated sales amounted to 7.9 billion euros generated by its four sectors of activity: Chemicals, Pharmaceuticals, Plastics and Processing. North American operations represent 26% of the company's sales.

Solvay has been quite acquisitive. Two major transactions were consummated in 2001, including the acquisition of Ausimont for about 1.3 billion euros, which was the company's largest acquisition to date. The joint venture with BP Specialty Polymers was the second major deal that year. Although Mr. Mercier is currently VP Finance and Administration at Solvay Pharmaceuticals, he was VP Finance at Solvay Polymers during 2001 and was one of the chief US negotiators on the BP deal.

Mr. Mercier points out "We have over 400 corporations organized in 12 different strategic business units — SBUs. Much of our growth has been accomplished through acquisitions. We have a very organized acquisition process that involves the SBU, the corporate planning department and the corporate finance department all working together in the planning, execution and integration of our deals."

Mr. James A. Beardsworth is Vice President and Controller at **AEGON USA, Inc**., and is in charge of business development and risk management in the Americas. AEGON is an international insurance group based in The Netherlands. The company focuses on life insurance, pensions and long-term savings, as well as accident and health and general insurance and has major operations in The Netherlands, the United States, the United Kingdom and Canada. Global revenues for fiscal year 2002 were $36.2 billion.

AEGON supplements its autonomous growth with selective acquisitions. Acquisitions are preferred in countries where AEGON already has a presence in order to build scale and enhance distribution. AEGON has been an active acquirer in the US. The company has acquired 12 companies in the US over the last decade, including Transamerica, Providian and the direct marketing services division of JC Penny. Income before tax attributable to US operations has increased from 33% of the total in 1994 to 62% of the total in 2001.

Mr. Beardsworth advises that AEGON does not really view itself as a global company, but rather a multi-national company. For example, in the company's insurance operations, each country represents a unique market, because every company is subject to very different tax and regulatory provisions. As a result, AEGON has implemented a very careful M&A process where it selected various countries over time as target markets and then evaluated opportunities within them.

AEGON has grown through acquisitions in three ways. In its developed markets (the Netherlands, UK and US), AEGON acquired companies as add-ons and expansion opportunities to further develop its product line and distribution base. In other countries, where AEGON has not had a presence, it used an acquisition to jumpstart its growth.. However, it also employed a satellite approach to control the acquisition process. For example, an acquisition in Mexico would primarily be handled out of the US office. Alternatively, an acquisition in Japan may be handled by the Dutch office. In some countries, it quickly becomes clear that an acquisition is not practical, and some deals are ruled out soon after they're considered.

Key Trends and Drivers of US Cross-Border Deals

The interest in US acquisitions by a wide range of continental European buyers is a relatively recent phenomenon. Very few continental European companies were active acquirers in the US until about 15 years ago. While some large companies have been active in the US market for a much longer time, most continental European companies preferred to simply export, or to execute license agreements or joint ventures, rather than conduct a formal acquisition program. Historically, when these companies did make acquisitions, they would generally not look to the US first, instead they tended to go to their ex-colonies or other European countries. However, during the last 10 to 15 years, the broad European middle market has been growing in sophistication and in their interest in US acquisitions.

Partly fueled by the growing European interest (as well as by a strong economy and a booming stock market), the M&A markets in the United States enjoyed unprecedented growth during the 1990s, but have clearly suffered from a cyclical downturn over the past several years. The total value of US M&A transactions (including cross-border deals) grew at a rate of about 45% per year from 1991 to 1999, reaching its peak at $1.4 billion in 1999. In 2002, the value of US M&A transactions fell to just $442 million. During the last four years, acquisitions of US companies by foreign acquirers have accounted for about 20% of the total value of US M&A acquisitions (see Appendix 2 for more information on M&A deal volumes).

There have been several key drivers to the growing interest of European buyers in the US M&A markets. Worldwide, cross-border deals have been driven by the increasing globalization of business and the new business opportunities/risks presented by changes in the global competitive environment (e.g., regulatory changes, technological changes, capital market changes, etc.). From a more micro perspective, individual firms pursue M&A strategies as a part of a strategic plan to maintain a sustainable competitive advantage in a changing environment (e.g., growth, synergies, access strategic proprietary assets, etc.).

More specifically, the Western European financial executives we interviewed have identified the following key drivers for investing in the US markets:

- **Access to one of the largest single markets in a global economy.** The vast majority of the business units in these multi-national companies operate in global industries. The US is by far the largest market in many of these industries. The size and growth of the US market alone has been a key incentive for M&A activity in the US.

- **Speed of entry into an important market.** Given that a company wants to participate in the large US market, then the next step is to determine the relative merits of an internal growth strategy versus an acquisition strategy. Since an M&A strategy allows a much faster access to this important market, many companies have opted to pursue US acquisitions rather than launch local start-up organizations (i.e., a green field strategy). Ms. Stercken observed that a "green field market entry is often ineffective." Mr. Mercier said, "A key motivation for Solvay is to be a global company and a leader in its market niches. Although start-up operations may be less expensive, an M&A deal is much quicker and will provide the momentum necessary to be a global company."

Mr. Beardsworth indicated, "AEGON limits its annual investment in green field and start-up activities to 3% of net income. However, there are some markets, like China, where a green field approach is the only approach."

- **Access to technology.** Regarding technology, US companies have a competitive advantage in the global arena because their home markets represent approximately 40% of the world market. Due to the size of the market, the leading companies serving this market will clearly have a substantial critical mass as well. This critical mass has contributed to the ability of US companies to gain competitive cost positions and to accelerate their rate of innovation, relative to other parts of the world. Mr. Mercier explained, "we are interested in specialty businesses with higher value added products. This translates into technology, which you cannot always develop on your own."

- **Access to financing.** The US capital markets are larger and more liquid than the markets in any other nation. Many of the largest investors in the world are US-based investors. As a result, it is beneficial to have a significant market position in the US in order to have access to the US capital markets.

- **Strong legal protections.** A weaker driver, yet still significant, is the additional protection on intellectual property, brands and copyrights that could be gained by having a major presence in the US. The legal protections afforded these intangible assets are considered to be stronger in the US than in other parts of the world.

Ms. Stercken pondered that "after looking at the high failure rates of acquisitions, you sometimes have to ask yourself what the drivers behind acquisitions are." Ms. Stercken then pointed out that "the importance of the US market has been largely driven by access — economic access, technology/management access and financing access." She explained that economic access to the US market is important not only because of its size, but also due to the attractive end market demographics. In addition, US products and brands are important in many other markets. Ms. Stercken indicated that technology and management access to the US is important partly because of the high rate of new product development and introduction in the country. The US is also an "exporter of entrepreneurial skills" and experienced managers (especially those who are familiar with the US capital markets). Finally, she pointed out that a US listing can improve access to capital and thereby reduce your cost of capital. Importantly, a significant US business presence supports a US listing.

Mr. Beardsworth observed "The US market was a key growth market for AEGON during the 1990s through 2001, and we made a lot of acquisitions. This was primarily due to the size of the market and to the fact that the industry was ripe for consolidation. However, as we look out into the next several years, the US market is not the top priority for us." He explained that from the perspective of his European parent, the growing and ever-present litigation threat in the US insurance market (e.g., frivolous class action law suits, etc.) has become a negative factor. Also, much of the rationalization in the industry has already occurred – AEGON alone has eliminated more than $500 million of expenses through acquisitions. However, Mr. Beardsworth stated, “With 1,000 life insurers still in the US market, there is probably still room for more consolidation.”

Study Findings

The goal of our research was to identify strategies that may be applicable to many companies, but with a particular focus on the practices of Western Europeans. Moreover, we wanted to determine whether these common approaches and practices could offer others a new paradigm — a better road map — that could lead to a more effective strategy for creating shareholder value through growth in the US market. Finally, we also wanted to provide a greater level of understanding to US companies that may be undergoing a merger, acquisition or divestiture transaction with a European company, and thereby increase the odds of a successful and mutually beneficial relationship.

Finding #1: Effective cross-border mergers and acquisitions must have a compelling strategic rationale. European buyers are typically not simply attempting to obtain a critical mass or to fill a gap. European buyers are looking for acquisitions that are truly a strategic step and part of a larger plan.

The M&A practitioners we interviewed insist that a transaction as an end in itself should never be a strategic goal. Especially during a hot M&A market, there is sometimes a temptation to become involved in a deal in order to gratify the ego of key decision makers in the company — i.e., to reinforce the image of the company and its executives as players in their industry. Even in a down market, a company may develop a growth strategy with a single mission — to do a deal — rather than focus on a thoughtful definition of the company’s priorities and objectives. In contrast, effective M&A practitioners view transactions as simply one means to achieve identified strategic objectives. An acquisition is a tactic, not a strategy.

Mr. Mercier states, “Many M&A deals fail because these deals were not pursued as part of a clear strategy.” He explains that some firms have done deals in order to compensate for problems in their own strategy. He further notes, “An M&A transaction will never solve a problem with your strategy. It will only exacerbate the problem by adding another level of complexity, and you are generally working with an unfamiliar management team.”

Ms. Stercken echoes these comments. She indicated, “no M&A transaction is ever considered without a clear strategic rationale. The statement, ‘If you can’t manage your own business, buy another one’, represents the absolute opposite of our approach.”

One discipline the dealmakers we interviewed recommend is to regularly communicate cogent, strategic reasons for executing each transaction before beginning the M&A process. The development of this compelling strategic rationale typically starts with a mission, either at the corporate or business unit level. The mission will describe the company’s vision and world-view — where it is going, how it is going to get there, the needs of its key stakeholders (shareholders, customers, employees, community, etc.). With a mission statement in place, the company can develop the key objectives that enable the mission to be accomplished. With well-defined objectives, the company can perform an analysis regarding whether the objectives can best be implemented through organic or external growth. To the extent that external growth is desirable, then an acquisition plan can commence.

Mr. Mercier described the strategic process at Solvay: “Each strategic business unit will develop a new five-year strategic plan every year. This plan will define the strategic direction of the business unit by market, product and technology. Importantly, the initial plan will only focus on the long-term direction of the business, not how to accomplish the objectives. After the strategic direction is set, then the business units will devise a tactical plan describing steps required to meet the strategic goals — expanding existing capacity, buying specific technology or licenses or acquiring a product or company in order to penetrate a selected market. If a portion of the plan involves the use of M&A as a tactic, then the business units will meet with the corporate planning and corporate finance departments to conduct a pre-feasibility study — how much would the company be willing to invest in an appropriate candidate. As a result, the boundaries and parameters of the deal are defined very early in specific acquisition criteria. In this way, Solvay is able to ensure a strong strategic rationale for its acquisitions.”

Mr. Beardsworth indicated that AEGON has a slightly less formalized structure. AEGON is very decentralized (for example, it has 300 corporate staff in a total employee base of over 25,000). Acquisition decisions are generally pushed out to the country units. So acquisitions in the US by AEGON are often similar to an acquisition of a US company by a US company.

Our interview subjects said they are generally not opportunistic buyers. If a seller that exactly matches the criteria of an ongoing acquisition search is unexpectedly brought to their attention, then they would certainly have an interest. However, the mere fact that an attractive company is on the block will not in itself be enough to motivate a buyer to pursue an acquisition.

Ms. Stercken explains, “First the strategy should be in focus. We do not invest in companies simply because they are on the market.”

The identification of appropriate target companies is not an easy process. Clearly, based upon the analysis described above, the first step in the process is to identify a target market. However, the process of finding a target company that is consistent with the strategic direction of the company can be difficult. Some companies may use the support of either investment banks or strategic consultants to look at the competitive landscape and identify potential targets that can meet the strategic objective. Other companies look for targets using their internal staff. In many cases, the industry is well known by the internal staff and they are in a position to identify targets by themselves.

Finding #2: European buyers pay cash -- however, European buyers bring more to the table than simply cash.

The use of cash to acquire shares or assets or to effect a merger is the form normally used by European buyers of US companies. The use of shares as an acquisition currency can be beneficial to sellers if properly structured, since there are potential tax advantages. However, in order for the deal to be attractive to the seller, the shares must be registered in a significant public market available to its shareholders. This represents a major hurdle for most European buyers, unless they have shares or American Depository Receipts (ADR's) trading on one of the major US stock markets, such as the New York Stock Exchange or the NASDAQ.

So, typically, European buyers pay cash, say the executives we interviewed. This restriction made European buyers slightly less competitive in the US during the strong bull market of the 1990s, especially when bidding for public companies. However, the Europeans' proclivity for paying cash has actually been an advantage for the past few years. Cash represents a cleaner, quicker deal, and there are no issues about how to structure the consideration (cash is cash).

Ms. Stercken said, "Siemens is currently in a position to offer non-cash consideration, but has not done so for various reasons. Siemens has been listed at the NYSE since 2001. Yet, no Siemens M&A transaction has been conducted on a 'stock for stock' basis due to Siemens' solid balance sheet and market preference for cash deals."

Mr. Mercier echoed Ms. Stercken's comments — typically the consideration offered for Solvay's deals is also cash. Solvay has a high degree of family and traditional institutional investor ownership so dilution is a key issue.

The executives we interviewed say these cross-border cash transactions need to be financed by the buyer. The buyer will seek to accomplish the financing in the most efficient way possible, which usually means balancing the need for a low cost, flexible, and accessible form of financing. Since cross-border deals by definition will involve two parties from different countries and are typically larger than the average deal, the financing for these transactions will often involve a combination of the international capital markets and the US capital markets or banks. For example, a common financing strategy for European multi-national buyers is to tap the US commercial paper market or short-term bank debt to initially finance the acquisition and to refinance later in the Eurobond market.

Mr. Mercier commented, "Solvay finances its deals with the cash available from corporate finance. Since we have a very organized strategic-planning process and corporate finance is a part of this process, then we are very aware of the cash needs of the company well in advance of those needs. So our corporate finance department has the ability to pre-arrange long and short-term lines (for example, syndicated lines) on an advantageous basis in anticipation of the future needs. If for any reason, we can leverage locally in an advantageous manner, then we will also optimize in that way."

Mr. Beardsworth indicated that the overriding concern of AEGON in financing its deals is to maintain a relatively stable debt-to-capitalization ratio — the company and the rating agencies are comfortable with 30%. As a result, AEGON has paid cash for deals, paid stock for deals and has raised cash through stock to pay for deals.

Importantly, in addition to the attractiveness of cash given the depressed equity markets, the strategic focus and industry expertise of the European buyer can represent a valuable benefit for a middle market seller who maintains an interest in the post-merger entity. The three financial executives say European buyers bring additional products for the US distribution system, additional markets for the US products, technology, know-how and a new way of looking at the business. Since the European buyer can represent smart money, not just cash, the long-term viability of the US entity may be more likely to flourish under the umbrella of the European buyer.

Finding #3: European buyers have a particularly strong appreciation of good management. It is critically important to a European buyer to work with a cooperative management team that shares the strategic vision of the post-acquisition company and can assist in communicating that vision to the other employees in the company.

One of the fundamental differences between a US buyer and a European buyer is the importance of a strong and friendly management team that can assist the European buyer in meeting its objectives in the US. A European buyer is faced not only with the task of executing a new business plan with the acquired company, but it must also communicate the plan to the target company's employees with the potential barriers of distance, time zones, language and certainly culture. It is very important for a European buyer to find the right management team — not only the quality of the management, but also a team which has bought into the plan which the European buyer desires to implement in the US.

Ms. Stercken said, "The key to a successful integration is a systematic approach to the process. One of the important first steps of the process — which lays the foundation for the rest of the process — is to identify the key leaders and influencers at the target company and to develop an executive alignment on integration vision and purposes."

Ms. Stercken explained that the core people at a target should typically be identified in a due diligence effort. She elaborated that these core people are developed into a leadership team that stands behind the acquisition idea and plan. They must develop a shared vision about the future of the combined entity. This core leadership team must be convinced that the acquisition is a good idea and that it will catapult the merged company's market position in the US ahead of the competition. In this way, the leadership group becomes an important instrument of change (i.e., opinion leaders) who can now communicate the shared vision with the rest of the employees and who can begin to identify the key employees to execute this vision going forward.

Mr. Mercier indicated that Solvay spends a great deal of time with the management of its acquisition targets in an attempt to understand the cultural aspects of the company. Even before they begin to negotiate, there is a first approach made to the senior management to ensure that the deal will be a good fit. Mr. Mercier points out that often a company may be a good technology fit, but then it is important to understand if there is a people fit as well. He poses several questions that address this issue:

- Is the value of the technology embedded in the patent, or is it a result of the knowledge of the people?
- Which people are key contributors?
- How long have they worked at the company? and
- What is their attitude?

These types of questions can provide much information about the prospects of long-term success for a transaction.

Mr. Mercier also commented that in most of Solvay's deals, there has been a conscientious effort to keep the president and top management in place. In order to facilitate the support of the parent company, it has also been common to bring in a Solvay CFO (a "flexible" CFO) for the new subsidiary. However, the maintenance of the top management has been considered a critical strategy to avoid destroying the value of an acquisition very early in the deal. Mr. Mercier summarizes the underlying message by stating, "There is no need to create a revolution, simply control the evolution."

Mr. Beardsworth indicated that AEGON is often viewed as a friendly acquirer. Until recently, they were able to keep much of the management team in place on most US deals. To a certain extent, the management of some potential sellers still hope that AEGON may be a buyer who can provide a "soft landing" for the management team. However, as its operations in the US have grown, AEGON has had to increasingly examine a rationalization of its employee base with new acquisitions.

Finding #4: Planning for post-merger integration is critical. The process must begin very early.

Perhaps the riskiest period for any merger is the integration process, our merger practitioners say. In most acquisitions, top management is intimately involved in the execution phase of the transaction (i.e., negotiations and closing the deal). However, in many deals, the focus of top management may shift to other activities after the deal closes. In fact, it can be argued that the most important part of the M&A process is the post-merger integration phase — when the real value is created. Ideally, many of the integration issues are uncovered and integration plans are made throughout the ongoing due diligence efforts. However, it is during the post-merger integration phase that the company needs to focus on the relentless implementation of value creation opportunities.

Ms. Stercken observed, "The successful post-merger integration process has three major objectives — build the new organization, assure that expected synergies are realized and continue to successfully manage the day to day operations. In order to coordinate this massive integration effort, we will assemble an integration team very early in the M&A process, ideally when the M&A project is first approved. The integration team will assemble all of the specialists along the value chain to assist in the integration effort, including research and development, marketing, manufacturing, distribution and, of course, human resources."

Some firms have permanent integration groups that are available to all business units that intend to make an acquisition. These groups can benefit from the lessons learned, the best practices and the experiences of other divisions in the preparation of an integration plan.

Commenting further on the selection of the members of the integration team, Ms. Stercken said, "The design of the integration team starts at a very early stage of the process. When it is initially formed, we may not even know what the difficulties in this specific integration process may be. So, at first, the integration team may be supporting the M&A team based upon their previous experiences and best practices. As the problems and opportunities become more specific, the team will examine every area of concern and will assemble the appropriate personnel."

Mr. Mercier described his experience with the BP Polymers transaction. He said that Solvay put together a team of seven people to plan and negotiate the transaction. The team included people from corporate finance, legal and the strategic business unit, as well as a person from corporate planning who was the team leader. In addition to their responsibilities on the transaction, the Solvay team was also responsible for running the operating company (which kept them close to the business). In contrast, they were negotiating and dealing with a team from BP that consisted of 45 people who were exclusively dedicated to the project. During the one-year negotiation, the Solvay team became quite adept at rapid communication.

Mr. Beardsworth indicated that the process at AEGON is less formal. When a deal is approved by the country unit board, a due diligence team is assembled. The team will include technical expertise from all of the country unit corporate areas (e.g., tax, human resources, systems, investments, etc.) and product/distribution expertise from the division level. Many of these people have worked together on previous deals and can benefit from lessons learned in previous transactions. Post closing, some of these same people will be involved in the integration activities, but they will be joined by other specialty areas such as IT, the data center, investments etc.

Human Resources (HR) planning in a cross-border US acquisition can be one of the most important planning areas. Ms. Stercken commented, "The three critical areas in HR integration planning are incentives, leadership and cultural issues. It is important to consider incentives and salary structure to ensure that there is a fit of systems to reward people." As discussed previously, Ms. Stercken indicated "there is also a focus on leadership to identify the core people who will move the merged business ahead of the competition."

The three M&A specialists all believe the cultural gap between Western Europe and the US is often underestimated. For example, some US financial executives might understandably assume that an Asian company acquiring a US business would confront a large cultural gap. By contrast, it would seem at first that a Western European acquirer would face a relatively small gap. In reality, the gap can be substantial. Ms. Stercken noted, "As a German company, we do not have to cross the Atlantic to find cultural differences — we only have to look at the French and the British to see these differences." Stercken's point is that every culture has its own habits and styles. Without appropriate sensitivity, it can be easy to offend or frustrate a person with a different cultural background simply out of ignorance.

Mr. Mercier echoed that problems with cultural clashes are easy to underestimate. Something as simple as a difference in the dress code (e.g. formal vs. casual) can create uneasiness in a post-merger company. In general, he indicated that it is easier to identify and deal with procedural differences in two companies, than with cultural differences.

Mr. Mercier commented that the incentives and benefits can be very tricky in the merger of a US subsidiary with the subsidiary of a European parent. The two companies can have very different incentive and benefit structures. Still, people from each company will need to work together after the merger. Mr. Mercier says it would be a mistake to assume that the easy answer would be to combine the best of both subsidiaries' incentives and benefits into one package. This rarely works because then the incentive and benefit structure of the merged subsidiary is out of alignment with the remainder of the European parent company's operations. Mr. Mercier suggested that a better answer is to have a transition period where the separate incentive and benefits programs are unchanged in the merger's immediate aftermath. But over time, the systems are gradually merged in a manner that proves least disruptive to employees and management.

Our M&A practitioners say that a very important member of the integration team is the integration manager, who is usually a mid- to upper-level executive transferred from his or her customary duties for six months to a year in order to lead the integration team. Best-practice firms will ensure that the integration manager is a relatively senior person with the authority and the management support to make difficult, yet important, decisions.

The manager must be brought into the deal as early as possible to develop a detailed understanding of the goals of the merger and aggressively seek synergies and value creation opportunities. The integration manager must be familiar with the customers, employees and projects that are critical to the success of the combined entity and ensure that no problems arise in these areas. Important political issues (e.g., which employees should stay in place and other organizational concerns) may often be decided with informal, unwritten understandings during the merger process. All of these responsibilities require the integration manager to be closely involved in the M&A process from the very beginning.

Mr. Mercier indicated that the leadership of Solvay's team on the BP deal consisted of two very senior people — the head of the strategic business unit and the head of corporate planning. These two front-line leaders from Solvay were having discussions directly with the senior management at BP.

However, Mr. Mercier conceded that perhaps more resources could have been dedicated to the post-merger integration effort. For example, the project manager of the team went back to his job after the closing of the deal — although the team itself continued to function following the closing of the merger. The post-merger integration was primarily accomplished through the definition of critical success factors for the functional leaders in each area. The functional leaders were provided with critical success factors that were 50% related to successful integration and 50% related to simply running the business. An incentive compensation system was then designed around the critical success factors.

Finding #5: European buyers tend to focus on profitable, successful businesses. They do not want to buy another company's problems, especially in a down market.

Implementing a turn-around strategy in a foreign country can be very difficult. The typical barriers to success are amplified with a troubled company. Distance and time zone differences may inhibit the speed of decision-making that may be critical with a company that is bleeding cash. The cultural and language differences may inhibit clear, direct and sensitive communication. While this communication is always important, it is even more important in a troubled company that may need dramatic changes. Although there are some notable exceptions (e.g., Samsonite), many European buyers seek out profitable, successful companies.

Ms. Stercken said, “It is usually not a good idea to acquire a company that is struggling. Often, you are buying someone else’s problem. This is especially true in difficult economic times when companies need to focus on becoming more efficient and streamlining their own operations.”

Mr. Mercier added, “It is important to resist the temptation to buy a struggling company just because it represents a good deal. A deep discount on the price will never make up for a bad strategic fit.” In fact, Mr. Mercier points out that, historically, Solvay has had a strong preference for well-known, established companies. Even though they recognize that these companies will typically require a premium payment, it is more important to Solvay to ensure a good fit and the development of long-term value.

The M&A practitioners we interviewed believe that the tendency to buy profitable companies is especially true for first time buyers, and it appears to be more prevalent during a cyclical downturn in the economy. First time buyers do not want to add to the already high risk of buying a company in a foreign market, especially while they are working their way up the learning curve. In addition, in a down market, even strong and experienced European buyers will tend to maintain efficiencies rather than aggressively promote growth. In this environment, the acquisition of another company’s problems would be considered an imprudent action. Ms. Stercken noted, “M&A transaction volumes in the entire market have been down. It is typically not a good idea to make acquisitions if you need to adjust your own resources to become more competitive.”

Finding #6: European buyers are very careful on valuation and due diligence. They do not like to overpay.

Especially in the current environment, European buyers are very careful and deliberate in their valuation and due diligence efforts.

For most best practice European buyers, the primary valuation approach is the discounted cash flow (DCF) approach. Effectively, every serious seller will provide a five-year financial projection as a part of the due diligence effort, and this will act as the basis of a DCF valuation. The due diligence effort will be guided by the European buyer’s prior knowledge of the value drivers and the industry-specific factors of the business. The analysis will cover all elements of a regular due process, including strategy, financial, human resources, IT, environmental, etc. Based upon the due diligence, the European buyer will adjust the seller’s financial projections in order to develop an actual estimate of the company’s value.

Ms. Stercken stated “before we even begin our due diligence, we know in most cases the numbers on a very broad scale and can apply a multiple to provide an indication about the magnitude of the transaction. But the fundamental and most important valuation approach is definitely the discounted cash flow analysis.”

Mr. Mercier commented, “We have a home-made valuation model which begins with the discounted cash flow approach, but also incorporates various risk evaluation methods (e.g., Monte Carlo, Value at Risk, etc.). We look at things like intellectual property, hidden liabilities, lack of synergies and regulations to assess their impact upon the deal. Our typical analysis will begin with a replacement value analysis and then look at a fair market DCF valuation. We do a lot of sensitivity analysis on the residual values, beginning with a terminal value of zero. This analysis leads to a worst case and a best case scenario, which ultimately leads to our base case.”

From a technical perspective, the executives we interviewed said there are a number of important issues specific to cross-border valuations that need to be considered in performing a DCF analysis, including: (i) the choice of currency, US$ or home country currency, in which to execute the analysis; (ii) whether or not to discount US cash flows at the time they are earned or only as they are remitted to the parent; (iii) whether or not to use US or home country tax rates; (iv) the proper calculation of the cost of capital used to discount the cash flow; and (v) the appropriate treatment of specific risks unique to cross-border investments (e.g., foreign exchange risk).

The executives said other valuation approaches are also used, including net asset value, precedent transactions (comparables) and acquisition premiums. The buyers will review the transaction with and without synergies. However, the larger European buyers are reluctant to pay for synergies, especially in this market. In fact, Ms. Stercken indicated that they will often investigate the risk of negative synergies in the transaction. Ms. Stercken elaborated, “Given the possible restructuring needs of the company, the synergies can even be negative. For example, if both the buyer and the seller have a significant market share in some areas and customers would rather have more than one supplier, then the combined entity could actually lose market share.”

Mr. Mercier echoed Ms. Stercken comments. He commented, “It is often difficult to predict how a customer will react to the merged company. It is important to be proactive with your customer and to really explain what the value of the transaction is to the customer.”

Mr. Beardsworth indicated that the people in his industry are by nature conservative, and this can be reflected in their valuations. In addition, he pointed out that AEGON, under Dutch Accounting Principles, does not recognize the concept of goodwill in a transaction. To the extent that goodwill exists, it is immediately deducted from the equity accounts. As a result, acquisition valuations need to reflect this concern.

Finding #7: European buyers are switching to US GAAP in order to facilitate US acquisitions.

The executives we interviewed say there are several reasons that explain why many European buyers have switched to US GAAP accounting. It allows a listing on the New York Stock Exchange, which provides better access to US capital markets for both equity and debt. The US financial community, including investors, analysts and rating agencies, expect a firm operating in US markets to report using US GAAP — in part because it allows a better basis of comparison with major competitors. Finally, US managers are more comfortable when their incentive compensation packages are based upon US GAAP.

Mr. Beardsworth stated, “Since we are listed in New York, we file with the SEC and are required to comply with US GAAP.” He explained that as a foreign filer, AEGON files Dutch accounting statements with a reconciliation back to US GAAP.

Ms. Stercken commented, “We are completely on US GAAP for our financials. We do our US GAAP accounting using a bottom up approach. Our US listed companies have accounting and reporting systems in place; we ask these companies to adapt to our chart of accounts. Naturally, we did have some issues with the new US accounting rules — SFAS 141 and 142 — and the implications for goodwill, but those are issues that everybody is dealing with.”

Ms. Stercken elaborated about the role of US GAAP as a facilitator for international companies that are both buyers and sellers in the US markets. She indicated that by switching to US GAAP, it simplifies M&A deal evaluation, the determination of transaction prices and the integration of acquired companies into Siemens accounting and controlling systems.

From a legal and regulatory perspective, the M&A business is a global market with many local jurisdictions. Best practices firms rely upon their professional advisors to assist them in navigating these waters. However, in some regards, the global mindset on M&A transactions is converging. For example, the procedures regarding merger control in the EU and the US are actually quite similar (see Appendix 3).

Conclusions
Overall, the interviews suggest a basic approach to successful acquisitions of US companies by European buyers. The key findings that emerged from the study are summarized below by topic areas:

Strategy
- Successful M&A is a process, not an event.
- Deals should be motivated by a clear strategic rationale.
- Globalization represents the main reason for European companies to invest in the US — the largest single market in the world.
- Acquisitions represent a fast, efficient means of achieving critical mass in the US market — especially compared to a green field market entry.

Financing
- Cash consideration is the norm.
- Debt financing offers tax advantages in the US and Europe.

Integration
- It is critical to involve key management — also helps to differentiate the European buyer from many US buyers.
- Culture is often underestimated as an obstacle to success.
- Communication with employees and customers is essential to successfully integrate acquisitions.

Valuation
- Publicly traded companies are influenced by market valuations.
- Discounted cash flow is the norm.
- In any event, the business plan as part of parent must justify the price.

Successful Deals
- Selecting the right target (a good strategic fit) is probably the most important task.
- Successful integration is also a critical driver of increased shareholder value.

Appendix 1
INTERVIEW PROTOCOL QUESTIONS

The interviews for this Executive Report were built around the following set of questions. While the interview questions were intended to elicit discussion with our study participants, the following questions also represent an useful checklist of issues for any company to consider as they begin to embark upon an M&A plan.

Trends, Motivations and Drivers

Trends. From your company's perspective, what are the current trends in the international M&A marketplace?

Drivers. What are the key drivers for growth in this marketplace?

Motivations. What are your motivations for participating in this marketplace?

Benefits/Challenges. What are the benefits of acquiring a US company? What are the challenges?

Strategy and Objectives

Mission Statement. Does your company have a written mission statement?

Acquisition Strategy. Does your company have a written acquisition strategy? How often is this strategy reviewed and updated?

- Planning process
- Who is responsible
- Country strategies
- Market strategies
- Acquisition criteria
- Finders/Intermediaries
- Recommendation document and approval
- Feedback and reinforcement

Identification and Screening. How are potential candidates identified? Does the screening process consider cultural considerations? Temperamental fit? Business style distinctions? Other similarities or differences from the buyer?

Valuation and Pricing

Due Diligence. Describe your due diligence process in the area of pricing. How is this process different in a cross border transaction?

Valuation. What valuation methods do you employ? What additional levels of complexity are created by a cross border transaction? (translation of foreign currency accounts, differences in tax and accounting regulations, determining the appropriate cost of capital, the effect of foreign exchange hedging on value, etc.)

Pricing. What are your key pricing criteria?

Structure. Describe your practices regarding an installment sale or contingent earn-out? (When applicable, what form, incentives and motivations?)

Obstacles. What are some of the key obstacles in consummating a cross-border transaction?

International Financing for Cross Border M&A

Financial Strategy. What sources of financing have you used to consummate your cross border transactions in the US? Have you been able to use the international capital markets in an advantageous manner to assist in financing?

- Eurobonds
- Swapping deal debt into appropriate currency
- Public offerings in US
- 144A deals
- Municipal revenue bonds
- Leveraged leases
- Limited partnerships
- High yield debt
- International equity securities

Government Assistance. Do you use any government assistance programs in your cross border financings?

HR Issues in International M&A

Pre-acquisition evaluation. Do you conduct a pre-acquisition evaluation concerning HR issues? If so, what issues do you consider? (e.g., structural issues, personnel strength/weakness, cultural issues, government/legal issues, infrastructure issues, etc.)

Staffing strategy. Do you develop a specific staffing strategy to implement the acquisition? If so, what issues do you consider in the development of a staffing strategy? (e.g., personnel requirements, available resources, staffing plan and timetable, etc.)

Compensation. Do you develop a compensation strategy to implement the acquisition? (e.g., compensation levels, philosophy and policies; benefits packages; severance packages; etc.).

Personnel information systems. What are your practices for integration of personnel information systems (e.g., create a new database merging all employee data, integrate new employee data into existing corporate database, maintain individual corporate database)?

Transitional support mechanisms. What transitional support mechanisms do you put in place regarding such issues as communications, staff training, acculturation, employee morale, etc.?

Post Merger Integration

General. What resources do you devote to the post-merger integration (e.g., finance, human resources, outside consultants)?

Transition team. Do you develop a team to manage the post-merger integration period? What mix of skills is included on the team? How do you safeguard that lessons learned by team (including outside consultants) are not lost to the organization?

Communications. Do you prepare a communications plan (e.g., what the community outside the target should know, employee surveys, identification of cultural differences, identification of appropriate media for each audience and message)?

Organizational structure. What general issues do you consider in the redesign of the overall organizational structure? (global vs traditional multinational, centralized vs. decentralized, amount of local autonomy, elimination of duplicate functions and processes, etc.)

Functional areas. What specific issues do you consider in the post-merger implementation of functional areas?

- Management Information Systems
- Finance
- Sales
- Marketing
- Manufacturing
- Human Resources

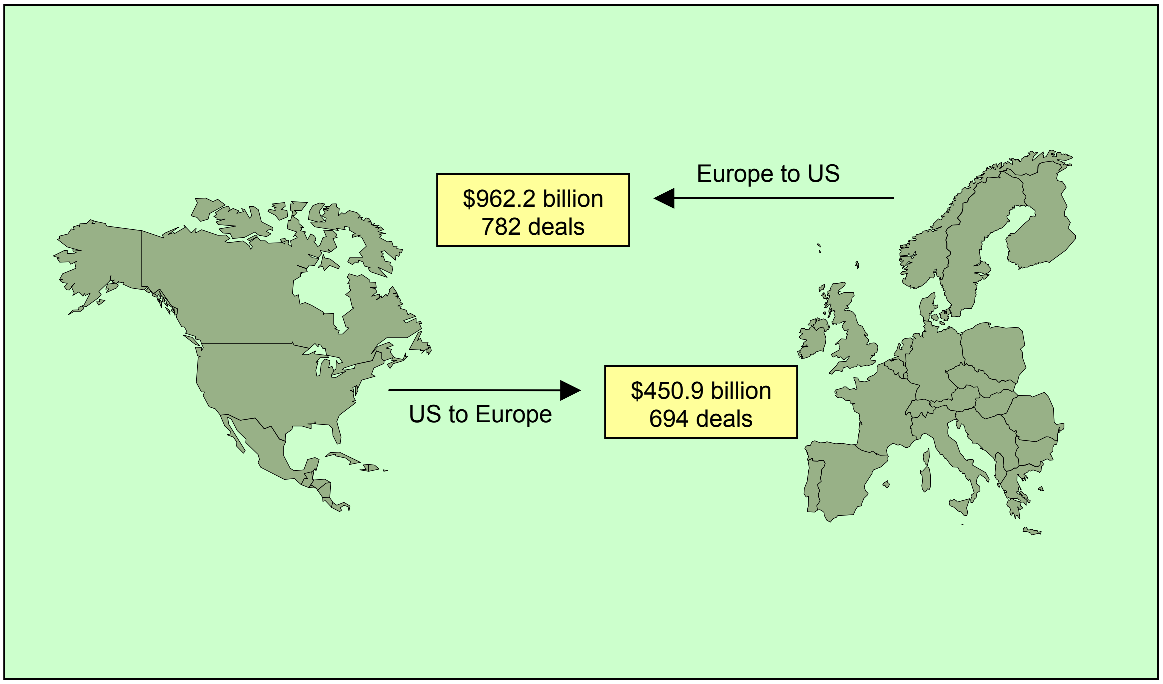
People. What are your human resource practices in the post-merger integration? (e.g., analysis of human resources strength and weaknesses vs. need, identification and timing of personnel to be eliminated, etc.)

National/Organizational culture. What practices do you employ to ensure a consistent culture? (e.g., identification of national and organizational cultural differences, respect for national cultural differences, definition of desired culture of post-merger organization, etc.)

Mission and values. What practices do you employ to develop a common mission, strategic vision and values statement (and to identify potential areas of conflict)?

Appendix 2
M&A ACTIVITY

EUROPEAN CROSS-BORDER TRANSACTION VOLUME
January 1, 1995 to September 30, 2002
Deals >100 mil. US$



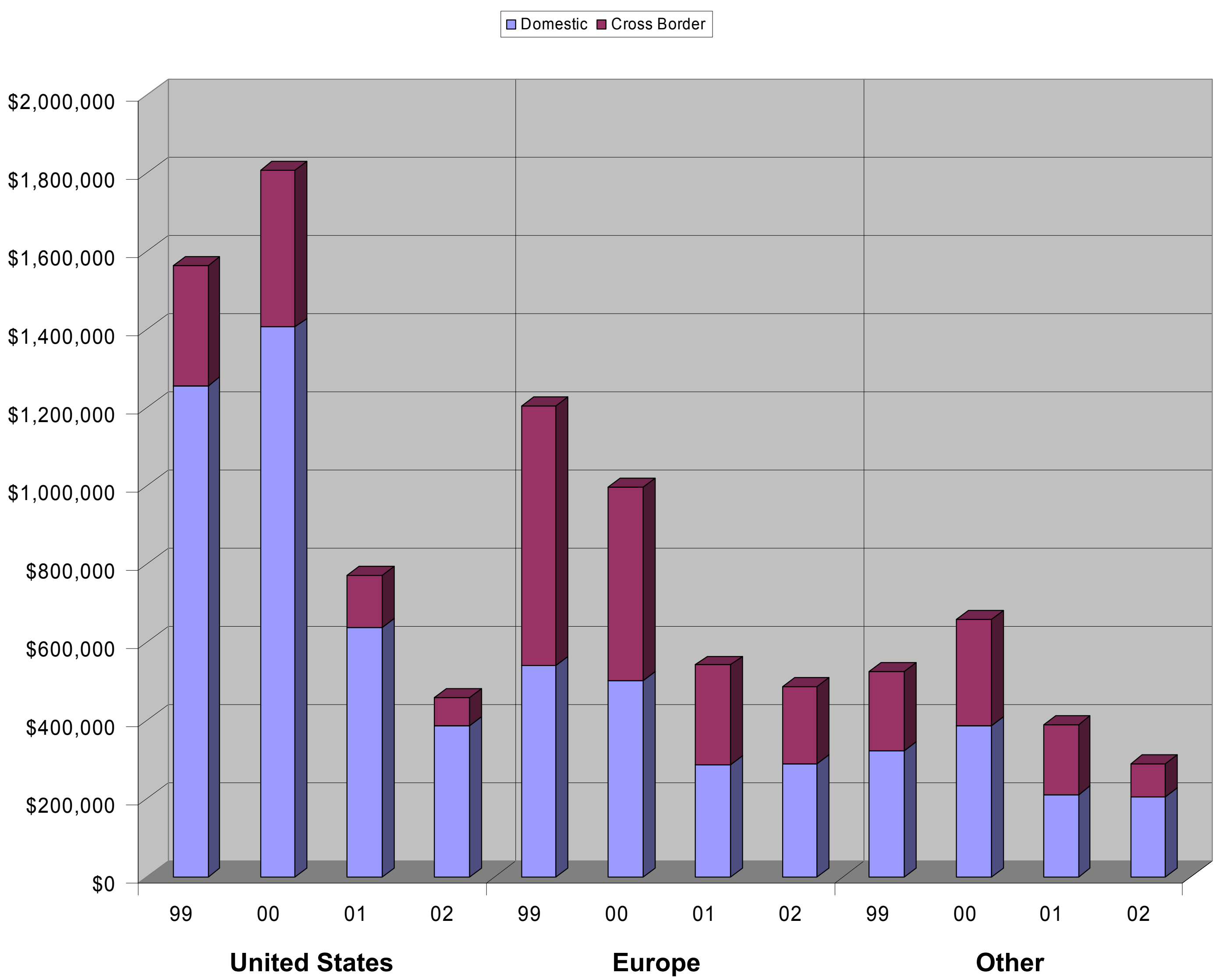
Average transaction size:

- $1.2 billion for European acquisitions in the US
- $650 million for US acquisitions in Europe

Source: Thomson Financial, Morgan Stanley, Siemens Presentation, May 6, 2002

Appendix 2
M&A ACTIVITY
(Continued)

GLOBAL CROSS-BORDER M&A TRANSACTION VOLUME
1999 to 2002



Source: Investment Dealers Digest.

Appendix 3
MERGER CONTROL IN US AND EU: COMPARISON OF REGULATORY PROCEDURES

	US	EU
Threshold	- If size of transaction (e.g. purchase price) exceeds US$ 200 million - If size of transaction between US$ 50 and 200 million, depending on other factors	Parties' combined worldwide turnover exceeds € 5 Bn and the individual turnover of each of at least two of the parties exceeds € 250 MM
Substantive Test	"Substantial Lessening of Competition"	"Creation or Strengthening of a Dominant Position"
Coordination with Regulators	Filing itself less complex; therefore usually no pre-filing contact necessary	Pre-filing consultation process became standard
Review Period.	- For first stage: 30 days (early termination possible). - After Second Request: if answered, 30 days. - If not answered, no deadline.	Fixed deadlines for Commission in EU (1 month; additional 4 months in second phase).
Preparation	Filing can be prepared within days (Note: Separate Filings for buyer and seller required)	Extensive filing form (Form CO); preparation takes 6 to 8 weeks (in complex cases maybe even longer)
Submission of Documents	Contract, info memo and 4(c) documents (drafted for officers with subject of competitve implications) with initial filing	Principally similar requirement

Source: Siemens Presentation, May 6, 2003

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With more than 20 years in the investment banking and corporate finance business, Charles A. Sheffield provides an extremely broad base of experience in the banking industry. Mr. Sheffield provides consulting services to both corporate clients and financial institutions worldwide. His corporate clients have spanned the spectrum from Fortune 500 companies to emerging growth companies. His financial institution clients include many regional banks in the United States, as well as some of the largest global banks in the world.

Mr. Sheffield's consulting assignments have focused on developing financial, business and risk management strategies for corporate and commercial banking businesses, including merger and acquisition advisory services and merger integration advisory. In addition, Mr. Sheffield is an instructor and facilitator for numerous workshops in the areas of corporate finance, capital markets, financial product alternatives, mergers and acquisitions, business and financial restructuring, as well as relationship management issues. In this capacity, he works with institutions to develop client, product and market knowledge among bank professionals and to link this knowledge with bank practices.

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