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Mergers & Acquisitions

Staying on course

M&A in Europe

Trends – Strategies – Success Factors

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Trends – Strategies – Success Factors

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Foreword

Financial market turbulence accompanied by economic uncertainty have taken some of the zeal out of the M&A market since mid-2007. Despite the wider gloom, however, uncertain business conditions are no reason to abandon M&A and may even present new opportunities. In particular the outlook for deal flow by cash-rich strategic buyers remains very strong.

This study – a joint effort of the M&A practices of Deloitte Denmark, Belgium, Central Europe, Germany and the Netherlands – shows that European executives remain upbeat about their M&A plans, focusing above all on improving their competitive position and expanding their business geographically. While financial investors are understandably cautious, the majority of corporate acquirers who responded are planning to accelerate the pace of activity over the next 18 months. Western and Eastern European targets are a main focus, with Russia and Asia gaining in importance.

Globalization and the rapid rise of emerging markets are clearly affecting businesses in many ways. Few companies manage to make the journey without engaging in successful relationships with companies abroad. Cross-border acquisitions will likely make up a rising share of transactions in coming years. In Europe, over half of all transactions already involve a company in a foreign country.

But creating international business relationships brings with it its own set of challenges and risks. Add to it a rising awareness about environmental and social responsibility of corporations and it becomes clear that companies need to sharpen their senses in many regards before engaging in M&A.

The analysis of factors that most contribute to successful transactions according to respondents to this survey found that emphasis on certain “non-traditional” aspects of M&A corresponds to a significant improvement in performance. Next to an obvious focus on accounting and finance, high-achievers put extra emphasis on topics such as due diligence of environmental and regulatory issues, as well as the implementation of a consistent HR strategy and cultural integration. There are still things to learn from best practice!

We wish an informative read!



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Executive Summary

The economic environment has deteriorated over the course of last year, but that is not deterring M&A decision makers from retaining a positive outlook on activity over the next 18 months. In this age of globalization, the pressure to use M&A as lever in building corporate success continues to build.

The chapter “Yesterday, today and tomorrow” illustrates the development of M&A sentiment over the past year and presents an outlook for M&A activity going forward. In a clear sign of stabilization following the recent financial market turmoil, the percentage of respondents planning to curtail acquisition activity in the next 18 months has declined since autumn 2007 among both private equity and corporate acquirers. The number of corporate acquirers planning to expand activity, meanwhile, more than doubled.

With a strategic focus on improving their competitive position and expanding into new markets, corporate decision makers seem relatively unfazed by short-term economic or financial developments. While the business cycle has become less conducive to M&A activity from a financial investor’s point of view, corporate decision makers still see the net impact of external factors as overwhelmingly positive.

From a regional perspective, Europe remains at the forefront of planned activity. The chapter “The winner is Europe” shows that while private equity respondents continue to pursue potential targets in Western Europe, corporate respondents are predominantly looking east to Russia and Central/Eastern Europe, Asia remains of key interest in the manufacturing sector.

As the share of cross-border activity continues to rise and the demands for sustainable and responsible corporate governance intensify, new aspects of M&A will grow in importance. Traditional success factors such as thorough due diligence of a target company’s finances and picking the right leaders for the new organization remain key aspects of overall success. But others – such as further investigative due diligence and a focus on cultural integration in the post-transaction phase – will become increasingly significant.

Finally, the “Learning from best practice” chapter highlights that an additional focus on extra-financial issues such as environmental, regulatory or cultural aspects along with a consistent HR strategy is making a difference in companies’ M&A success.

1. “Yesterday, today and tomorrow”

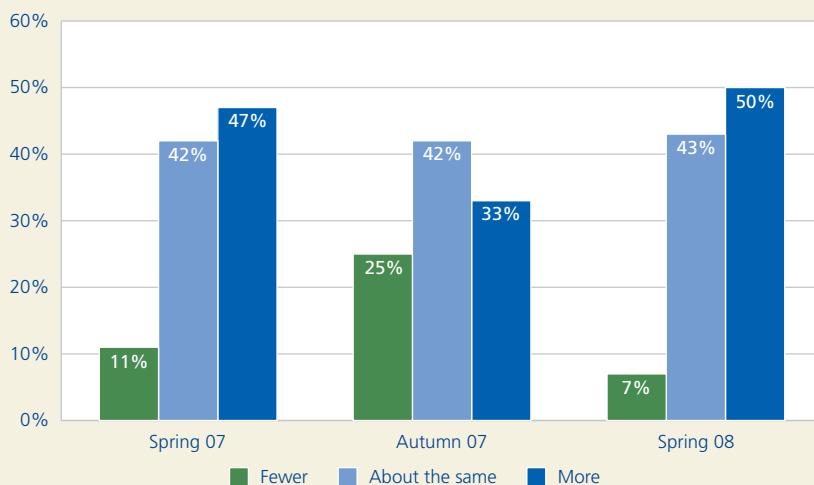
Outlook for transaction activity

The M&A market has come off the boil. However, there are initial signs of stabilization in global financial markets. Optimism in the transaction marketplace also seems to be on the rise again. Comparing the results of this survey (spring 2008) to those of Deloitte surveys from last year, we see a notable pickup in the percentage of respondents planning to expand activity. Net acquisition sentiment (respondents looking to expand minus those looking to reduce activity) has risen to 43 percent from 8 percent in autumn 2007¹ (see figure 1).

There is still a distinction to be made between sentiment among financial investors and strategic acquirers. Corporate M&A decisions are driven by long-term business strategy and are less dependent on current economic developments. We find that corporate M&A decision makers, with a focus on improving their company’s competitive position and expanding geographically, have become especially keen on M&A in recent months. Over 60 percent of corporate respondents say they plan to step up activity during the next 18 months (see figure 2).

Private equity respondents are more cautious after the financial turbulence of late. But it is notable that even the mood among private equity investors, while on the whole a bit more guarded with 42 percent of respondents planning expansion, seems to be stabilizing. Only 3 percent of financial investors in our survey say they are planning a reduction in activity, compared to 10 percent in autumn (see figure 2).

Figure 1 – Optimism on the rise: planned acquisitions in the next 18 months



Source: Deloitte surveys (see the appendix)

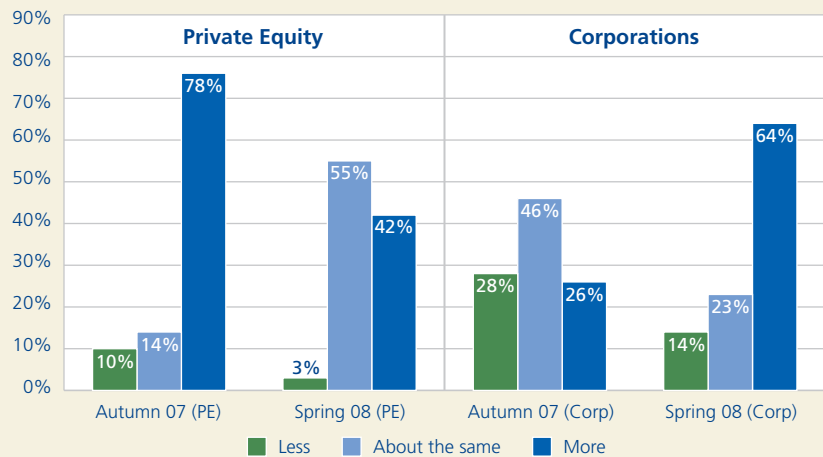
¹ For more details, see the appendix on survey background, chapter on historical comparison.

Strategic objectives

What will drive M&A activity over the next 18 months? As the world grows smaller and international interdependencies increase, companies are increasingly looking for partners outside their home nation to expand their network and build size for sustainable growth. Figure 3 shows the impressive rise of cross-border activity globally over the past four years.

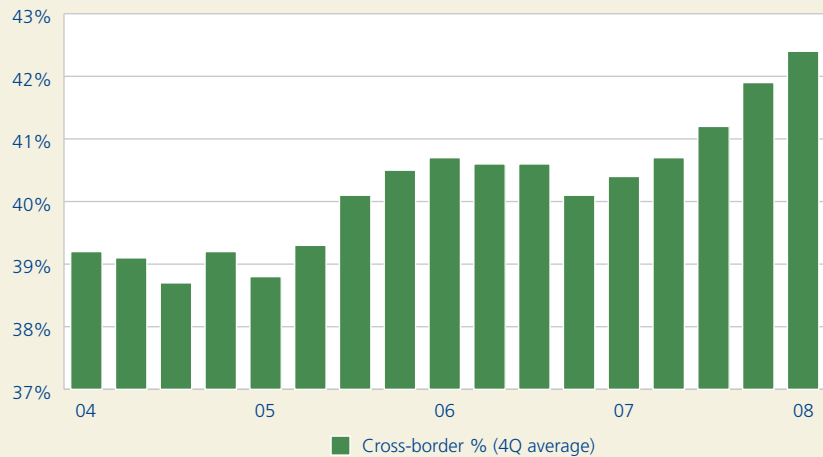
This trend is likely to continue, with cross-border acquisitions making up a rising share of overall activity in coming years. In Europe, over half of all transactions already involve a company in a foreign country.

Figure 2 – Seizing the day: planned acquisitions by private equity and corporate respondents



Source: Deloitte surveys (see the appendix)

Figure 3 – Interconnected: the share of cross-border activity continues to rise globally



Source: mergermarket

“Yesterday, today and tomorrow”

This is clearly reflected in the responses to our survey, which highlight competitive pressure and globalization as the main drivers of M&A activity. Over 80 percent of participants stated that an improvement to their competitive position is an important or very important driver of their M&A plans in the next 18 months, and three-quarters named geographic expansion as a main objective (see figure 4).

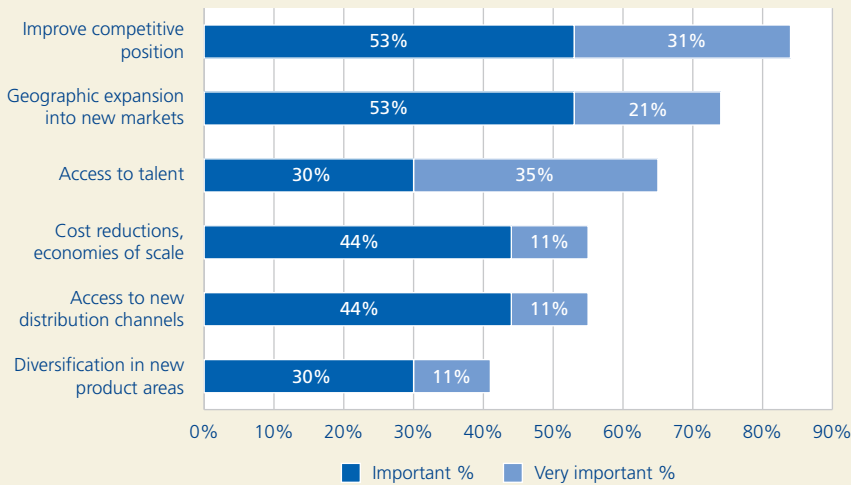
Globalization is here to stay. However, the study also shows that another megatrend – namely demographic change – is increasingly affecting companies’ strategic outlook. “Access to talent” ranked third overall among drivers of M&A plans in the survey, but it attracted the highest percentage of respondents (35 percent) ranking it as a “very important” motivation.

Evaluation of external factors – the glass half full

While M&A remains an important strategic instrument in long-term company plans, the economic environment has clearly become less friendly over the past year. We asked about executives’ expectations regarding the effect on their M&A transactions of various external factors over the next 18 months, including the business cycle, capital availability, political developments, regulation and tax policy.

The responses confirmed a deterioration of the business environment compared to the previous survey. Around one third of respondents ranked the influence of the business cycle as negative for their M&A activity, up from just 7 percent in autumn 2007. The percentage of respondents seeing a positive business environment, meanwhile, fell to 41 percent from 53 percent six month earlier (see figure 5).

Figure 4 – Competition and globalization driving M&A activity



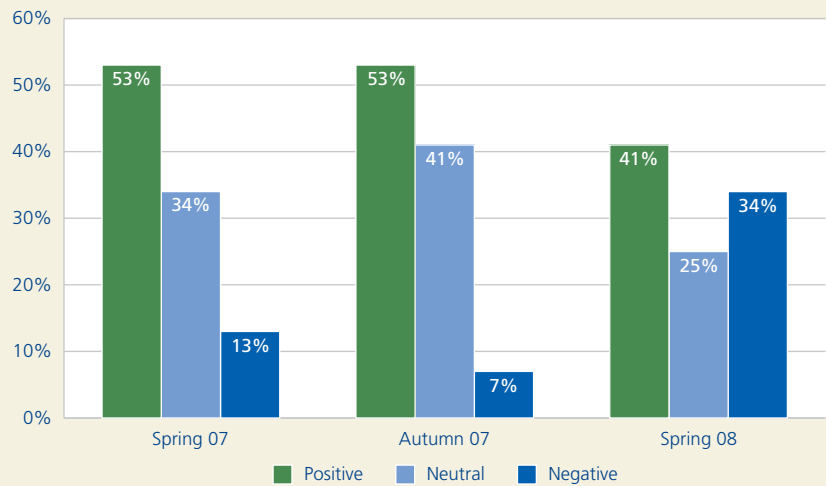
Source: Deloitte survey spring 08

“Competitive pressure and globalization remain key drivers of M&A activity. However, the talent shortage in at least some regions and industries is also becoming increasingly serious, forcing companies to look for new ways to expand.”

Remko Franssen, Partner M&A International Tax, Deloitte Netherlands

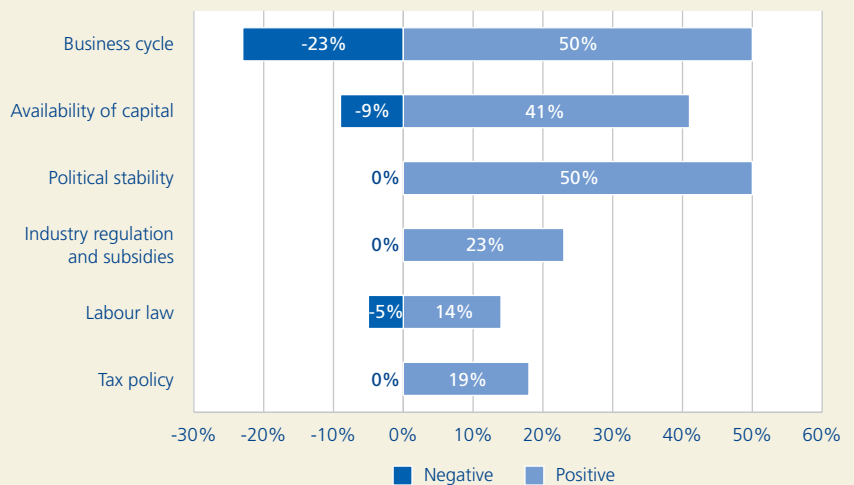
However, we found a notable distinction between corporate acquirers and financial investors in assessing external conditions. Corporate acquirers seem less fazed by current economic developments; they still rate the net impact of external factors (positive minus negative responses) as predominately positive. About half of respondents expect a positive cyclical influence on their planned M&A activity (see figure 6).

Figure 5 – M&A executives are facing a more unfriendly business climate



Source: Deloitte surveys (see the appendix)

Figure 6 – Corporate respondents still rate external factors generally positive



Source: Deloitte survey spring 08

“Yesterday, today and tomorrow”

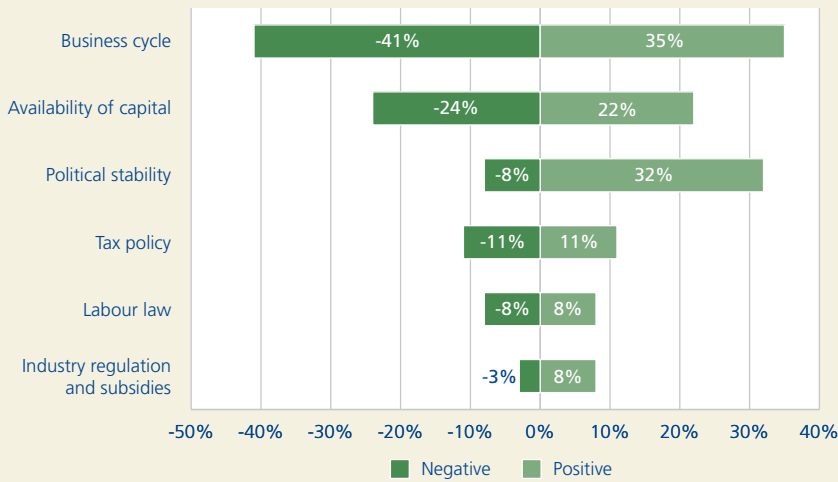
Availability of capital is not generally seen as a problem by corporate respondents. This comes as little surprise, particularly in Europe, where most corporations can boast healthy balance sheets and high liquidity. A strong currency lends further financial power to companies looking to expand abroad.

Financial investors, on the other hand, are clearly more affected by the financial turmoil and its aftermath, ranking the business cycle and capital availability as predominately negative for their business at present (compare figure 7). This, however, does not mean that they have stopped investing: as the survey showed, 42 percent of financial investors want to step up acquisition activity in the coming months.

This ties in with the results of Deloitte’s recent Central European Private Equity Confidence Survey, which also saw deterioration in sentiment among respondents in recent months, while optimism on activity going forward remained upbeat².

Private equity investors do not seem to be planning cutbacks in activity in the months to come. However, the more adverse economic and financial environment probably means that they will employ a more cautious approach to their investments.

Figure 7 – Financial investors acknowledge the negative impact of the economic environment



Source: Deloitte survey spring 08

“Given current market developments, the focus of private equity investors will likely shift to slightly smaller deals for the time being. Nonetheless, the pipeline of deals from this sector remains impressive. Meanwhile, the acquisition appetite of cash-rich corporate acquirers continues to grow.”

Christoph Röper, Partner M&A Tax, Deloitte Germany

² Central European Private Equity Confidence Survey, Deloitte, January 2008

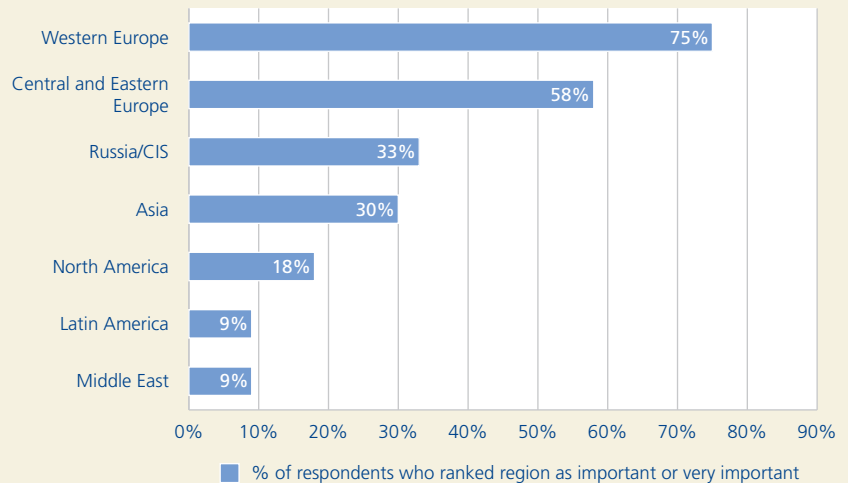
2. “The winner is Europe”

Regional M&A focus

Western and Eastern Europe hold top positions in the regional focus of survey respondents. This confirms the results of a German M&A survey last autumn and also ties in with other global Deloitte surveys from 2007, all of which put Europe at the forefront of respondents’ M&A plans. However, it is interesting to see that Russia and Asia are edging out America in terms of M&A appeal. North America has been pushed to fifth place (see figure 8).

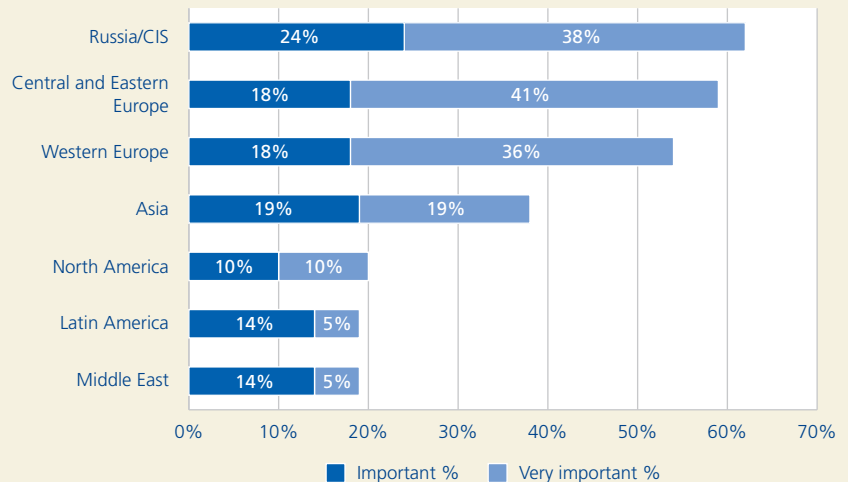
This particular result is influenced by the answers of corporate acquirers, who seem exceptionally keen on strengthening business ties with Russia. This is especially true for acquirers based in Eastern Europe. As a top-region for acquisition activity, Russia received 62 percent of the vote, followed by 59 percent for other Central and Eastern European countries. Western Europe was next with 54 percent ahead of Asia at 38 percent. Despite the favorable exchange rate, North America holds less appeal for corporate acquirers in our survey, with only 20 percent of respondents ranking it as “important” or “very important” for current M&A plans (see figure 9).

Figure 8 – Europe is a top priority for M&A decision makers



Source: Deloitte survey spring 08

Figure 9 – Regional focus of corporate acquirers



Source: Deloitte survey spring 08

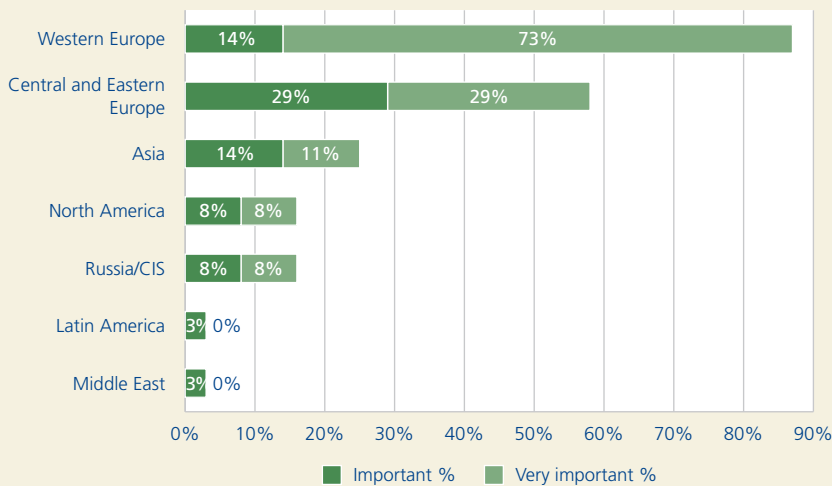
“The winner is Europe”

Financial investors, meanwhile, seem comfortable in Western Europe and continue to look for value there. Almost 90 percent of private equity respondents ranked Western Europe as important or very important for planned activity, followed by 58 percent for Central and Eastern Europe. Russia, however, plays a comparatively minor role for financial investors in our survey, with only 16 percent assigning an “important” or “very important” ranking to this region. In comparison, Asia holds a more prominent spot among private equity investors, with 25 percent of the vote (see figure 10).

Industry perspectives

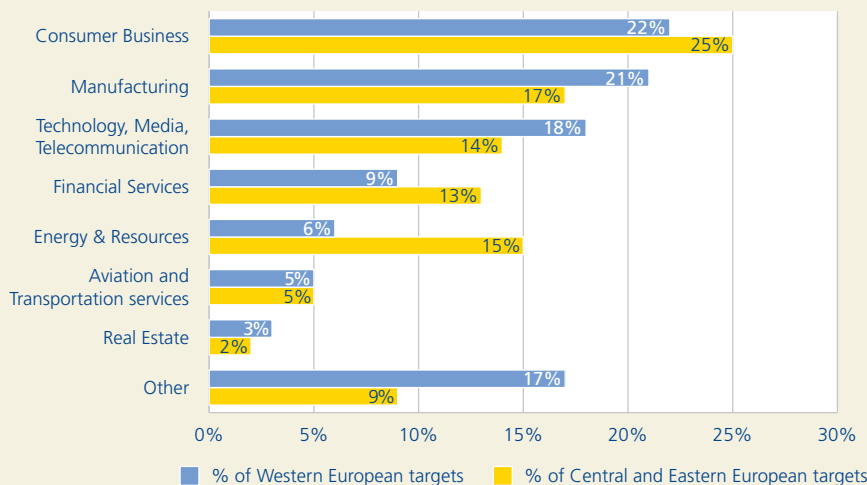
Against the background of this regional focus, it is interesting to highlight a few industry trends. In 2007 as a whole, Consumer Business and Manufacturing held the biggest share of the European M&A market. Technology, Media and Telecommunications transactions were also relatively important in Western Europe. However, they ranked behind Energy & Resources in Eastern European deal flow (see figure 11). In fact, Energy & Resources as well as Financial Services stand out as targets of

Figure 10 – Regional focus of financial investors



Source: Deloitte survey spring 08

Figure 11 – Industry shares of transactions in Europe 2007



Source: mergermarket

special attention in Eastern Europe, with a 15 percent and 13 percent share respectively (compared to 6 percent and 9 percent in Western Europe).

To illustrate the underlying momentum of deal flow for some of these key industries, figure 12 shows the trend in transaction volume (indexed to 100=Q1/05) over the past three years. In terms of industry dynamics, M&A transactions in the **Consumer Business** sector are on a strong upward trend in Eastern Europe while losing some momentum in Western Europe.

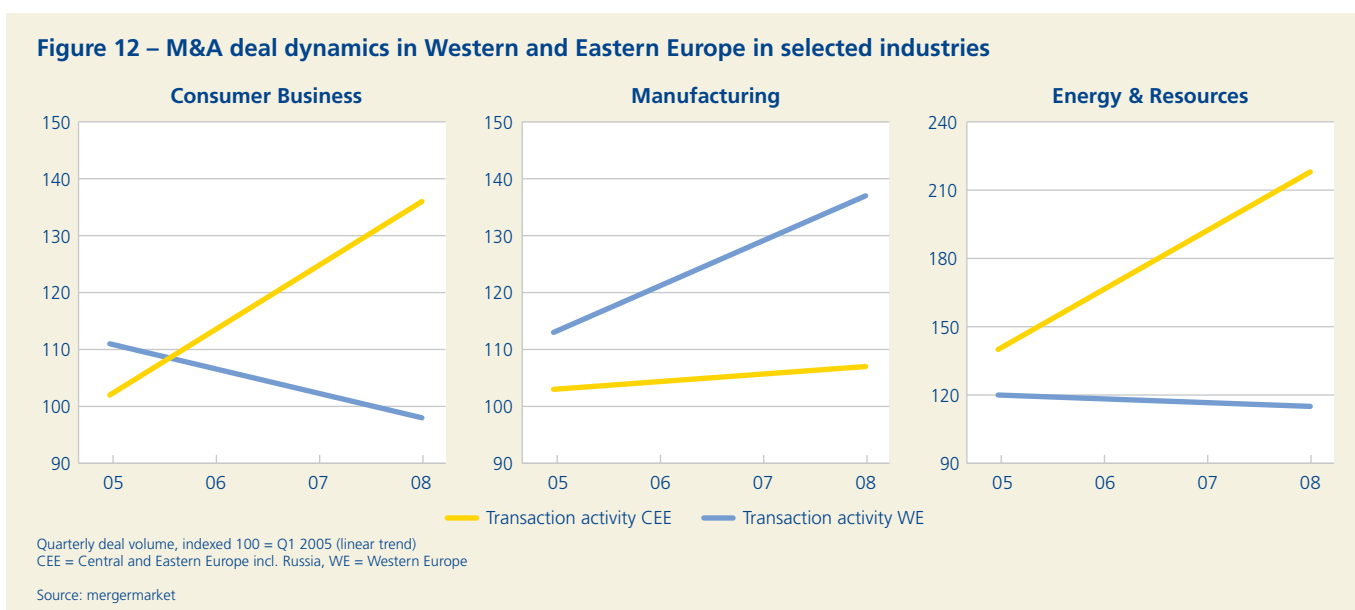
Thanks to continued positive economic development in most Eastern European nations, consumer purchasing power in the region is rising. This new marketplace presents a great opportunity for corporations looking to expand their geographical footprint. The beverage industry as well as luxury apparel and personal care are getting special mention in this regard.³ The leisure and financial services industries are further beneficiaries of this trend.

In general, the retail industry in Eastern Europe is still relatively fragmented, which is inviting consolidation – a lot of it cross-border. As bigger conglomerates are formed, merger activity also accelerates on the supplier side to generate the scale needed to supply these larger retailers.

Manufacturing deal flow, meanwhile, is not seeing a particularly strong upward trend in Eastern Europe. It is instead showing more vibrance in Western Europe (see second panel in figure 12). Industry consolidation is apparently still presenting opportunities in this sector in Western Europe. In addition, as far as the positioning of manufacturing centers is concerned, emerging markets in Eastern Europe compete with other rising powers, particularly in Asia.

As a matter of fact, manufacturing executives in our survey see Asia as the top region for acquisitions (77 percent of respondents ranked the region as “important” or “very important”), ahead of Eastern Europe (66 percent). This ties in with the results of the German M&A study of last autumn, in which China and India were named as top target regions for manufacturing M&A⁴. Tellingly, “cost savings” ranked higher as a M&A key objective among manufacturing respondents in our survey, tied with “access to resources” in third place, just after “improving competitive position” and “geographical expansion”.

The **Energy & Resources** sector continues to see strong momentum in Central and Eastern Europe (see third panel in figure 12). Government-sponsored privatization programs have provided the opportunity for investments in what were once state-owned monopolies, while liberalization and unbundling programs have further boosted M&A activity in the region.



³ mergermarket Deal Drivers, The Comprehensive Review of European Mergers and Acquisitions, Full Year edition 2007

⁴ Deloitte, “Auf Erfolgskurs – M&A in Deutschland”, Nov. 2007, p.16

“The winner is Europe”

At the same time, EU energy market consolidation has produced some major players in the West, who are increasingly looking east for acquisition targets that fit their long-term strategy. There seems to be particular interest in upstream resources (exploration and production) and alternative energy players.

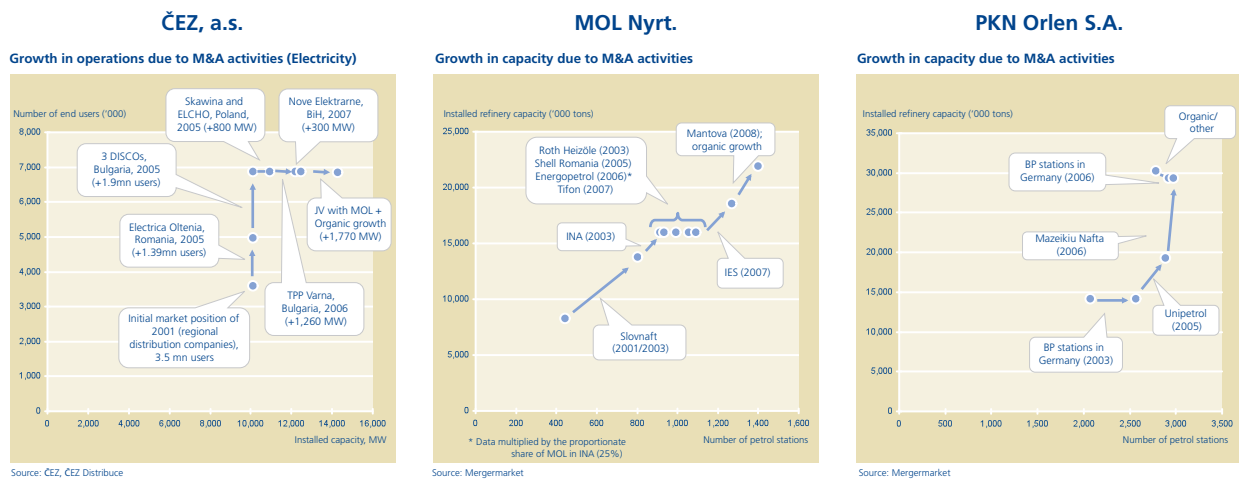
Of 40 transactions in the energy sector in Central and Eastern Europe last year (excluding Russia, which alone boasted more than 80 transactions)⁵, about 40 percent involved bidders from outside the region (Russia, Western Europe, North America and the Middle East). The majority of activity, however, was driven by players from inside the region, with acquisitions both within and across borders. Most active were Czech, Hungarian, Polish, Bulgarian and Lithuanian companies.

Energy & Resources M&A in Central and Eastern Europe

A prime example of the consolidation process in the region is the ČEZ Group. It was created in 2003, when ČEZ, the largest electricity producer in the Czech Republic, merged with several regional distribution companies. Following the acquisition of additional energy distributors and power plants in Bulgaria, Romania, Poland and Bulgaria, ČEZ Group has become a multinational enterprise comprising over 90 companies. Today, ČEZ Group is among the ten largest energy companies in Europe, both in terms of installed capacity and number of customers (see figure 13a).

While ČEZ Group was the first player in the Energy & Resources arena in CEE to start pursuing a dedicated M&A development strategy, others, like Hungary’s MOL Nyrt. and Poland’s PKN Orlen S.A. have also been especially active over the past five years. Both more than doubled in size (installed refinery capacity) between 2003 and 2008 (see figure 13b + c).

Figure 13a, b, c – M&A activity drives growth in the Energy sector in Central and Eastern Europe



Source: Compiled by Deloitte E&R

⁵ mergermarket, deal activity 31/05/2007 to 30/05/2008; targets in Eastern Europe

East and West

Despite progressing European integration and harmonization on the way to a single marketplace, we found quite a home bias in the regional acquisition plans of Western and Eastern European respondents to our survey (see figure 14).

Almost 90 percent of Western European companies see themselves active on the Western European M&A market, with the region achieving an average rating of 4.59 on a scale from 1 (unimportant) to 5 (very important). The second most important region for Western European acquirers is Eastern Europe, but at some distance, with an average ranking of 2.87. Russia/CIS ranks third.

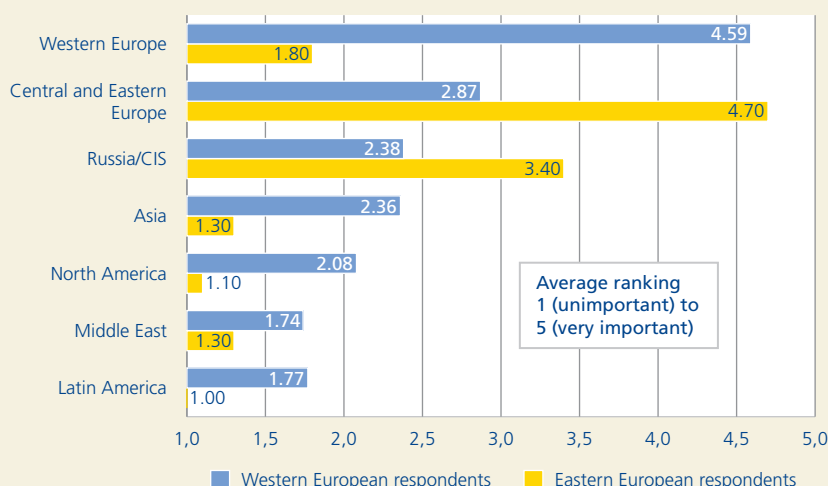
Eastern European acquirers, on the other hand, plan to be considerably more active on their own territory. Approximately 90 percent of Eastern European respondents ranked the home region as important or very important with regard to their M&A plans, achieving an average ranking of 4.70. They also attach higher importance to Russia, which outranks Western Europe as a target for their M&A plans (see figure 14).

Interest in Russia

Due to the rapidly emerging economy and a wave of privatizations, Russia has become an important playing field for M&A over the past few years. It is interesting to note the different assessment of Russian M&A opportunities in our survey between Eastern and Western European respondents. While Russia holds important or very important potential in the eyes of over two-thirds of Eastern European acquirers, less than one-third of Western European respondents attached the same significance to the region.

Much of recent M&A activity in Russia has, of course, been domestic: Russian investors have been the main players in the Russian transaction marketplace over the past three years, accounting for about 70 percent of deal activity. Nonetheless, our survey suggests it is not due to a lack of interest from their Eastern European neighbors. Western European acquirers, too, are showing interest in Russia (even ranking it ahead of North America), but not to the same degree. That may be due to the fact that for Western European acquirers, other regions – including Asia, Latin America and the Middle East – are also attractive. This cannot be said of Eastern European respondents.

Figure 14 – Regional acquisition plans highlight home bias



Source: Deloitte survey spring 08

“The winner is Europe”

Eastern European respondents do not seem to have any plans for M&A activity further afield. Asia, North America, Latin America and the Middle East were all ranked of little or no importance by the Eastern European respondents to our survey. Especially for smaller companies, which characterize much of the corporate landscape in Central Europe, an acquisition in a bigger Eastern European neighbor – much less Russia – is a big step. Their own market thus still offers plenty of scope for growth, so there is no great need to look further abroad.

Interest in Eastern Europe

A detailed view on M&A target countries in Central and Eastern Europe confirms this picture. As the emerging nations of Europe shake off their communist legacy and find their place in a common market, they offer great opportunities for companies looking to secure their share of business.

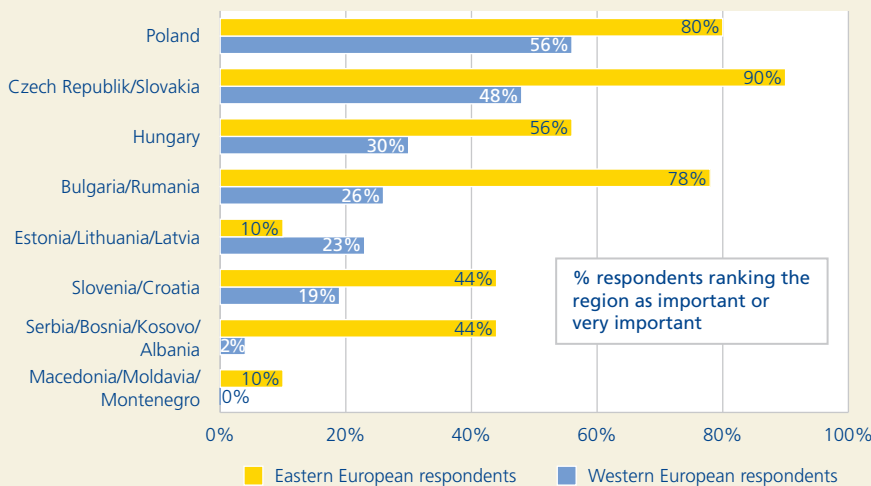
However, while there is generally greater interest from Eastern European respondents in the countries of Eastern Europe rela-

tive to Western European respondents, not all countries attract the same attention. Most appealing are Poland, Czech Republic and Slovakia as well as new EU members Bulgaria and Rumania. Interest in Hungary, which was one of the first Eastern European states to open its market, seems to be diminishing somewhat, with only 56 percent of respondents from Eastern Europe and 30 percent from Western Europe ranking it as important or very important for their M&A plans (see figure 15).

Western European respondents rank the Baltic States, EU members since 2004, roughly on par with Bulgaria and Rumania in terms of their M&A plans. In contrast, Eastern Europeans see greater future opportunities in the Balkans than the Baltic states.

When looking for M&A prospects in Eastern Europe, EU members clearly come out top. Thanks to EU transfers and subsidies, which strengthen growth, along with reforms, which should lead to more transparency and EU-compatible tax codes and laws, these markets seem to offer the most attractive opportunities (see figure 15).

Figure 15 – M&A target regions in Eastern Europe



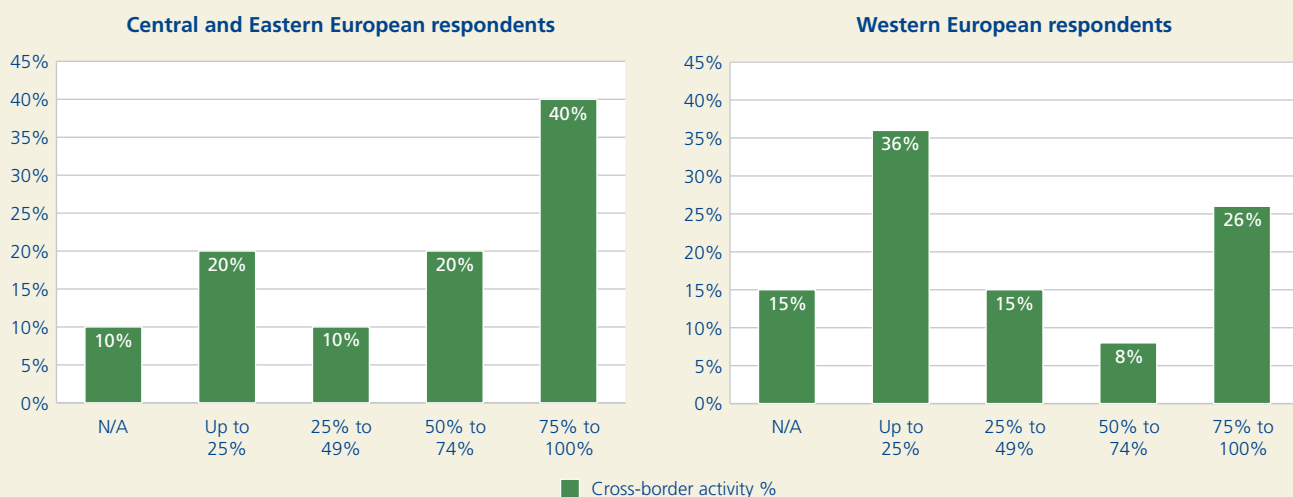
The survey results suggest that Eastern European investors are primarily looking for potential acquisition targets on European territory. But do they hide themselves behind national borders? The answer is clearly no. In fact, Eastern European acquirers seem to be more active in international M&A than Western European corporations.

About 60 percent of Eastern European respondents to our survey stated that more than half of their M&A activity in the past three years involved companies in a foreign country. In contrast, only

33 percent of Western European respondents made the same claim (see figure 16).

In Central and Eastern Europe, an area comprised of relatively smaller countries, companies often find that their opportunities to grow domestically through acquisitions are limited. There are still some sectors where regional consolidation can take place, but along with the increasing maturity of their economies, Eastern European companies increasingly look across borders for targets.

Figure 16 – Cross-border M&A activity by survey respondents during the past three years



Source: Deloitte survey spring 08

“Historically, companies in emerging markets have often been prey to takeover bids from businesses in the West. Today, supported by strong economic growth and ambitious management, it is also companies from emerging nations that are increasingly looking across borders for assets.”

Garret Byrne, M&A Transaction Services Leader, Deloitte Central Europe

3. “Learning from best practice”

Success factors

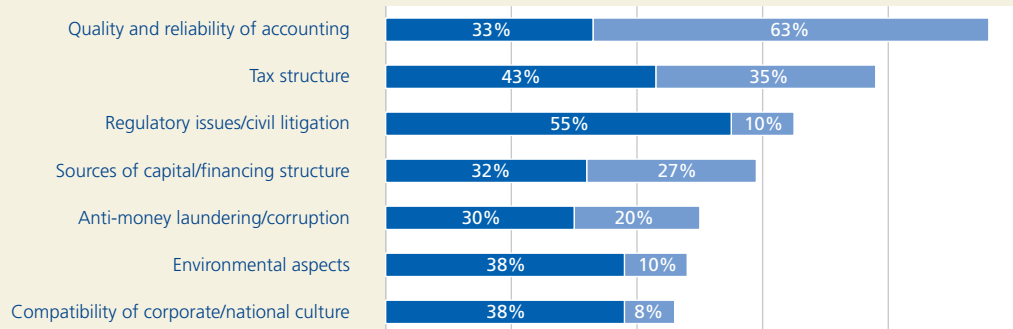
The M&A process is multi-faceted, posing challenges for strategic and financial investors alike. In its course, decisions have to be made to prioritize the allocation of effort, time and money while aiming for optimal results. In particular, the foray into new markets presents opportunities but also brings new risks. In view of their high complexity, there is no recipe for the per-

fect deal. But there are particular factors that seem to contribute to value creation more than others.

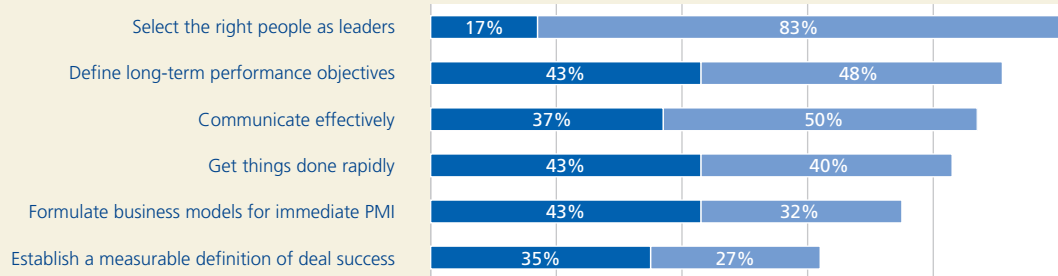
In our survey, we listed 20 deal management tasks grouped into three phases – due diligence, execution and post-merger integration – and asked respondents to rank them in terms of importance on a scale from 1 (unimportant) to 5 (very important). There were obvious winners in each phase (see figure 17).

Figure 17 – M&A success factors

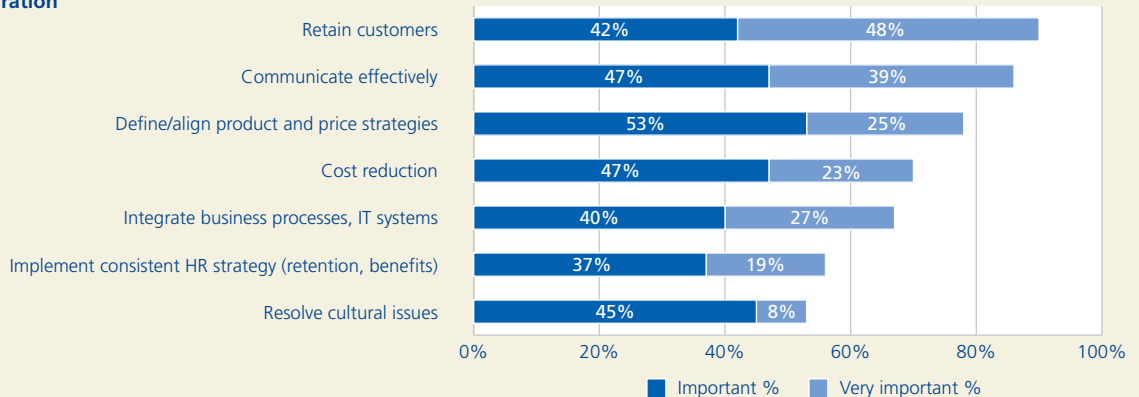
Due diligence on...



Transaction tasks



Post-merger integration



Source: Deloitte survey spring 08

The top five factors overall are summarized in figure 18. In the integration phase, there was a clear consensus on the importance of customer retention and transparent communication. A definition of long-term performance objectives in the transaction phase was seen as supportive of deal success, as was thorough due diligence on the quality and reliability of accounting.

Most importantly, however, all survey participants saw the selection of the right leaders as a key factor for a deal’s success. On a scale from 1 to 5 (maximum), this factor achieved an impressive score of 4.83 (see figure 18).

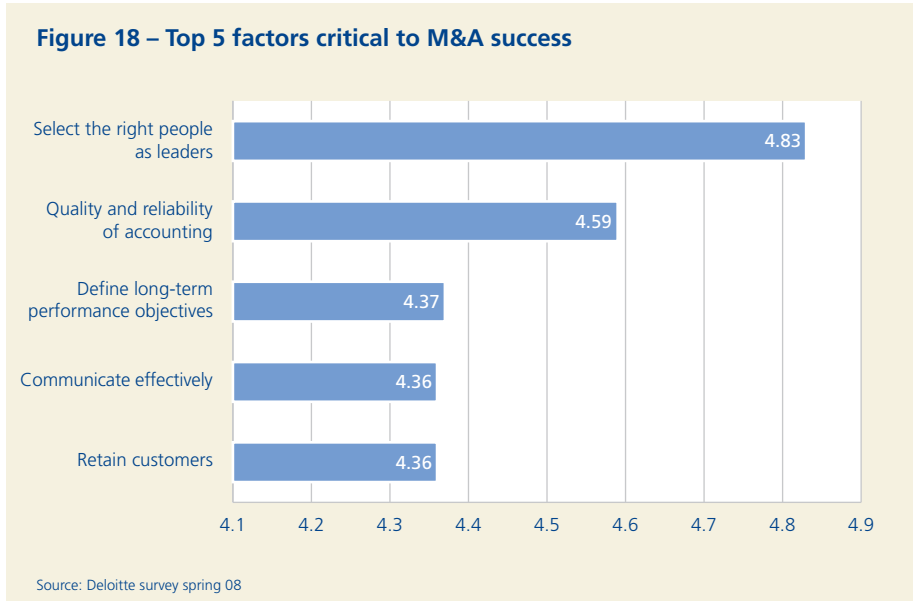
Experience shows that in Central and Eastern Europe, where the pool of experienced managers is thinner than in more mature markets, it can be hard to find the right leaders for a newly merged entity. At the same time, it is, if anything, even more important in those markets to find competent management capable of executing according to strategy from day one. Ninety percent of Eastern European respondents to our survey ranked “selecting the right people as leaders” as a very important success factor (compared to 80 percent of Western Europeans). In a fast growing economic environment, there is much to gain from perfect execution, but also much to lose if things go wrong because of inefficient management.

High and low achievers

The survey results highlight the importance of certain tasks in the M&A process as key to deal success. But is there a difference in the prioritization of tasks among respondents whose companies are at opposite ends of the spectrum in terms of M&A performance?

To explore this point, we compared the rankings of low and high-achieving respondents and found a strong correlation with deal success in some cases. In other words, we found tasks that were consistently ranked high by high achievers, while low achievers categorized them as less important. Respondents putting extra emphasis on these aspects of the M&A process seem to be attaining better results.

To get a measure of deal success, we asked respondents to state what percentage of their M&A deals achieve the planned objectives within the expected time frame. The results were mixed. While 30 percent of respondents reported success in three-quarters to all of their endeavors, 20 percent said less than half their deals hit the mark on a timely basis.



“Learning from best practice”

A notable fact is that private equity investors generally seem to be more successful than corporate respondents in their transactions⁶. However, private equity respondents also have different objectives in doing deals, so a direct comparison of priorities between them and corporate respondents, for example in the post-merger phase, might not be entirely meaningful.

Indeed, we found the biggest difference between the priorities of financial and corporate respondents in the transaction phase. To extract best practice in the pre- and post-transaction phase, we compared the ranking of tasks between high and low-achieving corporate acquirers.

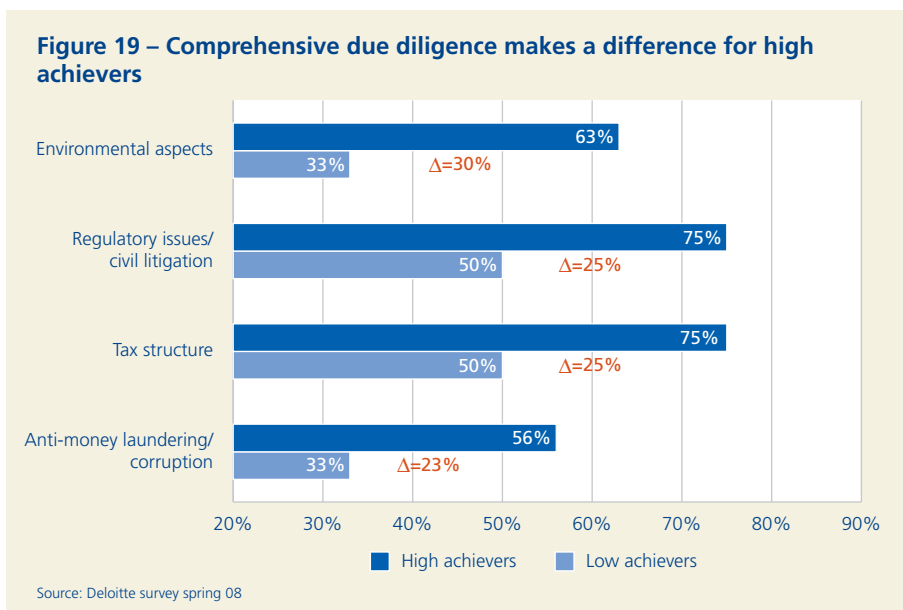
Due diligence – coping with a new generation of risks

With the increasingly international focus and rising complexity of transactions, the risks executives need to manage when engaging in M&A activity are growing. When unexpected problems arise, consequences can include negative publicity, regulatory violations or even criminal indictments that damage a company’s financial performance and long-term success. Conducting comprehensive due diligence is a critical step to identifying, and forestalling, potential risks in any business transaction.

As a recent Deloitte study highlighted, 70 percent of companies have pulled out of planned transactions as a direct result of the findings of an investigative due diligence. Another 57 percent of respondents renegotiated deals when encountering negative information from background checks. It is worth mentioning that only two-thirds of acquirers always conduct a background investigation, and even when they do, they often do not probe deeply into many critical areas⁷.

We found interesting evidence of this in our survey. While all respondents agreed on the importance of thorough due diligence of accounting standards at the targeted corporation, opinions of high and low achievers differed markedly with respect to due diligence on environmental aspects (63 percent vs. 33 percent), regulatory issues and civil litigation (75 percent vs. 50 percent), the tax structure (75 percent vs. 50 percent) and anti-money laundering and corruption issues (56 percent vs. 33 percent) (see figure 19).

The results highlight an important megatrend: in today’s business environment, sustainable and long-term corporate success is defined not only by profitability, but also by extra-financial aspects such as environmental and regulatory compliance. Putting extra emphasis on these factors in the course due diligence for an M&A transaction can make a difference to a deal’s success.



⁶ Private equity respondents also claimed greater experience with 84 percent having handled more than five transactions in the past three years. For more details see the appendix under survey background.

⁷ “Look before you leap – Investigative Due Diligence in International Business Relationships”, Deloitte Business Intelligence Services, Deloitte Financial Advisory Services LLP, 2007.

Environmental and regulatory risks

Awareness about social responsibility and the importance of good corporate governance is rising in board rooms across the globe. More and more companies nowadays publish sustainability reports, even when there is no legal obligation to do so. Improving resource efficiency increases competitiveness and improves workplace safety. A good reputation and quality products create additional advantages, not only in attracting customers, but also in luring and retaining key personnel.

Governance, risk and control (GRC) in general is a growing concern for executives and boards. Corporate scandals, regulatory actions, terrorist attacks, computer hacking, poor crisis management and danger to public safety and health are just a handful of the various forces converging to push risk management into the consciousness of management and boards.

As stakeholder expectations and activism rise, strong risk management practices and compliance with an ever more complex regulatory environment are essential for a company’s prospects for success. That it is important to have a good understanding of these aspects when looking at potential acquisition targets seems obvious.

High-achieving corporate acquirers in our survey seem cognizant of this trend, with 63 percent rating environmental due diligence as an important or very important task in the overall M&A process. Only 33 percent of low achievers assigned the same priority. Similarly, 75 percent of high achievers ranked investigation of the regulatory issues and civil litigation as key success factor, while only 50 percent of low achievers emphasised this aspect.

Especially in the EU, acquirers need to pay close attention to the regulatory environment – also with respect to environmental trends. Under the European Union Emission Trading Scheme (EU ETS)⁸ introduced in January 2005, many companies from energy-intensive sectors need to purchase emission rights or reduce their CO₂ emissions.

In the chemical sector, the EU introduced REACH in June 2007. This law regulates the registration of a large number of chemicals in a database as well as the testing for environmental compatibility⁹. The European Commission estimates the directive will cost the chemical industry up to € 2.3 billion over the next 10 years, impacting not only manufacturers, but also importers and users.¹⁰

As final example, the implementation of the 2007 EU directive on environmental liability¹¹ expands corporate responsibility regarding protected species and their natural habitats (notably 14 percent of EU’s land area).

“Not having a comprehensive understanding of the ecological footprint and general regulatory compliance of prospective targets can have important implications for the financial viability of M&A deals.”

Lieve Creten, Partner, Financial Advisory Services Leader, Deloitte Belgium

⁸ EU Directive 2003/87/EC

⁹ Registration, Evaluation, Authorisation and Restriction of Chemical Substances established by EC Regulation No. 1907/2006

¹⁰ “REACH in brief”, European Commission, September 2006, page 16.

¹¹ EU Directive 2004/35/EC

Central and Eastern European respondents recognize regulatory risks ...

It is noteworthy that 70 percent of respondents to our survey from Central and Eastern Europe view due diligence on regulatory issues and civil litigation as an important or very important part of the M&A process (close to the 75 percent mark among high achievers). Maybe partly because of the still diverging laws and regulations between EU members and non-member states, Eastern European investors are more sensitized to the importance of this aspect in doing business and thus also put extra emphasis on it in the course of an M&A process.

... but do not yet give the environment the respect it is due

On the other hand, only 40 percent of Eastern European acquirers see environmental due diligence as key to success (comparable to 33 percent among low-achievers). While adhering to existing rules and regulations is recognized as important, the wider aspect of corporate responsibility as key ingredient in itself for sustainable growth does not yet seem to be getting due respect.

However, according to another recent Deloitte study, the relevance of high environmental standards globally is rising. Emerging market companies that adopt superior environmental standards decisively increase their competitiveness in the global marketplace by attracting interest from Western corporations which are driven by demand from their own customers for higher standards and transparency.¹² We would thus expect this aspect to also grow in importance in deal-making going forward.

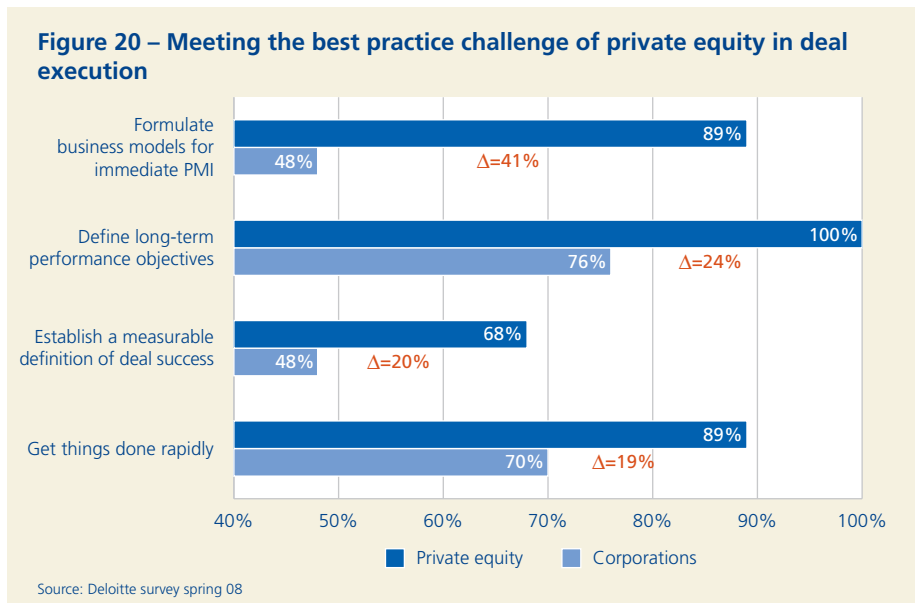
Transaction execution – private equity’s empire

The M&A landscape has gone through a dramatic change over the past decade, with the rise of private equity refashioning the way deals are transacted. The extensive and diversified experience of institutional investors sharpened their deal-making capability and perfected the deal strategy of successful key players.

Nothing shows the difference in approach between private equity and the corporate world more clearly than their priorities for successful deal execution. Obviously, financial investors operate under different constraints as corporations. Nevertheless, there is a nimbleness and focus about the way in which transactions are executed that make a positive contribution to their chances of success and can serve as examples for corporations of how to compete successfully in the transaction marketplace.

We found considerable differences between the priorities of financial and corporate investors in planning for post merger integration ahead of time (89 percent vs. 48 percent), clearly defining long-term objectives (100 percent vs. 76 percent) and measures of deal success (68 percent vs. 48 percent) as well as focusing on a swift execution (89 percent vs. 70 percent) (see figure 20).

These results correspond closely to the findings of the Deloitte study “Corporate fight back”, which extracted key disciplines in M&A from best practice.¹³ It determined that there are lessons to be learned from private equity especially when it comes to



¹² “Innovation in emerging markets 2008”, Global Manufacturing Practice, Deloitte, 2008.

¹³ “Corporate fight back – Five disciplines to win in M&A”, Deloitte UK, 2006

execution. For financial investors, the incentives for successful execution are simple and closely tied to remuneration. Similarly, corporate acquirers should set clear objectives with measurable targets and identify those who are responsible for meeting them.

“Accountability and coordination across a transaction are crucial for deal success. It needs to be clearly defined who is accountable for delivering the deal, and incentives have to be structured accordingly. An overly complex hierarchy can be a recipe for problems.”

Rene Steen Larsen, Partner, Financial Advisory Services, Deloitte Denmark

Post-merger integration – Not running out of steam in overtime

Even after thorough due diligence and a successful execution, it is the integration phase where M&A deals often go awry. The announcement of a merger sends employees panicking about their jobs, managers struggling to maintain control and leaders agonizing over the tough decisions that need to be made. Meanwhile, the customer focus suffers. Organizations that are unprepared to tackle these challenges may find their chances of achieving the desired results rapidly slipping away.

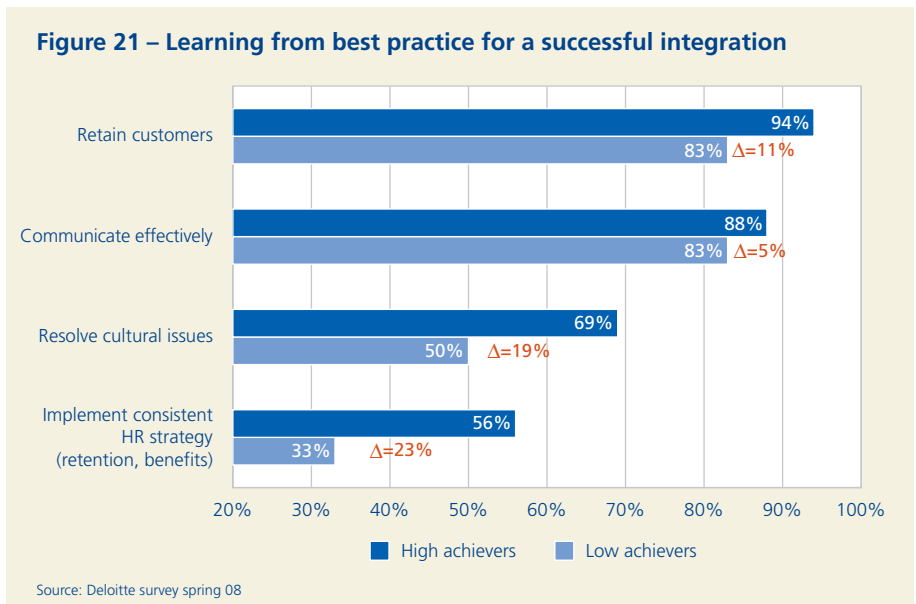
We found a general agreement in our survey among corporate acquirers that successful customer retention and clear communication are key factors for success following an acquisition. All corporate acquirers with deal experience rate these factors highly, although high achievers attach slightly more importance to them (see figure 21).

However, we found considerable differences between high- and low-achieving acquirers in the ranking of two other important success factors. High achieving corporations assigned much greater relevance to resolving cultural issues (69 percent vs. 50 percent) and implementing a consistent HR strategy (56 percent vs. 33 percent).

This, too, fits with the results of past studies, which have shown that best practice businesses prepare their HR team early and ensure it is fully skilled and resourced. They also identify and recognize cultural differences and plan for successful integration.

Failure to integrate separate corporate cultures saps staff morale and distracts senior management. Getting the merger of two organizations off to a good start and capturing the momentum of the deal is critical to extracting maximum value.

Especially on a background of rising cross-border M&A activity and increasing talent shortages, corporations planning and executing M&A will have to attach extra importance to cultural issues and retaining key personnel when forging new international businesses.



Sustainable deal success – merging people

Many merger and acquisition deals focus primarily on strategic, financial and legal issues. But “people issues” often make the difference between hoped-for and actual results. The survey highlighted the importance of human capital in M&A transactions, with some key success factors in this area still being underestimated. Sensitivity to cultural issues as well as retaining key people through a consistent HR policy is making a difference for high-achieving acquirers. Choosing the right people as leaders was named as a key overall deal management imperative, as was a clear communication strategy.

Aside from professional and methodological skills, dealing with these tasks requires well-developed soft skills. This ties in with the conclusions of Deloitte’s M&A study, “Auf Erfolgskurs”¹⁴, which found that the success or failure of a transaction is decided in the later stages of the M&A process. It also determined that four of the most critical success factors concern human relationships (selection of competent leadership, retention of key personnel, customer retention and mastering cultural challenges).

Ultimately it is people, not money, who merge, bond, ally, and work together. It is this people perspective that often gets lost when acquisitions focus on economic goals and financial targets. To secure success, Deloitte’s “Merger Aftershocks”¹⁵ summarized some critical actions needed to survive the “people challenges” of post-merger integration. The organizational design of the new venture must be clear and well defined, with leaders from both sides of the merger actively engaged in the integration effort.

There has to be an explicit strategy for retaining talent to ensure business continuity and performance. Where cultural differences are likely, new behavior should be encouraged that is a natural extension of current cultures and supports strategies people can identify with.

A comprehensive and strategic communications program should target all of an organization’s key stakeholders – managers, employees, customers, suppliers, shareholders, board members and the media – with messages and communication tailored to their specific needs and concerns.

Finally, the appropriate objectives should be set to deliver a “Day One” experience that brings two organizations together boosting morale, engaging the workforce and creating positive momentum for what could be a long process of bringing two organizations together as one.

¹⁴ “Auf Erfolgskurs – M&A in Deutschland”, Deloitte Germany, 2007

¹⁵ “Merger Aftershocks – Surviving the people challenges of a post-merger integration”, Deloitte Consulting LLP, 2007

4. Conclusion

In this era of globalization, cross-border M&A activity will continue to gain in importance. Increasingly complex international transactions bring with them new challenges and risks – from understanding local rules and regulations to mastering the cultural challenges of integration. Add to it a rising awareness about environmental and social responsibility at corporations globally, and companies will need to sharpen their senses in some new ways when engaging in M&A.

Our analysis demonstrates that important success factors are still underestimated. Next to an obvious focus on accounting and finance, high achievers already put extra emphasis on extra-

financial factors, such as due diligence of environmental or regulatory issues, as well as the implementation of a consistent HR strategy and cultural integration.

The merger of two corporations has many dimensions, but most importantly it brings together people with different backgrounds, cultures and experiences who are expected to work together in an uncertain environment from day one. Companies that address cultural, organizational and HR issues early and consistently will be better prepared for the challenges of integration and improve their chances of success (see figure 22).

Figure 22 – A summary of key findings



Source: Deloitte Research

5. Appendix

Survey background

This study is a joint effort of the M&A practices of Deloitte Belgium, Denmark, Central and Eastern Europe, Germany and the Netherlands to gauge sentiment among European M&A executives. Around 120 high-level M&A executives, both at corporations and private equity houses, were contacted and alerted to the survey. Sixty of them visited our website and completed a detailed online questionnaire about their M&A plans, objectives and success factors. The online survey was open from 10 March to 30 April 2008.

Respondents

Respondents to the survey were headquartered predominately in Western Europe (70 percent) and Eastern Europe (22 percent), with only 8 percent referring to a parent location outside the region (North America or elsewhere).

Surveyed companies included financial investors (54 percent) and corporate acquirers of diverse backgrounds and sizes (see figure 1A and 2A). All respondents possess extensive deal experience, with three-quarters having completed more than five deals in the past three years (see figure 3A).

Historical comparison

The historical comparison of M&A sentiment is based on past Deloitte surveys of M&A executives, the most recent of which was a German study in autumn 2007 (August/September) that surveyed 115 German companies and 25 private equity houses and investors. The results of a global survey from spring 2007 (April) reflected the sentiment of 276 M&A executives in Europe, Asia and North America.

Detailed results of these past surveys can be found in the publications "Auf Erfolgskurs – M&A in Deutschland", Nov. 2007 and "Strategic acquisitions amid business uncertainty: Charting a course for your company's M&A", Nov. 2007 (see list of recent thought leadership on page 29).

Figure 1A

Industry background

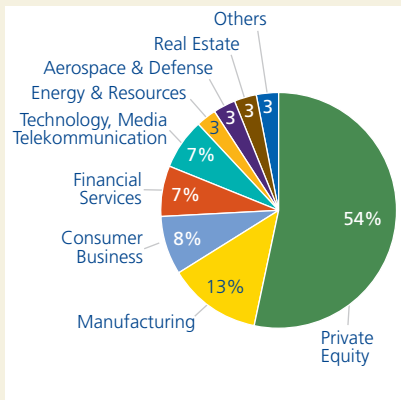


Figure 2A

Total revenue

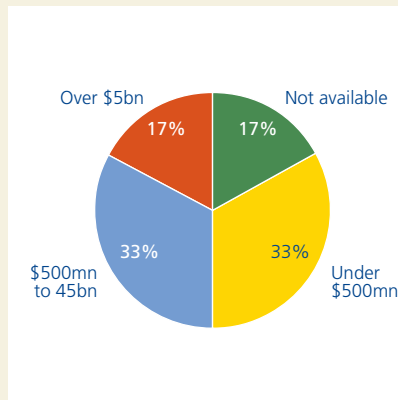
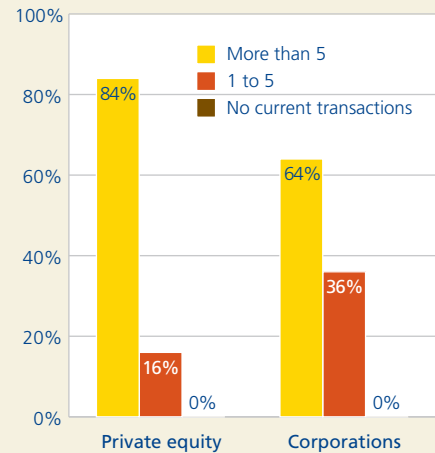


Figure 3A

Deal experience



Source: Deloitte survey spring 08

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