

## CFO insights: M&A value maximization: From due diligence to finance transformation

M&A offers companies the opportunity to create significant enterprise value when managed well. The problem is that so few organizations actually do get it right. Organizations with recently transacted deals achieved integration success only about thirty percent of the time.<sup>1</sup> The current deal environment has low toleration for poor outcomes. With heightened levels of board, shareholder, and management scrutiny, the definition of deal success has changed. It is no longer enough just to get to the altar or to close the deal ahead of schedule. Today, success is attained once the value has been demonstrated from an integrated company producing accretive results at levels at or above those anticipated. Managing M&A to deliver success from a transaction is where the role of the CFO assumes greater importance.

CFOs have long been looked to for the “stewardship of value” by their organizations, generally in regards to accounting and reporting, or their operations oversight responsibilities. In the new M&A environment, the CFO is also the steward of value in the transactional setting. In this context, the CFO must achieve the desired outcome and preserve value in every phase of the deal. The CFO facilitates the due diligence process to identify and mitigate significant risks or exposures that could impact the transaction or the finance transformation required to realize the fullest value from the merger post-closing. In this CFO Insights article, we discuss the CFOs’ role as a steward in these two critical phases of a deal – due diligence and finance transformation.

<sup>1</sup>Deloitte M&A Consulting Services Survey 2007.

### Due Diligence for Value Realization

M&A results depend on how closely the ultimate value captured from the deal mirrors or exceeds the value envisioned at the beginning of the process, and the CFO is in a unique position to shepherd the projected value through to its ultimate realization. In order to accomplish this, the CFO must take an active role in the due diligence process prior to driving the actions from projection or modeling through the realization provided from actual results.

The crux of due diligence is the need to mitigate overall transaction risk through the identification, quantification and substantiation of value drivers or value inhibitors, and to recognize the differences, if any, between these and what was the basis of anticipated deal value at the beginning of the process. For every transaction, one can define a transaction value matrix, which frames the key sources of value to be derived from the target either alone or as a synergy from the combined operation. The due diligence process endeavors to these value metrics and begins the planning which can increase the likelihood of realizing significant value from different parts of the deal matrix. In short, when looking at the value of the target, due diligence helps identify what actually exists.

On the buy side, the CFO must substantiate the claims made by the target company and others, both good and bad, and identify other matters that can impact the value. The financial and tax positions and the sustainable cash flows and earnings of the target company need to be evaluated and either supported or challenged. Additional questions to be answered during the overall diligence include: should the potential operating risk and other inherent contingencies of the seller be adjusted into the purchase price; how does the target company manage their business and how must that model be adjusted to operate as part of the consolidated group; how does the target manage their finance function and what changes will be required; are their reporting standards in line with the buyer’s reporting standards; do their information



systems align well with the purchaser's existing system and what will the cost be to integrate the two. All of these issues should play into a CFO's analysis of a target and preparation for life beyond the close.

This activity may be undertaken by members of the corporate development group or outsourced to third parties who specialize in due diligence. Beyond a review of the finances and operations of the company, and the technical aspects of the diligence process, what the two parties to the transaction are doing culturally and whether they can work cohesively to be accretive to shareholder value is also a fundamental consideration. Cultural and operational-related due diligence can help identify the likelihood that conflicts or misaligned goals and values could undermine the potential of the transaction and the resulting combined company.

In some cases, the sell side of a transaction can be much more complex than the buy side. Buyers are naturally skeptical about the numbers and other facts presented by the seller. Thus, as discussed in a previous CFO Insights piece on Divestitures and Carve-Outs, being a prepared seller with accurate and comprehensive diligence materials can help achieve desired transaction value for the selling stakeholders by expediting the process and building trust and credibility with the acquirer. Sellers need to make sure that everything they have put forth meets the appropriate standards. Conducting "sell-side diligence" before the sales process begins can help sellers anticipate issues a buyer may raise and develop responses that adequately address the questions before they become problems.

Beyond identifying risks that can potentially undermine the value of a deal or generating information to facilitate the transaction and integration, due diligence is an important step in identifying the finance transformation requirements or integration steps required to achieve the desired value from the deal for both the buyer and the seller. For example, if a seller elects to dispose of certain "non-core" assets from their consolidated portfolio, the CFO must direct his or her team to not only carve out those operations effectively to support the divested entity, but often the CFO must also look at creating a revised operating model or business model as a result of the carve out. In finance, the CFO must decide how much of the existing staff and infrastructure will be required to effectively support and manage the new entity and what stranded or excess costs will exist in the selling company that may need to be reduced or eliminated over time.

Whatever the approach taken to deliver finance to the new organization, the CFO is likely to have to drive a finance transformation initiative to support the new entity and the parent organization of the future. Similarly, after the due diligence process, buy-side CFOs will have to develop a plan to effectively integrate the finance organizations of newly merged entity to provide efficient but well controlled operations and reporting.

### **Finance Transformation: Some Key Considerations**

The goal of any CFO embarking upon a transaction should be to ensure that Day 1 post-merger is issue-free, calm, and smooth and ultimately leads to the desired value from the deal. This means ensuring that the base business is still functioning from a business continuity perspective. As the steward of value, the CFO is also responsible for making sure that the transactions are done effectively and in compliance with prevailing regulations. These goals are likely to require finance transformation along multiple dimensions. Based on our experience, four areas that generally need to be considered include:

#### ***Accelerating and expanding synergy capture***

As the steward of value, the CFO has an instrumental role in the synergy process. From identifying to tracking and realizing synergies, the role of the CFO facilitates this process for the combined entity. To accelerate the synergy process, leading organizations invest in clean teams (which are legal constructs that allow buyer and sellers to review competitively sensitive information without impacting gun jumping rules) which allows the organization to identify and develop synergy plans pre close such that you can get to value quickly. On expanding synergy capture, leading CFOs set top-down targets 20-30% more than goal as the organization often finds opportunities that are greater than the initial estimates based on the investment model.

#### ***Process and technology simplification***

One of the main drivers of finance transformation during a transaction is the ability to simplify the business. M&A is one "event" that can be the catalyst associated with simplifying the business. For the finance organization, this simplification can mean rationalizing your legal entity structure, rationalizing control procedures, converting into a shared service model, and focusing on the analytics that drives value for the business. More often than not, technology is the enabler to make this a reality.

### **Compliance**

Tax and accounting compliance are major issues in getting through an issue-free Day 1. For domestic deals, the CFO will need to examine what is required to align accounting policies and make sure that consolidated GAAP reporting can be produced by first period close without disrupting the business. He/she should make sure that the combined entity is reporting various new taxes appropriately and effectively, and must be aware of any new rules given the new combined entity. CFOs must also ensure that the new auditor relationships are well maintained. In the case of cross-border transactions, CFOs should look into additional reporting and compliance requirements of the subject jurisdictions and ensure processes are in place to handle U.S. and international disclosure requirements.

### **Flawless Talent Transition**

At the end of the day, your human talent is what makes and sustains finance transformation. CFOs should look early on in assessing the talent, developing retention strategies, and setting a vision that excites the finance community in becoming a value-added partner to the business. The CFO's role in this talent transition process should not be underestimated. He/she will be involved in designing the new organization, determining if roles will change given the potential changes in the business model, recruiting and selecting the new finance management team, and being the "face" of finance to organization. This requires significant planning and a communication infrastructure to keep the finance organization informed and setting the right tone for achieving the transformed state.

### **Learning from past mistakes**

In light of what's happened in the last three years, there is increased scrutiny on M&A that is well-warranted. As C-level executives and board members, demand greater assurance of business sustainability and value from deals, CFOs have to own the entire process from exemplary due diligence to finance transformation to realize value from deals. We are seeing this skepticism and greater demand in a majority of businesses regardless of the size of the deals. For CFOs and finance organizations, this can create added challenges in terms of work, but can also provide huge opportunities to drive higher and more consistent returns from both acquisitions and divestitures.

### **Primary Contacts**

Steve Joiner  
Partner, M&A Transaction Services  
Deloitte & Touche LLP  
sjoiner@deloitte.com

Trevar Thomas  
Principal  
Deloitte Consulting LLP  
trethomas@deloitte.com

This Deloitte CFO Insights article was developed with the assistance of Dr. Ajit Kambil, Global Research Director, Deloitte CFO Program.

Deloitte's CFO Program harnesses the breadth of our capabilities to deliver forward-thinking perspectives and fresh insights to help CFOs manage the complexities of their role, drive more value in their organization, and adapt to the changing strategic shifts in the market.

For more information about Deloitte's CFO Program visit our website at [www.deloitte.com/us/cfocenter](http://www.deloitte.com/us/cfocenter).

This publication contains general information only and is based on the experiences and research of Deloitte practitioners. Deloitte is not, by means of this publication, rendering business, financial, investment, or other professional advice or services. This publication is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor. Deloitte, its affiliates, and related entities shall not be responsible for any loss sustained by any person who relies on this publication.

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee, and its network of member firms, each of which is a legally separate and independent entity. Please see [www.deloitte.com/about](http://www.deloitte.com/about) for a detailed description of the legal structure of Deloitte Touche Tohmatsu Limited and its member firms. Please see [www.deloitte.com/us/about](http://www.deloitte.com/us/about) for a detailed description of the legal structure of Deloitte LLP and its subsidiaries.

Copyright © 2010 Deloitte Development LLC. All rights reserved.  
Member of Deloitte Touche Tohmatsu Limited.