Grant Thornton

Realizing value from key aspects in the transaction lifecycle

September 21, 2010

Kevin Fraser, CA, CFA

© 2010 Grant Thornton Corporate Finance Inc. A Canadian Member of Grant Thornton International Ltd

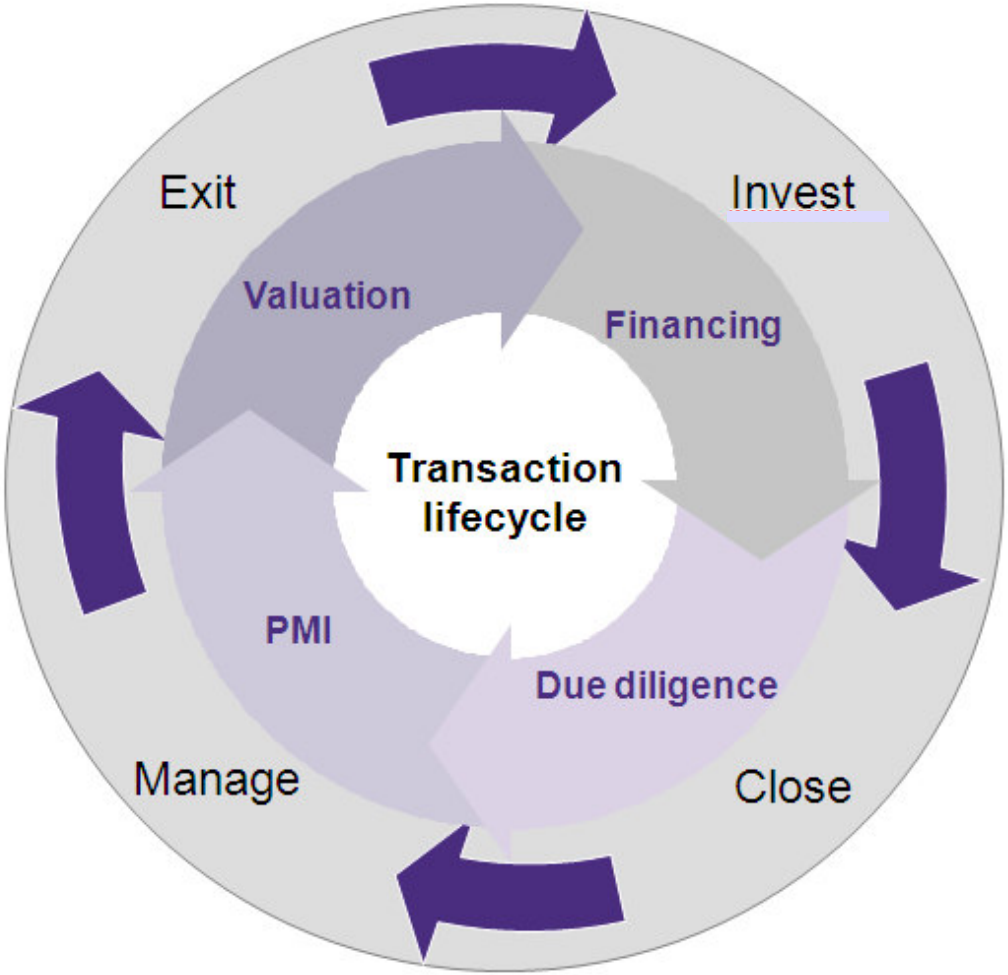
Session overview

- Introductions
- State of the market
- Financing
- Post merger integration
- Questions/discussion

© 2010 Grant Thornton Corporate Finance Inc. A Canadian Member of Grant Thornton International Ltd

Grant Thornton

Lifecycle overview



© 2010 Grant Thornton Corporate Finance Inc. A Canadian Member of Grant Thornton International Ltd

Grant Thornton

Grant Thornton

State of the market

© 2010 Grant Thornton Corporate Finance Inc. A Canadian Member of Grant Thornton International Ltd

Grant Thornton International Business Report (IBR) M&A survey

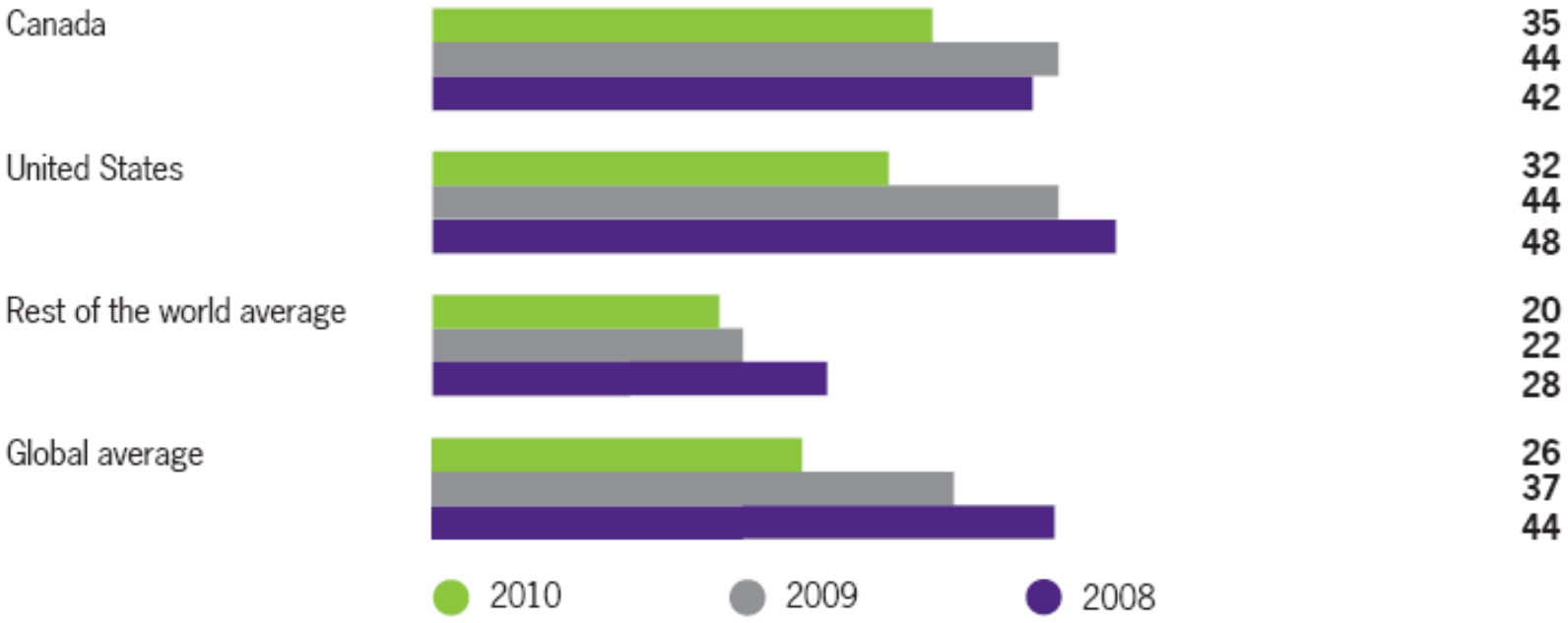
Grant Thornton IBR

- Grant Thornton IBR offers rare insight into the M&A plans and expectations of over 7,400 privately held businesses (PHBs) from 36 economies across the world.
- IBR research took place in late 2009 and asked PHBs about their deal plans.
- Insight into regional M&A activity in North America, United Kingdom, Ireland, mainland Europe, BRIC economies, rest of the world is also included.

© 2010 Grant Thornton Corporate Finance Inc. A Canadian Member of Grant Thornton International Ltd

Grant Thornton International Business Report (IBR) M&A survey

Figure 5: Plans to grow through acquisition
Percentage of businesses



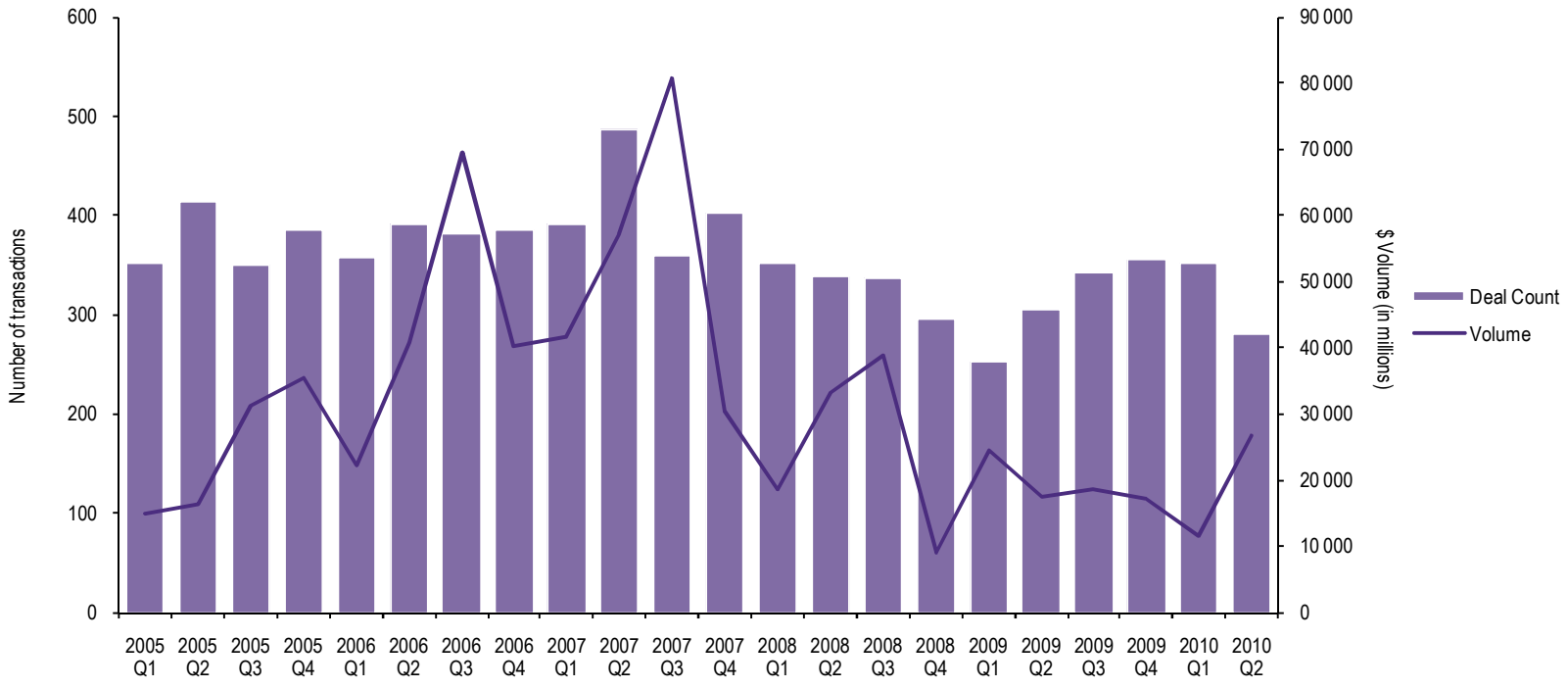
Source: Grant Thornton IBR 2010

© 2010 Grant Thornton Corporate Finance Inc. A Canadian Member of Grant Thornton International Ltd

Grant Thornton

Transaction volumes – Canada

Canadian transactions
Announced deal count and value

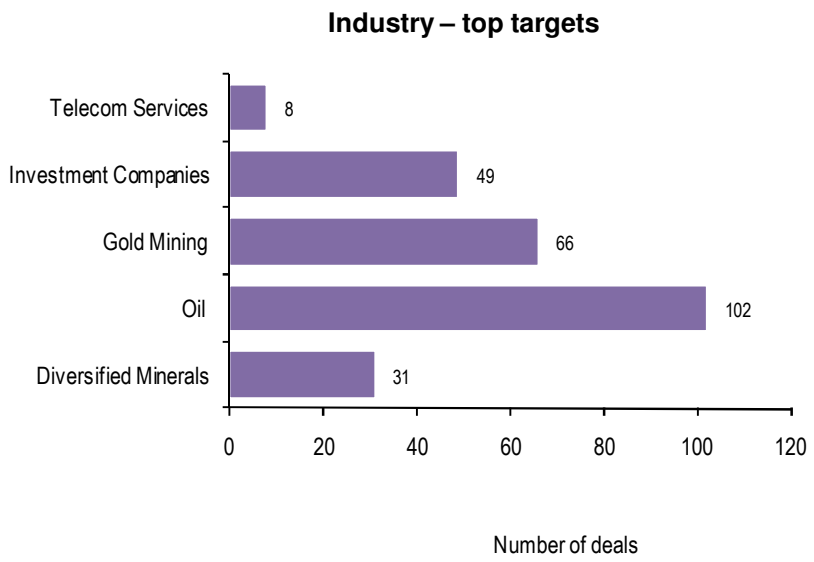


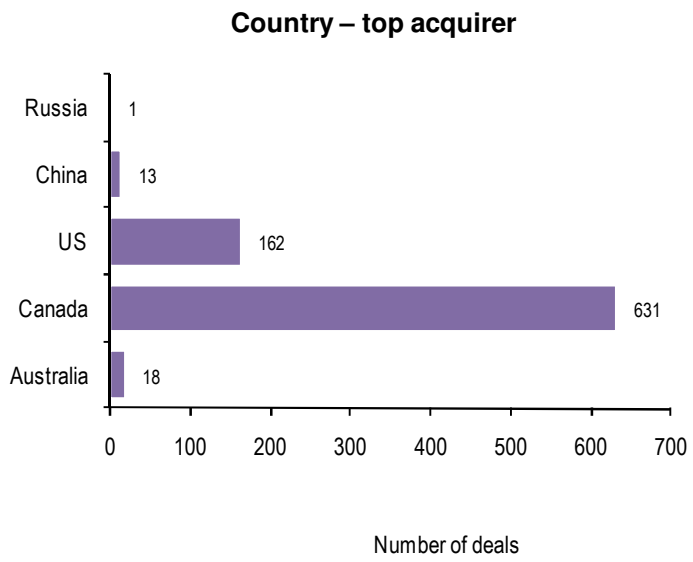
© 2010 Grant Thornton Corporate Finance Inc. A Canadian Member of Grant Thornton International Ltd

Grant Thornton

Overview – Canada YTD 2010

- Date range 1/1/2010 to 9/14/2010
- Number of deals 888
- Volume 103.03B
- Average deal size 191.86M





Sources: Bloomberg

© 2010 Grant Thornton Corporate Finance Inc. A Canadian Member of Grant Thornton International Ltd

Grant Thornton

Deal sector – North America

Notes: Completed deals
Sources: Capital IQ

© 2010 Grant Thornton Corporate Finance Inc. A Canadian Member of Grant Thornton International Ltd

Grant Thornton

Grant Thornton

How to incorporate financing into M&A

© 2010 Grant Thornton Corporate Finance Inc. A Canadian Member of Grant Thornton International Ltd

How to incorporate financing into M&A? Overview

- Today's CFO needs to evaluate M&A against both transaction specific financing and the overall financing structure

© 2010 Grant Thornton Corporate Finance Inc. A Canadian Member of Grant Thornton International Ltd

Grant Thornton

How to incorporate financing into M&A? Overview (continued)

- In this section, we will undertake the following:
  - identify the key concepts in linking financing and M&A;
  - discuss key measures that should be utilized to understand these linkages;
  - identify the key problem areas; and
  - conclude on an overall approach to incorporating financing into your M&A decisions.

© 2010 Grant Thornton Corporate Finance Inc. A Canadian Member of Grant Thornton International Ltd

How to incorporate financing into M&A?
Key concepts

Market value

- Enterprise value to EBITDA commonly used to compare pre-financing

Cost of capital

- Varies by industry due to growth and risk profile
- In volatile times the cost of capital can shift significantly through reduced leverage, as well as increasing debt and equity costs

© 2010 Grant Thornton Corporate Finance Inc. A Canadian Member of Grant Thornton International Ltd

How to incorporate financing into M&A?
Key concepts (continued)

- It is important to understand the cost of capital in your industry and amongst your competitors, as well as the trends impacting it

Cash flow projections

- Target's stand-alone operating earnings and cash flow on a forward looking basis
- Consider potential changes to the business

© 2010 Grant Thornton Corporate Finance Inc. A Canadian Member of Grant Thornton International Ltd

How to incorporate financing into M&A?
Key concepts (continued)

- Integration and transaction costs
- Realistic synergies
- Debt and equity financing costs
- Impact on acquirer's stand alone forecast

© 2010 Grant Thornton Corporate Finance Inc. A Canadian Member of Grant Thornton International Ltd

Grant Thornton

How to incorporate financing into M&A? Measures

- Levered and unlevered internal rate of return
- Economic value added or return on capital employed
- Accretion/dilution of earnings per share
- Key financial covenants

© 2010 Grant Thornton Corporate Finance Inc. A Canadian Member of Grant Thornton International Ltd

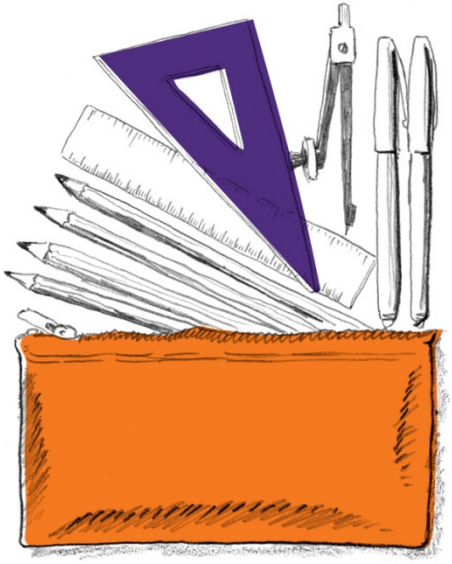
How to incorporate financing into M&A? Measures

- Using increasing leverage assumptions to justify the acquisition
- Creating additional stress on the existing financing structure as a result of the transaction
- Not anticipating a changing cost of capital in the future
- Not understanding the overall corporate financing capacity

© 2010 Grant Thornton Corporate Finance Inc. A Canadian Member of Grant Thornton International Ltd

How to incorporate financing into M&A? Measures (continued)

- Quality of projections
- Adjusting for risk
- Strategic value



© 2010 Grant Thornton Corporate Finance Inc. A Canadian Member of Grant Thornton International Ltd

Grant Thornton

How to incorporate financing into M&A? Fundamental solution

CFO must have a full understanding from all perspectives:

- Ignoring financing creates risk of overpaying for an acquisition
- CFO must understand their cost of capital and hurdle rate to push creation of shareholder value
- CFO must utilize a variety of measures to truly understand the impact of the acquisition on the company's financing.

© 2010 Grant Thornton Corporate Finance Inc. A Canadian Member of Grant Thornton International Ltd

How to incorporate financing into M&A? Fundamental solution (continued)

- CFO must understand the underlying financial projections
- understand these measures both on a stand alone basis and post synergies.
- CFO needs to understand the valuation from both a market basis (EBITDA multiples relative to comparables) and specific to their own company.
- CFO should engage lenders and investors early to ensure all financing impacts are considered.

© 2010 Grant Thornton Corporate Finance Inc. A Canadian Member of Grant Thornton International Ltd

Post merger integration

© 2010 Grant Thornton Corporate Finance Inc. A Canadian Member of Grant Thornton International Ltd

Too often, M&A transactions do not live up to the **hype**.

Top reasons for M&A failure

- Not performing adequate due diligence to uncover hidden risks and/or associated costs required to maintain or grow the business
- Failure to prioritize and focus attention on the highest value-producing areas
- Inadequate attention to retaining key employees

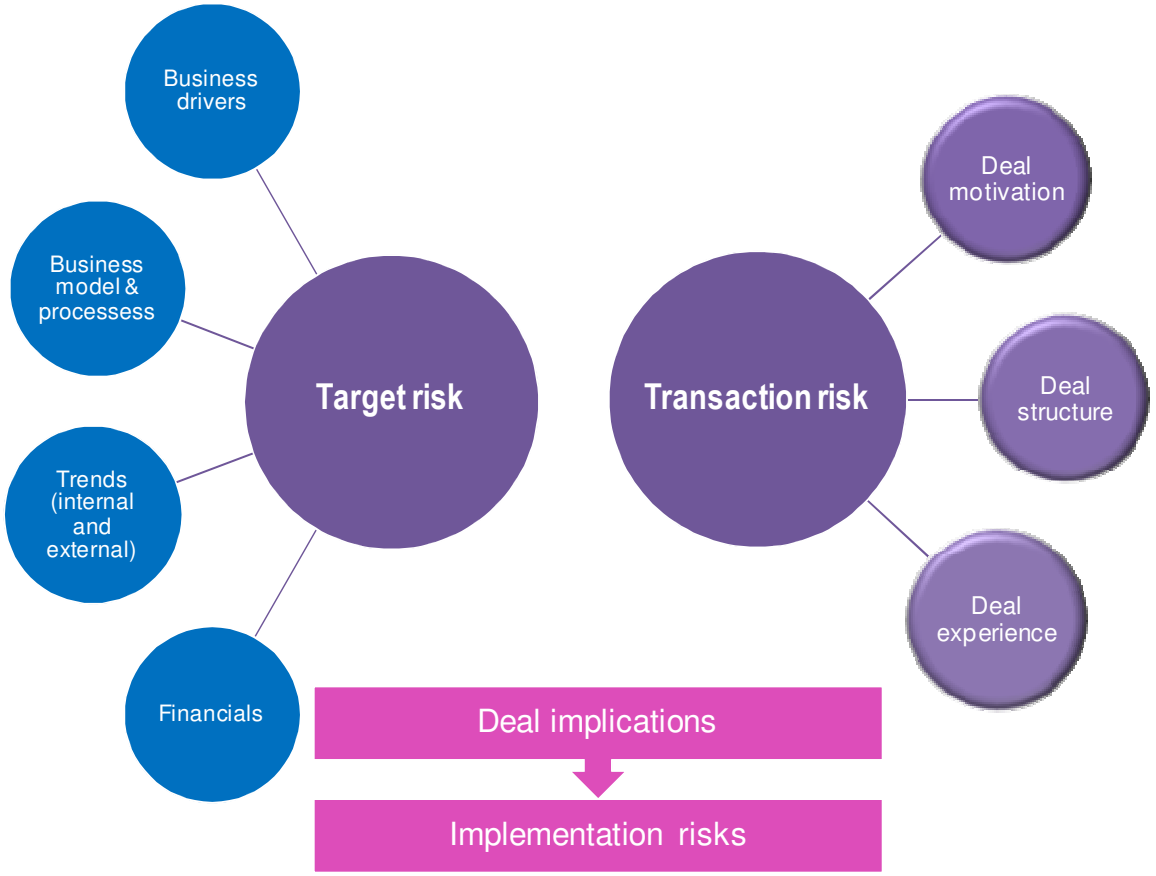
© 2010 Grant Thornton Corporate Finance Inc. A Canadian Member of Grant Thornton International Ltd

Too often, M&A transactions do not live up to the **hype.** (continued)

- Not addressing the challenges of integrating distinct cultures
- Poor communication
- Lack of up-front integration planning and poor project management over execution of integration plans/tasks

© 2010 Grant Thornton Corporate Finance Inc. A Canadian Member of Grant Thornton International Ltd

What do we need to understand?

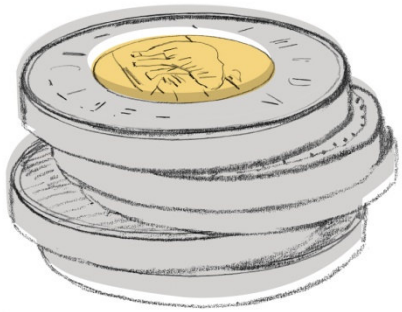


© 2010 Grant Thornton Corporate Finance Inc. A Canadian Member of Grant Thornton International Ltd

Grant Thornton

Two sides of the same coin.

The soft side of an acquisition is as critical as the hard part to extract value from what you buy



© 2010 Grant Thornton Corporate Finance Inc. A Canadian Member of Grant Thornton International Ltd

Grant Thornton

Hard side	Soft side
Integration planning • Up-front integration planning • Strong project management • Quick execution of integration plans	**Strategy and vision** • Having a clear business case for change • Establishing early on a strong leadership
Identifying synergies • Finding the hidden value • Prioritizing / realizing quickly the value	**People and culture** • Retaining key talent • Addressing the challenges of integrating distinct cultures • Managing personnel bandwidth needs
Due diligence • What are the business drivers? • Providing in depth knowledge/ mitigating risks • Establishing the standalone value	**Communications** • Communicating up, down, and across the organization, as well as outward to customers, suppliers, and other stakeholders

© 2010 Grant Thornton Corporate Finance Inc. A Canadian Member of Grant Thornton International Ltd

Business drivers

- Business drivers are at the core of our analysis and should be considered at an early stage
- They are the 2 to 4 primary features that can be used to explain the performance of a company in its market
- They are measured using Key Performance Indicators (KPI's)
- Identifying business drivers focuses due diligence on the key areas
- Need to understand them to sensitize forecasts

© 2010 Grant Thornton Corporate Finance Inc. A Canadian Member of Grant Thornton International Ltd

Financial due diligence focus areas

Deal drivers	Quality of earnings	Assets and working capital
Attributes of the target that contribute to sustainable earnings and cash flow	Attempt to identify normalized EBITDA or earnings stream	Measure true value of assets being acquired and assess working capital needs
• management team	• correction of errors	• receivables
• trade names	• timing issues	• Inventories
• customers and suppliers	• non-cash transactions	• contingent liabilities, off balance sheet financing, commitments
• geography	• non-recurring transactions	• deferred costs
• products and technology	• adjustments for past transactions (acquisitions etc)	• accounting issues
• synergies with acquirer	• tax related adjustments	• working capital volatility

© 2010 Grant Thornton Corporate Finance Inc. A Canadian Member of Grant Thornton International Ltd

Why are you doing the deal?

Typical M&A "value drivers" include:

Revenue growth

- Access to new/better technologies
- Access to new products
- Cross-selling opportunities
- Expand customer base
- Brand synergy
- Competitive synergy
- Access to improved distribution channels

Operating synergies

- Elimination of duplication
- Economies of scale in operational areas
- Best practices/ combined learning
- Product and technology rationalization
- Lower cost distribution channel
- Technology improvement
- Workforce rationalization

Asset efficiency

- Investment portfolio economies of scale
- Improved cash management techniques
- Intellectual properties
- Improved asset liability management

Cost of capital reduction

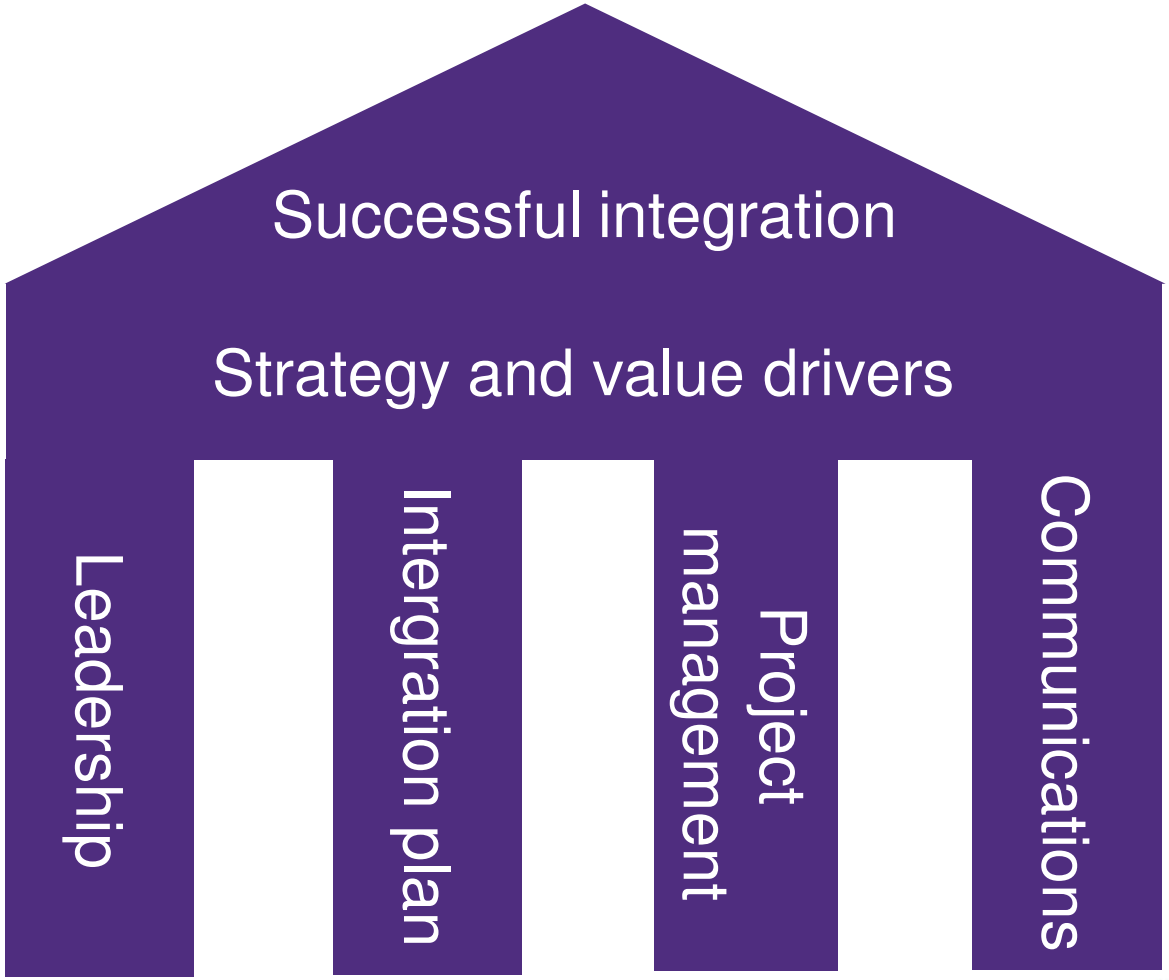
- Lower financing costs
- Less earnings volatility
- Increased diversity of insurance risk
- Increased purchasing power

Integration

© 2010 Grant Thornton Corporate Finance Inc. A Canadian Member of Grant Thornton International Ltd

Grant Thornton

KSF of a successful integration

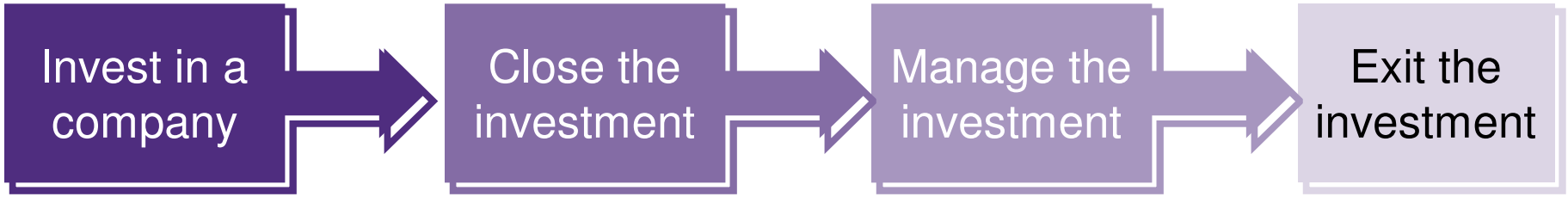


© 2010 Grant Thornton Corporate Finance Inc. A Canadian Member of Grant Thornton International Ltd

Grant Thornton

Specific activities associated with merger integration that contribute to realizing deal value if activities **begin early enough** in transaction lifecycle

M&A transaction lifecycle



1. Target evaluation
2. Synergy identification
3. Exploratory due diligence
4. Financing

5. Confirmatory due diligence
6. Synergy analysis
7. Integration planning

8. Day 1 stabilization
9. Integration plan execution

© 2010 Grant Thornton Corporate Finance Inc. A Canadian Member of Grant Thornton International Ltd

Grant Thornton

Integration planning should begin during due diligence, with consideration given to all key integration areas.

Primary integration "functional" areas

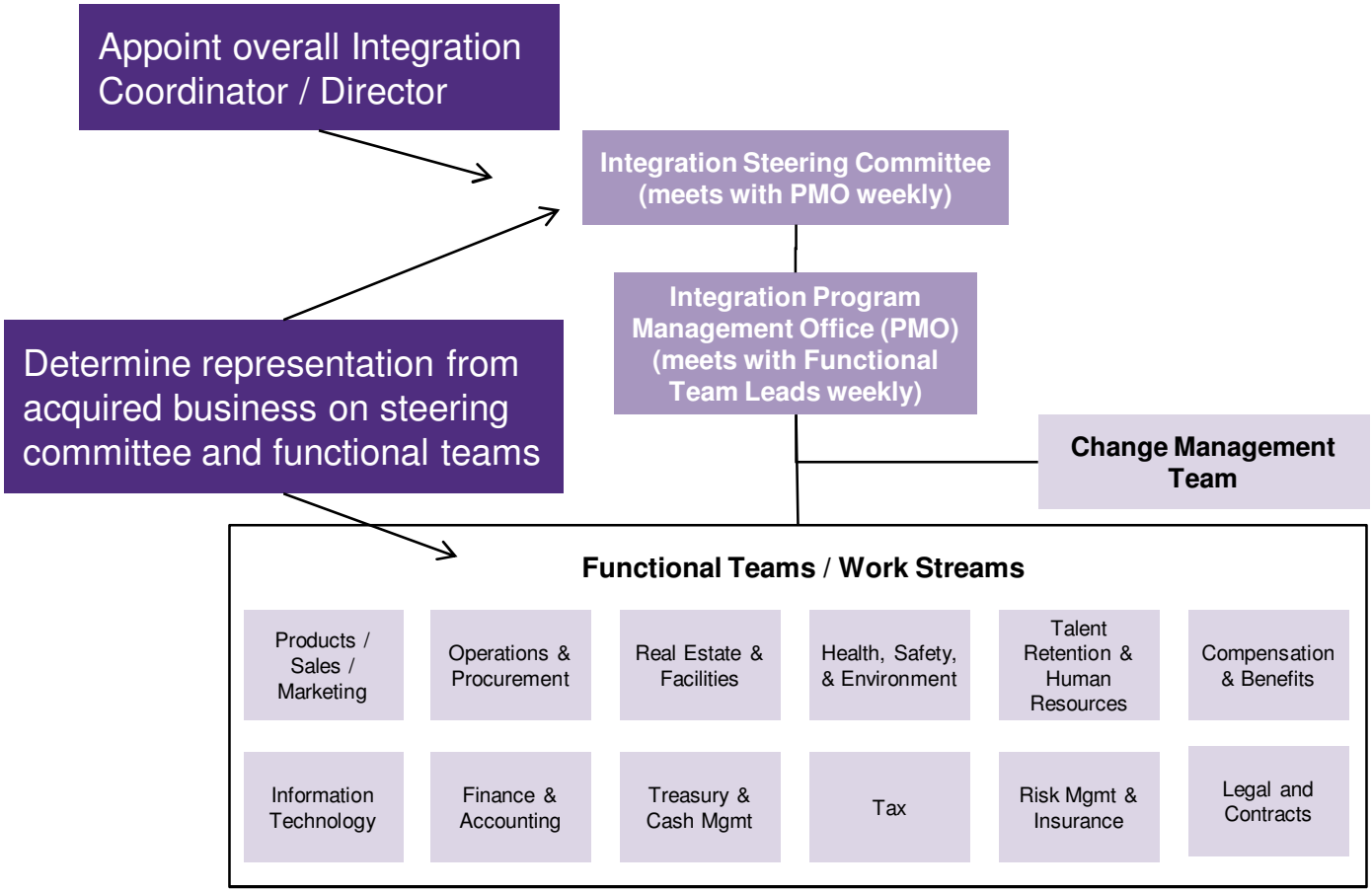
- Product/Service line
- Procurement
- Real Estate and Facilities
- Health, Safety, and Environment
- Human Resources
- Compensation and Benefits
- Finance and Accounting
- Treasury and Cash Management
- Tax
- Legal

Key planning activities

- Identify potential integration challenges and develop mitigation strategies
- Identify critical path activities and deliverables
- Identify individual work streams for each area
- Customize Day 1 checklists for each area
- Develop project plans and timelines
- Identify all resource needs and constraints
- Set measures and milestones to track progress
- Ensure communication plans are in place

© 2010 Grant Thornton Corporate Finance Inc. A Canadian Member of Grant Thornton International Ltd

A well-defined **team structure** with dedicated and experienced resources must be in place prior to integration



© 2010 Grant Thornton Corporate Finance Inc. A Canadian Member of Grant Thornton International Ltd

Grant Thornton

Prepare communication strategy and communication plan

- Communicate the business case (Why? What's in it for me?)
- Develop a formal communication plan before Day 1
- Align external and internal communications
- Ensure consistent communication based on facts and figures and up to date to avoid the rumour mills

© 2010 Grant Thornton Corporate Finance Inc. A Canadian Member of Grant Thornton International Ltd

Prepare communication strategy and communication plan (continued)

- Diversify communication means. Create opportunities for Q&A sessions and feedback/lunch & learn sessions
- Communicate good as well as bad news – be realistic
- Continue communication process long after the "first 90 days"

© 2010 Grant Thornton Corporate Finance Inc. A Canadian Member of Grant Thornton International Ltd

The **integration timeline** should establish key milestones for each work stream in the integration process

Theme	No. code	Activity	Description	Responsible	Liaise	How to deliver	Prio.	Initiated	Deadline	Status	Comments
MG	2.1	Key people to Purchaser location	Manufacturing focus (include CFO)	KM	JWP	Schedule visit and follow	M	6-Nov-09	30-Jun-10	Complete	ON HOLD - Arrange with John at Purchaser (Joe now busy converting to new product lines). **This item is considered UNNESCESSARY and will be considered complete**
BA	2.2	Establish Monthly Report	Use template	RB	KM	Submit report	M		12-Feb-10	Complete	Data from Hyperion system, must begin in 2010. Need a budget for 2010 by month. RB had promised to deliver budget by end of 2009, postponed until mid Feb. 2010. First President's Report in March
CF	4	Target's cash needs in 2009 and 2010.	Establish credit facility at Purchaser	RB	AQC	Submit budget to CFO of Purchaser	H	6-Nov-09	12-Feb-10	Complete	Cash level at end December higher than expected. RB satisfied that cash-flow to-date is also strong. $5 Mil. Approved line w/Treas., CFO still to sign. Discussed at March board meeting, CFO promised to deliver.
	7.3	Is ERP system integrated with banks?	Investigate	RB	KM	Inform Parent Company CFO	L		15-Jun-10		Call Lasse if need help with this. Look at when implement new ERP
	10	Follow-up on Parent Co. Policies to ensure understanding		LRo	RB	Meeting and report	L		22-Mar-10	Complete	All policy manuals received. Will discuss at Board Meeting to ensure understanding. **Policy understanding will be a topic of board meetings ongoing.**
CA	6	Review agreements/contracts	Supplier, lease, etc.	RB	KM	Report	M	6-Nov-09	30-Jun-10	Complete	Agenda item for June Board Meeting
	11	First Escrow payment day (2.5 MCdn if no claims have been asserted) JeD/NiG/Lasse		AQC	RB	Execute payment	L		31-Jul-10		
	12	End of general warranty period		RB		Date	M		30-Apr-11		
	13	Establish Tax value of fixed assets as of closing (shall be no less than 7.4 MCdn)		RB	AQC	Year-end Inventory - report	H		15-Apr-10	Complete	Discuss w/AQC 12/15/09. Between RB and Target auditor to assure fair value of May '09
	14	Move place of incorporation from Ontario to Alberta		NIG	KM	Document change	M		3/12/2010 **5/31/2010**	In progress	Must appoint a Canadian resident board member to meet 25% reqt. Alberta will save money. **Potential board member will be interviewed in April.**
added	23	Audited accounts to be submitted	To be submitted to Purchaser	RB	AQC		H	16-Dec-09	2/22/2010 3/15/2010	Incomplete	No information provided thus far.

LEGEND:	H =	By end of 2009	**BLUE TEXT - Added since last update**		Completed
	M =	By end March 2010			In progress
	L =	By end of 2010			In danger

© 2010 Grant Thornton Corporate Finance Inc. A Canadian Member of Grant Thornton International Ltd

Grant Thornton

Grant Thornton

Questions/discussion

© 2010 Grant Thornton Corporate Finance Inc. A Canadian Member of Grant Thornton International Ltd