fs viewpoint

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June 2012

Deal or no deal: Methods, processes, and models for the new M&A environment

pwc

Point of view

PwC research and experience indicate that deal risk is a function of how well questions such as those listed here are addressed.

Strategy

What is the deal trying to achieve relative to the company's strategy?

How is the deal aligned with the company's business model?

Is the transaction a defensive or offensive opportunity?

What is the risk of doing or not doing the deal to our business—both near-term and long-term?

Is the deal's price relatively high or low? Does it provide a reasonable "margin of safety"?

What synergies are required to justify the price offered? How will these synergies be achieved?

Tactical

What integration issues might arise based on the capabilities of the organization and the required steps to execute and achieve deal value?

What is the target operating model for the combined organization? How is it going to be achieved (for example, will "best of breed" complete absorption of target)?

What items impacting the integration strategy have been referred for due diligence?

What cultural impediments exist both in the target and within our own organization that threaten a successful integration and can adversely impact value creation?

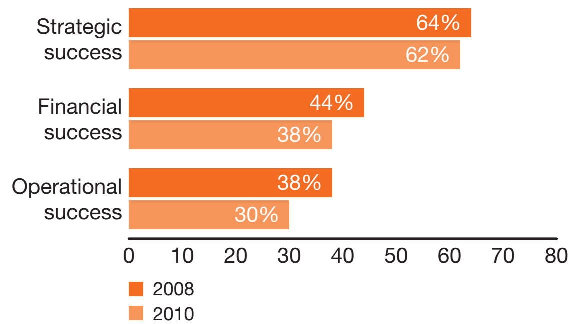
Firms interested in how to proactively address these questions are encouraged to read more.

There has been a decline in the rate of self-reported success in deals from 2008 to 2010.

Fewer deal makers today say they are meeting deal goals—regardless of whether those goals are strategic, financial, or operational (see chart).

Those who reported achieving significant operational success were among those most likely to also report a similar level of financial success. This suggests a relationship between the achievement of operating goals and a deal's overall financial success.[1]

Percentage reporting significant strategic, financial, or operational deal success



Source: PwC M&A Integration Survey Report, June 2011, in which 12% of survey respondents were financial services institutions.

Common reasons cited for deal failures include the following:

Buoyant 20-30-year capital markets gave the impression institutions could simply grow their way out of failed deals.

Since bad deals seem to affect many institutions, their costs came to be viewed as just another cost of doing business.

Executives simply have no apparent way of knowing, before the fact, whether a deal is at risk of failure or not.

Studies indicate that anywhere from 65% to 85% of mergers fail to create the value expected at the time the deals are announced.[2]

1 Do the right things. Get the right results. Findings from PwC's 2011 M&A Integration Survey, June 2011, p. 6.

2 L.J. Bourgeois, Lipi Patel, "Note on Post-merger Integration," *Harvard Business Review*, February 19, 2009.

Economic risk is currently very high, and this environment will likely not allow acquiring firms to grow their way out of bad deals.

The current economic environment, both in the United States and abroad, continues to prove challenging.

In his press conference on January 25, 2012, Federal Reserve Chairman Ben Bernanke remarked, "Incoming information suggests that the economy has been expanding moderately, notwithstanding some slowing in global growth. The Committee expects the pace of economic growth to be… moderate over coming quarters, reflecting ongoing drags from the housing sector and still-tight credit conditions for many households and smaller businesses. Specifically, participants' projections for the growth rate of real gross domestic product in 2012 have a central tendency of 2.2 to 2.7 percent. Strains in global financial markets continue to pose significant downside risks to that outlook."[1] (See chart.)

"For advanced economies, the International Monetary Fund estimates growth of only 1.9 percent in 2012 compared with a historical average of about 3 percent."[2]

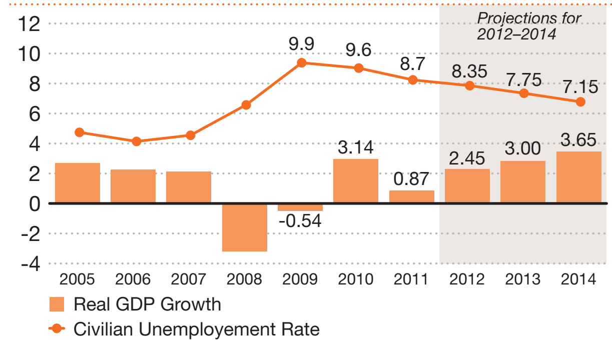
"The European sovereign debt crisis has worsened the economic growth problem. And the uncertainty over how far the crisis will spread in Europe is bound to drive down takeover volume."[3]

1 Ben Bernanke, Federal Open Market Committee Press Conference, January 25, 2012, accessed February 9, 2012, www.federalreserve.gov.

2 Steven M. Davidoff, "As the Economy Goes, So Go Takeovers, Even Though Bargains Abound," *The New York Times*, October 19, 2011.

3 Ibid.

Federal Open Market Committee (FOMC) projections for real GDP growth and civilian unemployment rate

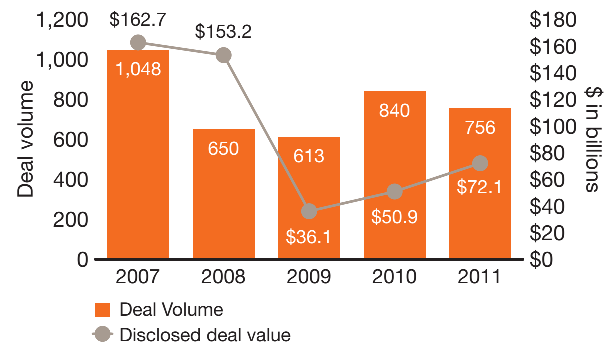


Note: *Unemployment rate and GDP projections are central tendencies (mean).*
Sources: *Federal Reserve Board and Haver Analytics.*

The environment driving consolidation in banking, insurance, and asset management over the past few years will continue to impact profitability and drive the need for scale.

Although total announced financial services M&A deal values increased from $50.9 billion in 2010 to $72.1 billion in 2011, the market remained significantly below the $153.2 billion of disclosed deal values seen when the financial crisis began in 2008 (see chart).

Announced US financial services deal activity



Source: *PwC's 2012 US Financial Services M&A Insights Report. March 2012.*

Looking forward, consolidation could be driven in part by the following[1]:

Banking and capital markets:

- Need to improve capital strength.
- Exit highly regulated products and/or markets.
- Garner efficiencies of scale to address significant regulatory oversight costs.
- Significant commoditization of consumer banking products and services.
- Expansion in new markets/geographies.
- Historically low valuations.
- Diversification of earning streams across synergistic products (such as expanding the share of wallet).

Insurance:

- Pressure on underwriting and investment income.
- Persistent soft market and industry-wide excess capacity.
- Regulatory change.
- Expanding product breadth.
- Broadening reach via multiple channels.
- Looking for scale.
- Access to different customer segments.
- Creating a counter-cyclical asset base.

Asset management:

- A general quest for scale.
- Access to research and investment teams and existing product line-ups:
  - Absolute return offerings.
  - Exchange traded fund (ETF) offerings.
  - Liability-driven offerings.
  - Non-domestic offerings (tracking ex-US growth prospects).
  - Guaranteed income offerings (to capitalize on the burgeoning retirement demographic).
- New and/or broader distribution capabilities.
- Offset continued high costs associated with execution of fiduciary and regulatory responsibilities.

1 PwC's 2012 US Financial Services M&A Insights Report. March 2012.

Traditional valuation approaches are discounted cash flow, comparables, and multiples, which are used by virtually all acquirers and sellers.

In our view, the widespread use of traditional valuation approaches facilitate cyclical M&A activity in that these methods often support increasing prices on the way up and then cause acquirers to pull back on the way down.

Graham and Dodd valuation offers an alternative, often contrarian view of value that could be leveraged by both buyers and sellers in all deal environments.

An elite group of professional investors focuses on activity contrary to current market expectations, and use Graham and Dodd valuation to inform their investment activities.

Despite the success of many of these investors, Graham and Dodd valuation has not yet had an impact on corporate M&A, thereby providing an opportunity for early adopters in the current market environment.

	Buyers:	Sellers
Bull markets	The bottom-up orientation of Graham and Dodd valuation can be used to mitigate pricing risk in bull markets.	The alternative view of value provided by Graham and Dodd can help inform the selection of which business(es) should possibly be sold and at what price level(s).
Bear markets	In bear markets, Graham and Dodd valuation can be used to locate deals offered at reasonable discounts from estimated value. Note: Many times, value-creating deals can be found at premiums to the market price. Examples include the successful acquisition of GEICO, which is profiled on the next page.	The approach can be leveraged to identify potential acquirers based on fundamental, as opposed to purely relative, considerations.

The modern Graham and Dodd approach assesses value across a unique continuum that offers an alternative view of value from the more traditional valuation approaches.

Each level of the Graham and Dodd value continuum is profiled below, and then illustrated by way of example in the right-hand panel, which is a graphical depiction of GEICO's value prior to its 1995 acquisition, based on a popular case study.

Net Asset Value (NAV): reproduction-based, line-by-line valuation of the balance sheet

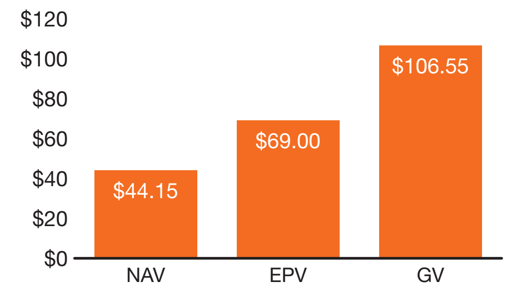
Earnings Power Value (EPV): based on a level of historical earnings that should be sustainable into perpetuity

Franchise Value: based on sustainable competitive advantage considerations and calculated as the difference between EPV and NPV

Growth Value (GV): least tangible level of value, but one based on current values

All assumptions are explicit and transparent in each level of value, which facilitates risk management analyses, due diligence efforts, post-deal integration, and value realization.

GEICO was acquired in 1995 at a price of approximately $70/share, which represented a premium of nearly 26% over the market price at the time. To put this into perspective, a 26% market premium equates to a PE of 21. To reach this level of PE at the end of 2011, a price premium of nearly 50% would be required.



Source: *Joseph Calandro, Jr., Applied Value Investing (NY: McGraw-Hill, 2009), p. 56*

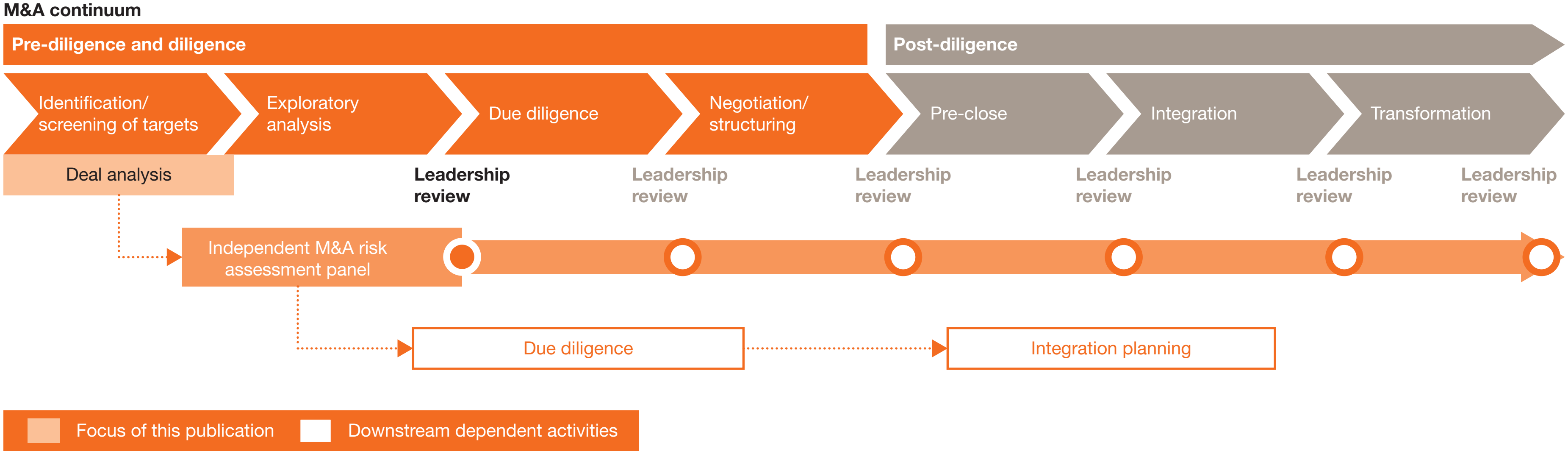
Graham and Dodd valuation is widely applicable and can also be used to value carve outs, large-scale projects, capital-intensive organic growth strategies, buyback initiatives, turnaround opportunities, and responses to activist investors.

The success of a deal is dependent upon effective delivery along the entire M&A deal continuum. Failure at any stage of this continuum can cause negative downstream effects.

M&A continuum

This Viewpoint presents a unique approach for assessing M&A risk focusing on the early stages of a deal. However, the approach can be leveraged across the full deal continuum, as illustrated below. It can also be used to assess the "lessons learned" in past deals that were won, lost, and that failed. Such retrospective analyses could be invaluable in formulating strategies and processes for future deals.

M&A continuum

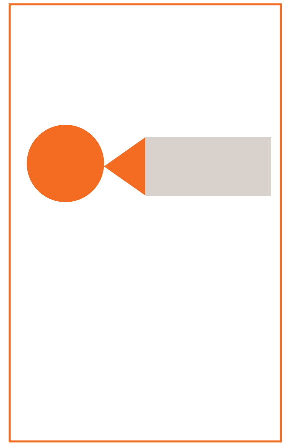


The type of transaction being considered establishes the risk profile of subsequent deal activity. Therefore, transaction types should be defined at the front end of the deal continuum, rather than during pre-integration.

Consolidation

Calls for rapid and efficient conversion of one entity to the superior strategy, structure, processes, and systems of the other

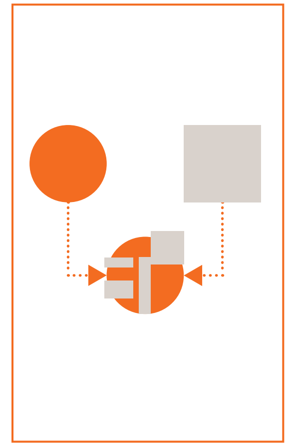
Transfer the operations of the target to the acquirer, and maintain the acquirer's back-office functions



Combination

Entails synthesizing disparate organizational and technological pieces into a new whole

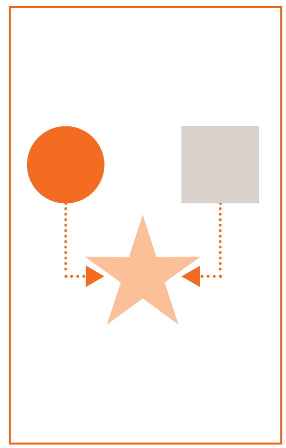
Integrate internal channel capabilities to one site with "best of breed" functionality from both merged entities



Transformation

Means replacing both entities' processes, structures, and systems with a new operating model

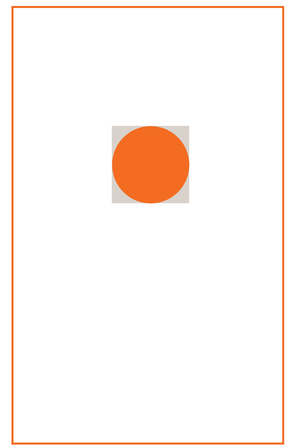
Merge sales forces from multiple subsidiaries. Combine product offerings, create new territories, and establish a new compensation structure



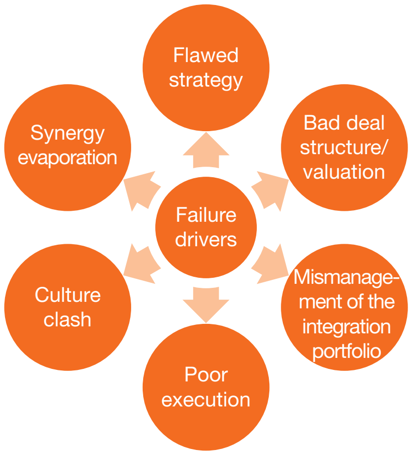
Preservation

Allows individual companies or business units to retain their unique capabilities and cultures

The acquirer and target organizations remain largely unchanged, with the exception of a streamlined enterprise and improved communication



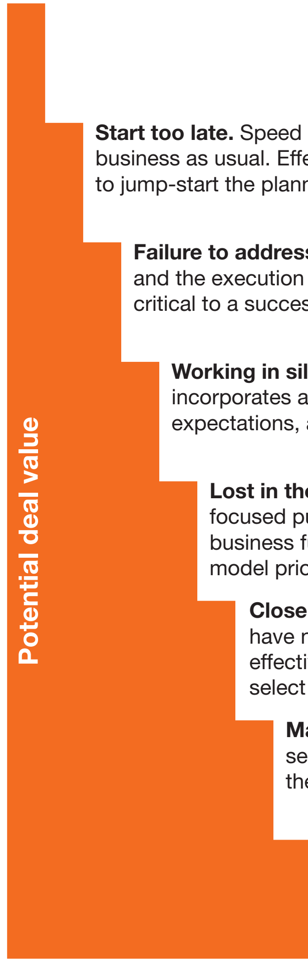
Mergers and acquisitions fail for many reasons. Pre-deal, acquirers can proactively mitigate deal risk by understanding the most common drivers of M&A failure.



Failure drivers	How failure can occur
Flawed strategy	• Misunderstood or incompatible business models • Faulty assumptions about the ability to achieve a transformational integration (such as a strategically inconsistent adjacency move)
Bad deal structure/valuation	• Overly aggressive/optimistic valuation assumptions • Poorly executed financial analysis and/or due diligence • Not adequately understanding the operational infrastructure and associated capabilities
Mismanagement of the integration portfolio	• Lack of an effective merger integration program team and an overall planning and governance process • Failure to instill key indicators to monitor the progress of an integration and to assess performance • Lack of an ongoing effective decision-making process governing integration
Poor execution	• Lack of infrastructure dedicated to value realization activities (such as strategy-focused performance measurement) • Poor cross-team collaboration
Culture clash	• Inability to bridge the gap between differing priorities and personalities • Ignoring or discounting cultural differences as part of the overall integration
Synergy evaporation	• Efforts to consolidate systems or processes is more complicated than anticipated

Post-deal, issues often materialize during integration. Mitigating the risk of such issues should occur at the front end of the deal continuum.

Execution issues tend to be additive and thus can increase the risks of a suboptimal deal



Start too late. Speed is critical to executing a transaction, integrating, and transitioning back to business as usual. Effective acquirers engage functional leaders early in the due diligence process to jump-start the planning process.

Failure to address soft issues. Poorly run integrations typically focus only on tactical development and the execution of work plans. Cultural, communication, and governance components are also critical to a successful integration.

Working in silos. Effective acquirers develop a single integration strategy that incorporates all functional areas. This helps ensure consistency of delivery, level-sets expectations, and provides complete visibility across the enterprise.

Lost in the details. Many organizations view integration as a tactical project, focused purely on work-plan development and execution to integrate all business functions. Proper time should be spent rethinking the business model prior to executing an integration plan.

Close-minded ("We are the best at what we do"). Effective acquirers have no pride of ownership. When integrating large-scale mergers, effective acquirers take time to understand the target and collaboratively select the best people, processes, and technology to support the new business.

Market awareness at the lower levels. For public companies, the market generally expects to see value in two quarters after an acquisition. By educating and holding the integration team to these timelines, an integration is much more likely to achieve the expected value.

Delayed decision-making. Leadership needs to be actively involved in the integration. Early in the process, regular involvement is critical to making decisions that will guide the overall planning and execution of the integration.

Value can be diminished through the impact of multiple factors. While acquirers focus their efforts on addressing the most prevalent issues, they sometimes lose focus of others.

An independent and objective M&A risk assessment panel should be given a charter to raise questions that challenge the logic of a deal in a fact-based manner.

Proprietary forms of alternative M&A risk analyses

A single target or a short list of targets can be assessed strategically against the M&A failure drivers identified in PwC research.

Pricing risk can be assessed using Graham and Dodd valuation, which is a proven method of investment analysis.

Execution risk can then be assessed against common integration risks identified in PwC research.

The results of these analyses are then profiled, discussed, and debated in an M&A risk assessment panel.

What is an independent M&A risk assessment panel?

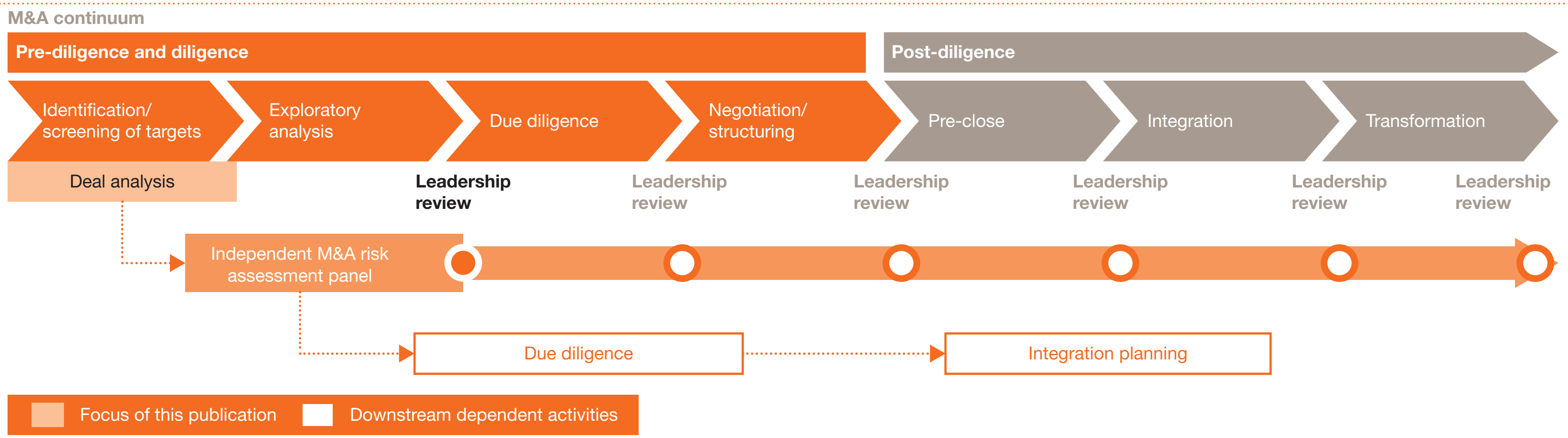
An independent and objective panel is given a charter to raise questions that challenge the logic of a deal in a fact-based manner.

There is a process by which preliminary recommendations and open questions from a target/deal analysis are formally reviewed and discussed without prejudice or bias.

The panel is driven by the realization that benefits accrue to those who think deeply and contrarily into the fundamental specifics of a deal, and plan accordingly.

Organizations can leverage independent panels throughout all phases of the M&A continuum.

Questions identified by the panel can help inform due diligence and integration planning activities



An independent risk assessment panel's benefit is not limited to M&A. Panels can be used across a broad array of strategic initiatives (such as carve outs, large-scale projects, capital-intensive organic growth strategies, buyback initiatives, turnaround opportunities, and responses to activist investors).

Competitive intelligence

Our observations of industry practices.

M&A risk can be significant, even in the best of times for some of the best run firms as the sample reflects.

M&A screening, valuation, integration, and value realization

	Financial institution A Deal outcome: Failure	Financial institution B Deal outcome: Successful	Financial institution C Deal outcome: Failure	Financial institution D Deal outcome: Failure
Independent risk assessment panels can be leveraged across the spectrum of deal assessment activities including: screening, valuation, and value realization.	**Pricing**: At tens of billions of dollars, this deal was priced very aggressively. **Due diligence**: The acquirer did not uncover/heed/understand warnings about predatory lending practices of acquired unit. **Integration**: The acquirer's integration efforts failed; as a result, the acquirer was forced to close newly acquired overseas unit. **Result**: Significant losses arose out of the subprime mortgage market and its subsequent lawsuits.	**Pricing**: Similar to the acquisition of Financial Institution A, this deal was priced at tens of billions of dollars, but in contrast to that deal this deal was priced reasonably. **Due diligence**: Successfully confirmed the strategic logic of the deal as a merger of financial institutions with complementary strengths. **Integration**: The acquirer achieved its strategic and financial goals, and expanded its geographic and product scope. **Result**: There was increasing EPS in the years following the merger.	**Pricing**: This was a distressed deal, but its pricing was nevertheless very aggressive, especially with respect to the target's risk profile. **Due diligence**: The target's significant embedded risks were not identified prior to deal closure. **Integration**: The deal was partially successful as the acquirer achieved some of its strategic goals, realized some synergies from cost reductions, and eliminated some redundancies. **Result**: Significant losses arose out of the subprime mortgage market and its subsequent lawsuits.	**Pricing**: Aggressive pricing was based on expected synergies. **Due diligence**: Significant synergy risks were neither assessed nor rationalized during due diligence. **Integration/value realization**: The expected synergies, particularly in cost savings, did not materialize. There were a number of reasons for this, but the most prominent one was culture clash. **Result**: The merged firm had to sell off many assets that it acquired as part of the deal. It eventually had to be acquired by a rival.
	M&A failure drivers: Flawed strategy, bad deal structure/ valuation	M&A failure drivers: N/A	M&A failure drivers: Flawed strategy, bad deal structure/ valuation	M&A failure driver: Synergy evaporation

Leading On Par Lagging

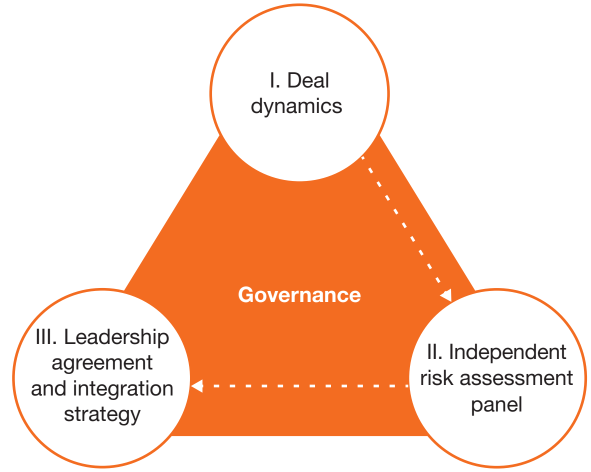
A framework for response

Our recommended approach to the issue.

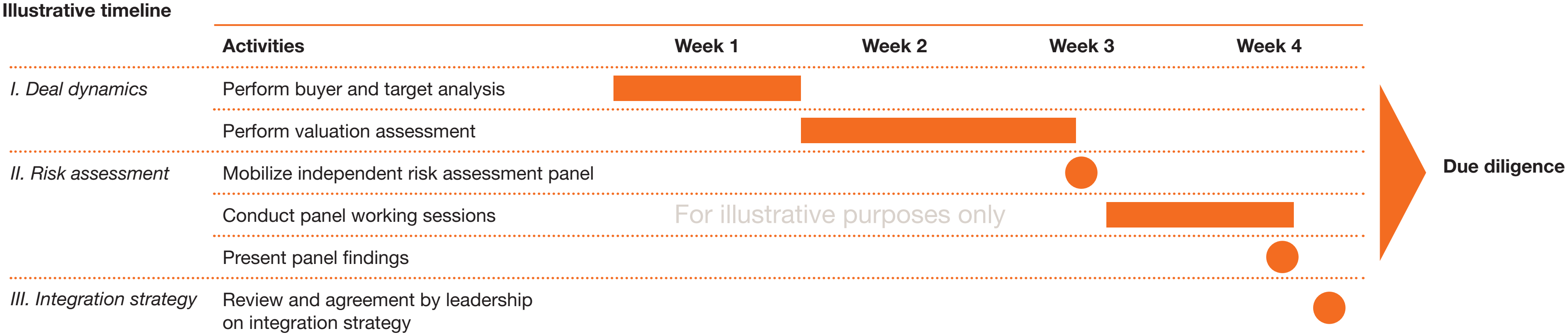
A rigorous independent assessment is an economical way to mitigate M&A risk.

The expected value of an acquisition can be significantly reduced by embedded risks and failure drivers that result in costly integration and/or value destruction.

A key benefit of an independent risk assessment review panel is that it leverages alternative points of view to rigorously question the logic of a deal. Answers to the questions often serve as important inputs into due diligence, integration, and value realization activities.



Illustrative timeline

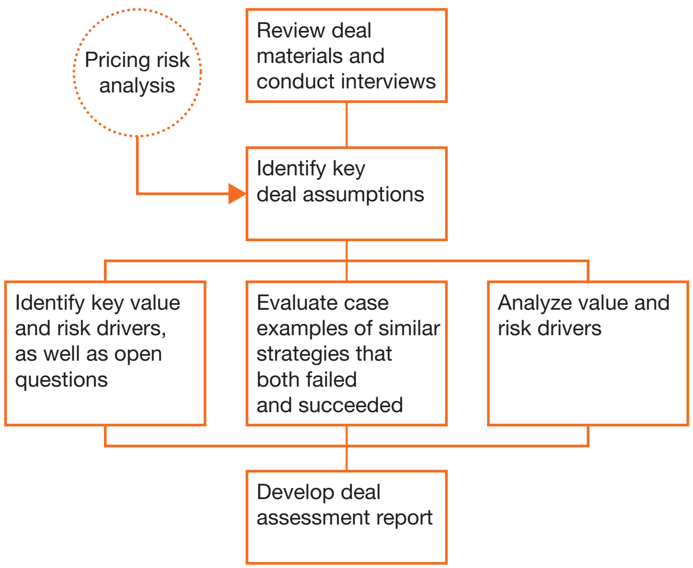


The above timeline is representative; our approach can be modified from two-to-four weeks, depending on a deal's timeline requirements.

I. Deal dynamics
Independent deal analysis sets the stage for a robust risk assessment panel.

The first phase focuses on assessing the background and strategic logic of a deal, including failure driver analysis. Graham and Dodd analysis is used to assess pricing risk (which is frequently the most common deal risk).

Key assumptions and questions from this phase are used to assess deal design and will serve as the foundation for the risk assessment panel.



Questions to consider:

What opportunities and threats are being signaled by the market? For example, are there other likely suitors or competitive threats (such as, anti-trust implications)?

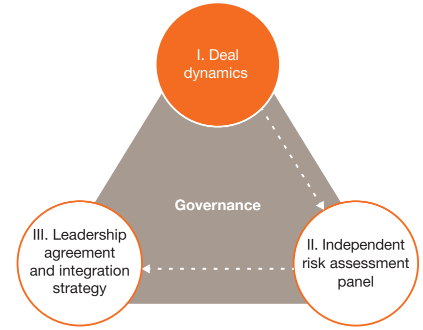
How does this deal align to opportunities and threats?

Who are the internal and external stakeholders of this deal, and how are they engaged? This could include political, economic, and environmental outlooks, especially in non-US deals.

What critical assumptions must hold true in order for the deal to succeed?

What are case examples of similar strategies that have succeeded and failed?

What is the strategic and pricing risk of the target?



I. Deal dynamics

Overview: Pricing risk and the Graham and Dodd process.

Each step of the Graham and Dodd process can be incorporated in a risk assessment review. For example, from a screening perspective, potential targets outside of routine deal flow can be identified to question the selection of a target.

Graham and Dodd strengths

- Begins with explicit balance sheet analysis.
- Earnings power is more conservative than DCF-based valuations.
- It is often the case that a firm's earnings power value will reconcile with its net asset value as most firms do not operate with a sustainable competitive advantage providing a useful pricing check and balance.
- It is a proven investment methodology.

Screening
Analyze both quantitative, such as low market-to-book and price-to-earnings ratios, and qualitative factors, such asfranchise-based research and special circumstances.

Initial valuation
Perform "first cut" review. "First cut" means that significant valuation assumptions have not yet been validated by experts.

Net asset value (balance sheet) adjustments
Obtain expert input (i.e., appraisers, auditors, and consultants) on select balance sheet line items and apply accordingly.

Earnings power value (income/cash flow statements) analysis
Conduct inquiries with management on investigative and earnings-based items.

Franchise value (strategic) analysis
Conduct inquiries based on competitive advantage assumptions with executive management.

Growth value analysis
Identify consistent, strategic themes that can support growth initiatives.

Final valuation

Source: Joseph Calandro, Jr., *Applied Value Investing* (New York: McGraw-Hill, 2009), p. 203.

I. Deal dynamics

The independent risk assessment review process is focused on assessing total deal risk: from pre-deal assessment to due diligence, integration, and value realization.

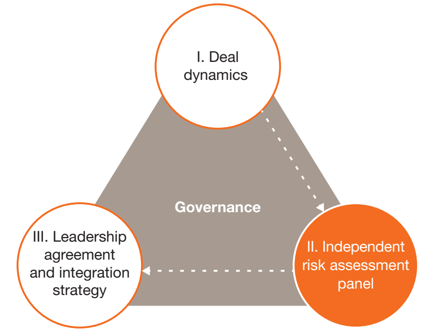
By performing each step of the deal dynamics analysis, team members will develop a set of assumptions and questions to be addressed in Phase II as part of the risk assessment panel.

Potential questions and assumptions that may arise in this phase:

- Is the deal "at risk" based on one or more M&A failure drivers? If so, what alternatives exist to mitigate the risk?
- Does the deal price seem to offer a reasonable "margin of safety" or discount from estimated value?
- Are certain key deal/pricing assumptions candidates for due diligence?
- Have potential integration risks been identified? If so, do any accelerators or solutions exist to mitigate and manage the risk over time?

Key phase I outputs

- Pricing risk analysis
- Preliminary assessment of strategic failure patterns
- Preliminary integration risk analysis
- List of open assumptions and questions
- Risk assessment panel approach (charter, panel participants, objectives, etc.)



II. Independent risk assessment panel

An independent M&A risk assessment panel provides a structured and objective forum for assessing a deal.

The second phase includes an independent risk assessment panel in which panel members challenge deal team members with the aid of role-playing exercises. Such exercises facilitate strategic discussion that segues into more tactical pre-due diligence, due diligence, integration, and value realization discussions.

The independent nature of the panel facilitates rigorous debate because executives within a firm could have a vested interest in a deal or may not want to argue against one too strongly for career reasons.

Timing: approximately 1–2 weeks

Structure the risk assessment review panel

Structure should be guided by findings of Stage I: Deal Dynamics.

- Identify independent panel moderator who will coordinate review activities
- Identify 1-to-2 independent industry or subject matter experts to participate on the panel
- Determine if 1-to-2 internal experts (i.e., employees of the acquirer) should participate on the panel
- Prepare a scoping document of review protocols
- Document roles and responsibilities

Convene the panel and agree on the panel operating model

All efforts should be made to conduct the kickoff meeting with leadership and panel members appearing in person.

- Conduct kickoff meeting with leadership and panel participants
- Confirm understanding of roles, responsibilities, objectives, timing, and deliverables

Conduct panel review sessions

Duration and frequency will be determined by the specific characteristics of each deal.

- Assess the impact of risk drivers on the deal design
- Quantify potential value gaps
- Agree on opportunities and threats
- Recommend areas to mitigate deal risk
- Review integration requirements and firm capabilities
- Document open questions and potential tripwires for due diligence, integration, and value realization

Synthesize panel findings

Firms may decide to include communication coaches in their sessions.

- Create executive summary including panel's discussions and recommendations
- Synthesize detailed session notes including all supporting and challenging points
- Capture all assumptions and remaining open questions

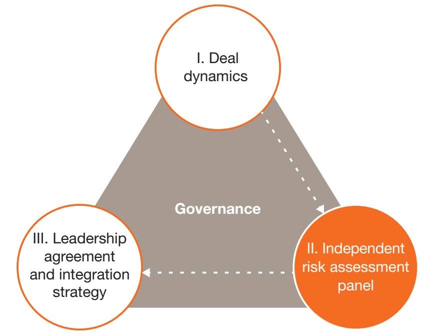
Leadership review questions:

- Does leadership accept the potential tripwires—the key assumptions that, if incorrect, might dramatically affect the success or failure of the overall strategy or the individual deal?
- Is leadership aligned on potential risks and corresponding risk mitigation measures and alternatives?
- Does leadership understand the path required to reaching its desired end state? For example: key integration activities, potential internal resource skill gaps, risks the integration may have to the core business, etc.
- Is the integration team prepared to deliver the deal's expected value during the expected timeframe?

II. Independent risk assessment panel

The independent risk assessment panel will compare the deal against the characteristics of M&A failure drivers to identify whether any of those characteristics are present.

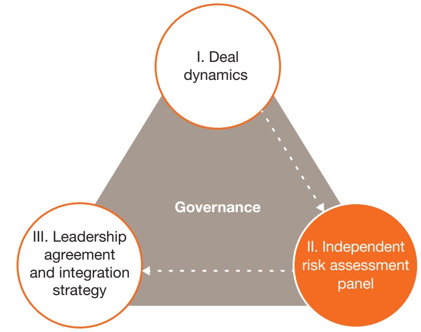
A thorough review of key failure drivers as outlined below can lead to practical risk-based findings and insights.



M&A failure drivers	Questions to consider
Flawed strategy	Have long-term strategic plans been updated to address significant changes in the market? *If executives underestimate the significance of possible change, a deal may result in missed opportunities or squandered resources.*
Poor execution	Are individual departments and business units closely examined when assessing the inherent complexity of integration? *If the complexities of executing a deal are not well understood, unanticipated costs and delays may occur.*
Bad deal structure/valuation	Does the deal value imply a discount vs. the expected value? *If there is little differential between price and value, the slightest unforeseen challenges or estimates that prove inaccurate could jeopardize value realization.*
Culture clash	Are the cultures of both companies aligned with each other? *If the two companies clash, then productivity may be reduced and synergies delayed or unrealized.*
Mismanaging the integration portfolio	Has leadership defined key success criteria, and is the firm capable of tracking progress? *If key performance indicators are not identified and tracked, leadership's ability to identify issues and make remediation decisions will be impacted.*
Synergy evaporation	Has a sensitivity analysis been performed on forecasts and assumption? *If the strategy is dependent on overly optimistic synergy assumptions, then anticipated deal value may not materialize.*

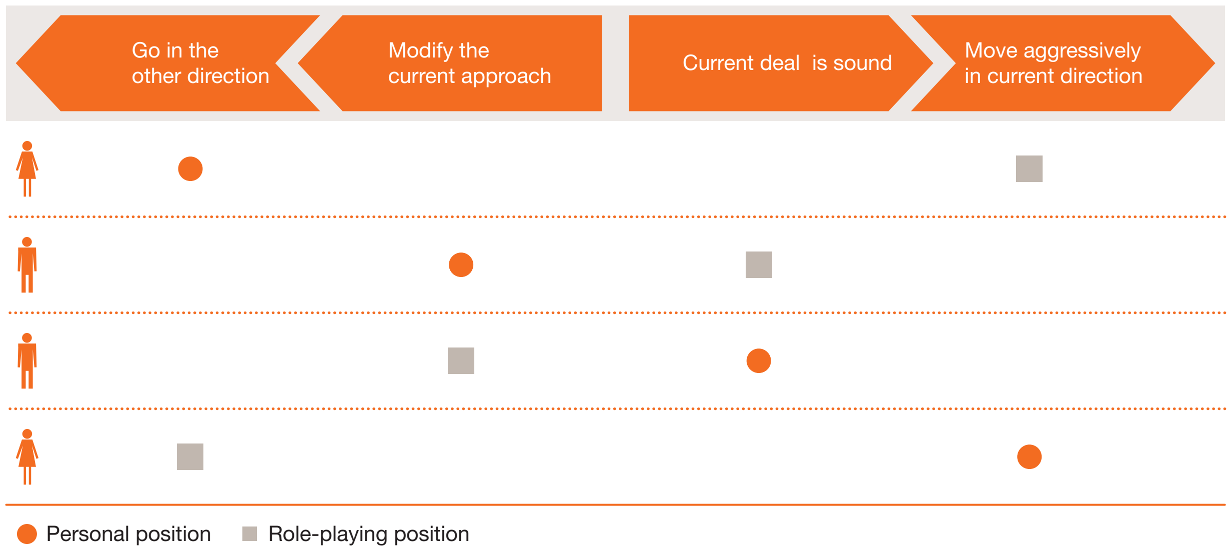
II. Independent risk assessment panel

Role playing allows for an open forum of ideas and questions to better assess the risk of the deal at hand.



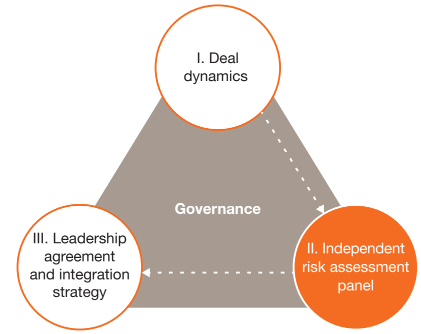
Independent risk assessment panels are created to explore a spectrum of positions on a deal.

Each panel member is encouraged to take a position unlike his/her actual position. Participants role play in their new mindset to build arguments for their positions and to challenge other team members with pointed questions. Session formats include brainstorming, presentations, Q&A, and debate. Independence is necessary in this process, as a firm's employees may not feel comfortable opposing the views of those senior to them.



II. Independent risk assessment panel

A summary of the information discussed and responses from previous steps are compiled for further discussion.



To prepare for the leadership alignment review in the third phase, participants on the panel formally compile information such as:

- Detailed points raised throughout the deal review.
- All assumptions and open questions with each team's supporting and challenging points.
- Listings of new capabilities that would be necessary to move forward with the deal.
- Any deal characteristics that pose a risk related to the strategic failure patterns and/or integration risks profiled above.
- Quantification of potential risk drivers and value gaps identified.

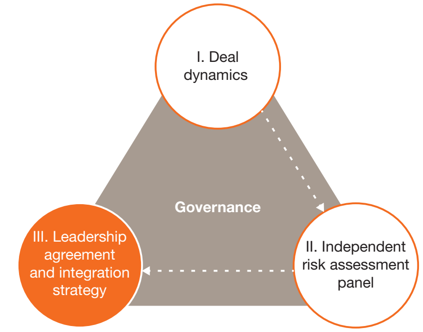
Key phase II outputs

- Executive summary of the panel's deliberations
- Profile of opportunities, constraints, value gaps, and risk drivers
- Prioritized inquiries to be addressed during due diligence
- Potential integration risks and Integration Management Office (IMO) recommendations

III. Leadership agreement and integration strategy

Leadership alignment on key deal risks and mitigation options facilitate reward-to-risk decision-making.

In the final phase, executives are briefed on a deal's potential risk drivers and the mitigation options identified in the panel review. By leveraging the outputs from the first two phases, a Go/No Go decision can be made, and if the deal is to move forward, appropriate plans for due diligence and integration can be formulated.



Phase I: Outputs

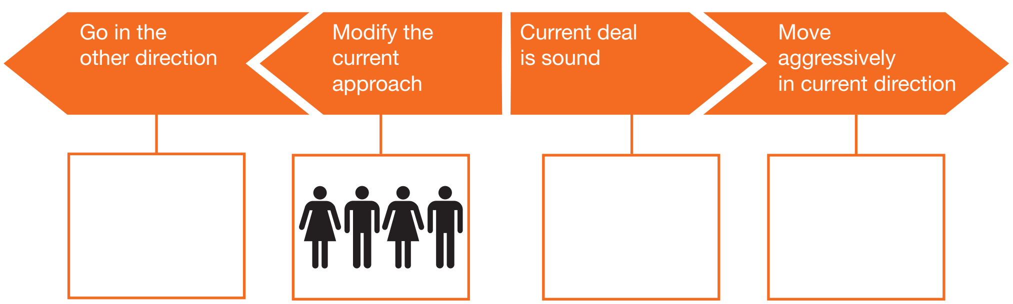
- Pricing risk analysis
- Preliminary assessment of strategic failure patterns
- Preliminary integration risk analysis
- List of open assumptions and questions
- Risk assessment panel approach (charter, panel participants, objectives, etc.)

Phase II: Outputs

- Executive summary
- Profile of opportunities, constraints, value gaps, and risk drivers
- Prioritized due diligence inquiries
- Potential integration risks and IMO recommenda-tions

Phase III: Leadership Alignment and Integration Strategy

Leadership alignment

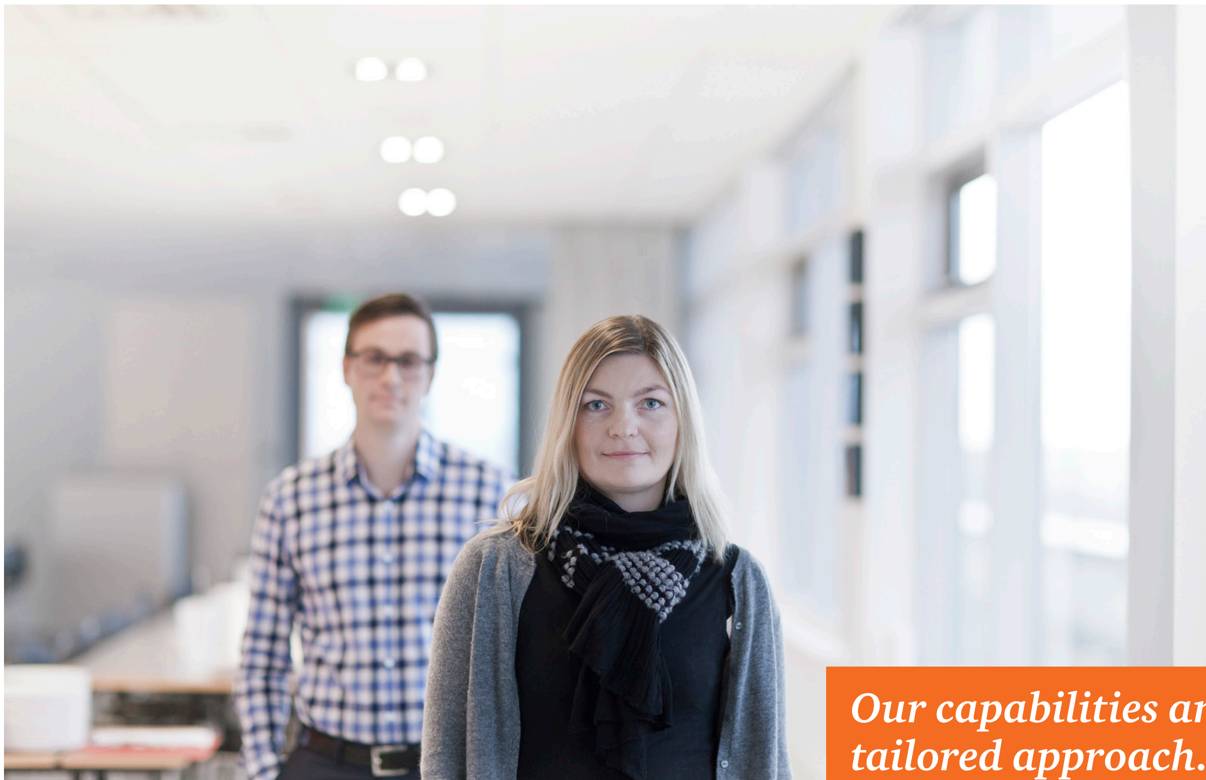


Integration strategy

Questions to Answer

- What is the deal trying to achieve relative to the company's strategy?
- How is the deal aligned with the company's business model?
- What integration issues might arise based on the capabilities of the organization and the required steps to execute and achieve deal value?
- What is the target operating model for the combined organization? How is it going to be achieved (e.g., "best of breed," complete absorption of target)?
- Is the deal's price relatively high or low? (Does it provide a reasonable "margin of safety"?)
- What synergies are required to justify the price offered? How will these synergies be achieved?
- What items impacting the integration strategy have been referred for due diligence?

How PwC can help



Our capabilities and tailored approach.

PwC has considerable experience in assisting merging companies within and across organizational functions throughout the M&A deal continuum.

Business strategy and operating model

- Business vision and goals
- Future-state operating model development
- Future-state capability definition
- Pre-deal due diligence

M&A integration office

- Overall integration process definition and management
- Synergy planning and tracking
- Day 1 planning and execution
- Integration project planning and execution

Sales and marketing

- Re-branding and brand rationalization
- Pricing strategy
- Sales force consolidation

Operations

- Product line rationalization
- Distribution network improvements
- Operational efficiency improvements
- Operational risk and controls analysis
- Facility consolidation

Information technology

- IT and business strategy alignment
- Technical platform migration
- Data center consolidation
- Application rationalization
- Program management
- Project portfolio analysis
- IT organization rationalization

Corporate functions and shared services

- Organizational redesign
- Back-office consolidation
- Consolidation of financial reporting tools
- Alignment of accounting policies
- Regulatory analysis
- Loss reserve analysis
- HR compensation and benefits analysis

Procurement and sourcing

- Renegotiation of direct and indirect spending
- Analysis of spending not under contract
- Sourcing strategy
- Third-party contract analysis

Chart shows representative activities. Other activities may be considered based on specific situations.

Our multi-phased approach provides clear, objective analysis with a broad perspective that helps clients define and assess deal opportunities.

	Independent risk assessment review panel governance	Market dynamics and deal analysis	Independent risk assessment panel	Leadership alignment review	Integration strategy and execution
Key activities	• Form an independent risk assessment review panel - Identify the PwC moderator of the panel who will coordinate review activities - Identify 1-to-2 industry or subject matter experts to participate on the panel - Determine if 1-to-2 experts inside the firm should participate on the panel	• Identify key market dynamics to monitor and the strategic opportunities impacted • Surface strategic and pricing assumptions • Find cases (such as other comparable deals) that fit to assess conditions and outcomes • Qualify/Quantify deal sensitivities	• Challenge deal logic • Determine potential value gaps • Agree on opportunities and constraints • Create risk driver analysis • Recommend options to mitigate deal risk (including both pre-due diligence and due diligence activities)	• Develop responses to key assumptions and open questions. • Develop leadership alignment workshop materials. • Conduct leadership alignment workshops and develop a high-level plan to address opportunities and threats • Establish leadership alignment on high-level plan to address opportunities and threats	• Develop first 100 day plan, including tactical projects and quick win opportunities • Interview stakeholder groups • Develop detailed integration plan • Assess impact of plan against core business strategy and other initiatives • Assess resource capacity and capabilities • Assess incentives with integration objectives • Determine key dependencies • Develop tracking mechanisms
Key outcomes	• Scoping document of review protocols • Documented review of roles and responsibilities	• Value driver and potential margin of safety analyses • Key assumptions and open questions • Preliminary deal assessment report	• Opportunities/ Threats identified • Strategic focus/deal impact assessment • Open questions and potential tripwires for due diligence and integration	• Prioritization and methods to address value drivers and risks for due diligence and value realization	• Integration execution playbook • Tactical closing requirements to help ensure Day 1 readiness • Integration blueprint including strategy, timeline, processes, and technology • Methodologies, tools, and templates to manage the integration • Synergy target and tracking mechanisms

What makes PwC's Financial Services practice distinctive.

Integrated global network	With 34,000 industry-dedicated professionals worldwide, PwC has a network that enables the assembly of both cross-border and regional teams. PwC's large, integrated global network of industry-dedicated resources means that PwC deploys the right personnel with the right background on our clients' behalf whenever and wherever they need it.
Extensive industry experience	PwC serves multi-national financial institutions across banking and capital markets, insurance, the asset management/hedge fund/private equity industry, payments, and financial technology. As a result, PwC has the extensive experience needed to advise on the portfolio of business issues that affect the industry, and we apply that knowledge to our clients' individual circumstances.
Multi-disciplinary problem solving	The critical issues that financial services companies face today affect their entire business. Addressing these complexities requires both breadth and depth, and PwC service teams include specialists in strategy, risk management, finance, regulation, and technology. This allows us to provide support to corporate executives as well as key line and staff management. We help address business issues from client impact to product design and from go-to-market strategy to operating practice across all dimensions of the organization. We feel equally comfortable helping the heads of business and the heads of risk, finance, operations, and technology; we have helped clients solve problems that cross all of these areas.
Practical insight into critical issues	In addition to working directly with clients, our practice professionals and Financial Services Institute (FSI) regularly produce client surveys, white papers, and points of view on the critical issues that face the industry. These publications—as well as the events we stage—provide clients new intelligence, perspective, and analysis on the trends that affect them.
Focus on relationships	PwC US helps organizations and individuals create the value they are looking for. We are a member of the PwC network of firms with 169,000 people in more than 158 countries. We are committed to delivering quality through assurance, tax, and advisory services.

Appendix

Select qualifications.

Pre-deal due diligence for the acquisition of an options, equities, and futures clearing corporation—International investment bank and broker-dealer

Issues

An international investment bank/broker-dealer was considering the acquisition of a mid-size US regional options, equities, and futures clearing company. The client engaged PwC to better understand how best to integrate the organization into its global equity finance division.

Approach

PwC assisted the client in undertaking pre-deal due diligence. Specifically, our team:

- Coordinated all business-led due diligence efforts, including senior officer and staff assessments, real estate analysis, and operational workflow analysis prior to the acquisition.
- Helped develop "vision" plans that detailed all business-led activities such as workforce resizing, office space consolidation, and systems decommissioning and expansion.
- Helped formulate new business operational models to merge the newly acquired company with an existing business unit while maximizing efficiencies across the holding company's global equity finance division.

Benefits

As a result of our work, the client had a better understanding of how the target would be integrated and function, should it be acquired. After careful consideration, the client decided to move forward with the acquisition.

Post-deal integration for an options, equities, and futures clearing corporation— Bank and broker-dealer

Issues	An international investment bank/broker-dealer had previously acquired a US regional options, equities, and futures clearing corporation. One year later, it acquired another US regional options, equities, and futures clearing corporation. The organization needed to integrate the existing client bases of the two organizations to optimize the mix of services provided and to reduce the number of systems required to maintain the two client bases. The client hired PwC to assist with the integration of the two organizations.
Approach	The PwC team: • Coordinated the initiative to migrate more than 80 clients (consisting of more than 550 regional floor and off-floor equities, options and futures specialists, and market makers) from their existing trading, clearing, and accounts processing systems to those of the acquiring company. • Developed detailed client analysis for each entity prior to migration, managed client requirement intake meetings, and provided tools and matrices to track the progress of each migration. • Served as the liaison between senior business managers and associated support areas such as technology, operations, finance, treasury, regulatory reporting, and legal/compliance.
Benefits	As a result of our work, the international investment bank/broker-dealer successfully migrated all of its clients to the new operating platform within the established seven-month timeframe. In addition, the client decommissioned all of the support systems for one of the acquired companies within two months of migration completion, resulting in substantial cost savings.

Acquisition of regional bank— Top-ten national bank

Issues

The client, a top-ten national bank, acquired a regional bank that was failing as a result of rapid credit deterioration, asset write-downs, and liquidity and capital shortfalls. The client acquired more than $100 billion in impaired single-family residential mortgage loans that had to be accounted for under SOP 03-3. Requiring a quick turnaround as a result of financial reporting deadlines, the client engaged PwC to help it navigate the accounting requirements, implement a back-office infrastructure, and develop a reporting framework. The company developed an interim solution that supported the Day 1 operational, management, and financial reporting needs.

Approach

PwC assisted with management as it navigated the accounting and reporting complexities associated with purchasing credit-impaired loan portfolios. Additionally, we provided recommendations to improve the implementation of the acquisition. Our team's focus included the following areas:

- Engagement of senior management in the governance process, including policies and procedures, risk management, reviews and approvals, and documentation of key judgments.
- Model reviews focused on data validation, model execution, and output reviews including model validation programs and documentation. Our team reviewed models that supported the Day 1 asset valuation (including credit losses, prepayments, and discounted cash flows), ongoing cash flow and impairment assessment, and income recognition processes.
- Performance analysis and management reporting, including analysis of cash-flow performance, credit quality, prepayments, interest income, and stress scenarios.
- Financial and regulatory reporting, including analysis of potential reporting enhancements for purchasing credit-impaired loans to capture additional information relevant to stakeholders.

Benefits

As a result of our work, the client quickly established a credit-impaired purchase accounting and reporting process. With the help of PwC, this process has evolved into a more systematic, sustainable, and financially sound process with an appropriately designed control structure. This process supports management's communication of portfolio performance to investors in a clear and understandable fashion.

Acquisition of multiple banks from the FDIC under loss-sharing agreement— Top-ten regional bank

Issues	The client, a top-ten regional bank, acquired multiple banks in receivership from the FDIC under the terms of a newly implemented loss-sharing agreement. One of the acquired banks had a sizable commercial portfolio with significant credit deterioration, with loans housed on four different technology systems. Adding to the complexity, key pieces of information such as charge-offs, performing status, and real-estate owned write-downs were stored on separate schedules. The client engaged PwC to help identify points of clarification on the loss-sharing agreement, compile the applicable loan data, implement an ongoing process for creating the loss-sharing certificate on a quarterly basis, and train permanent staff.
Approach	To complete the loss-sharing certificates, PwC began by understanding the commercial loss-sharing agreement and identifying points in need of clarification. Because the FDIC was renewing the loss-sharing program after a hiatus of more than 20 years, there were several points in need of clarification, some of which drove the FDIC to modify both the loss-sharing agreement and the loss-sharing certificate, including the accompanying data files. After the team received guidance with respect to a new agreement and certificate, it was able to obtain the necessary data from disparate commercial systems, perform the necessary computations, and prepare the certificate and accompanying data files to meet the revised requirements. Subsequently, we focused on developing a usable process for the client to create the commercial loss-sharing certificate on an ongoing basis. As the data was converted to the client's systems, PwC worked with the client's technology teams to provide requirements for an automated data feed that would greatly expedite the process of obtaining data. In addition, PwC worked with the special assets group, accounts payable, corporate accounting, and credit administration to assist these teams in evaluating their processes and making recommendations to modify processes to support or facilitate the loss-sharing certificate process.
Benefits	The FDIC loss-sharing work-stream enabled the client to meet its short-term requirement to file a quarterly loss-share certificate as well as its longer-term requirement for an ongoing process to create the certificate on a quarterly basis. As a result of our work, the client has processes and a trained team in place to complete the quarterly commercial loss-sharing certificates throughout the loss-sharing period. In addition, through PwC's efforts in directly filing for the first and second quarterly certificates, the client received reimbursements in excess of US $125 million.

Derivatives and commodity exchange merger negotiation and post-deal integration— Wall Street consortium

Issues	A Wall Street consortium wanted to merge an existing exchange with an established global market leader to maintain competition in the futures industry. The consortium engaged PwC to help negotiate and execute a merger transaction between US and European derivatives exchanges, including pre- and post-deal integration. The merger involved two firms operating in the same markets, but with very different reach and scale in each market. Both firms aimed to achieve rapid US financial market penetration.
Approach	The PwC team helped the client facilitate the merger by assisting with the following activities: • Established an overall merger planning and supporting methodology, including financial management, personnel transition, legal consideration, and business synergies. • Helped wind down the acquired company's IT and operations areas through change-of-control and subsequent business optimization. • Led the effort to work with regulators to conduct an orderly unwind of member and client positions to prevent market disruption. • Coordinated and facilitated integration of personnel into the new entity. • Migrated remaining clients onto the new technology platform.
Benefits	By maintaining competition in the market, the client reduced transaction costs by approximately 50 percent.

Integration of bank acquired in receivership from the FDIC— Top-ten foreign bank

Issues	A top-ten foreign bank was looking to expand its US footprint through acquisition. With its risk-averse culture and having avoided the brunt of the financial crisis by taking deposits only and making conventional loans, the bank was well-positioned for its US subsidiary to acquire a failed bank. Integration of the failed institution (a US bank) required dealing with complex accounting, operational, FDIC reporting, and technology issues in order to integrate the failed bank's assets.
Approach	The PwC team helped the client:. • Develop an integration plan. • Address complex accounting issues. • Capture, update, post, and report historical data. • Estimate the fair value of acquired loan assets. • Develop and document the accounting processes for SOP 03-3, FAS 141R, IFRS, and loss-share accounting. • Expedite payment losses from the FDIC. • Resolve technical tax issues relating to an FDIC acquisition. The team focused on several key issues to help position the client for future failed bank acquisitions from the FDIC including: • Creating a well-defined and appropriately documented process to manage multiple bases of accounting for acquired loans in order to facilitate our client's year-end financial audit. • Implementing a loss-sharing reporting process to accelerate the collection of cash from the FDIC.
Benefits	PwC's assistance in building a framework and playbook is helping accelerate and adding rigor to the bank's integration process. As a result of our work, the bank: • Reduced integration burdens, costs, and disruptions. • Is focusing on critical business processes impacting revenue, cost management, risk management, and regulatory compliance. • Is now well-positioned to navigate the pitfalls and challenges associated with establishing and sustaining multiple bases of accounting required by FDIC loss-sharing, SOP 03-3, FAS 141(R), and IFRS.

Merger integration—Two California-based banks

Issues	As part of the merger of two large regional California banks, PwC was engaged to run the Integration Management Office (IMO) for overall merger and integration activities.
Approach	Working with the client project manager, PwC performed the duties of the IMO, which included: • Help developing a transition framework. • Creating and communicating transition principles. • Operating the on-site IMO. • Conducting transitional risk management. • Identifying and tracking synergies. • Conducting user acceptance testing.
Benefits	As a result of PwC's work, the client recognized the following benefits: • Internal resources remained focused on core business issues. • The client gained access to a variety of external resources, experience, and subject matter specialists, as well as a vast library of tools including methodologies, risk matrices, reporting samples, analytics, synergy tracking tools, and best practice benchmarks. • Leveraged external, unbiased perspectives that appropriately challenged traditional approaches and processes.

Insurance companies merger— Large US insurance company

Issues	A large insurance company was planning a merger and required assistance developing a future-state strategy and operating model for the merged entity. A unique aspect of the merger was that the acquiring company was half the size of the target. The highly complex transaction involved multiple entities and required a high degree of skilled expertise. The goal for the integration was to complete the transaction within 24 months and begin seamless operations from Day 1.
Approach	The client engaged PwC to oversee the IMO and help develop an operating model for the new entity. We also helped create a strategy for shared services to help ensure broader support and efficiency without compromising the value of the individual organizations. This involved: • Creating an IMO model that included a toolkit, performance measures, and 100-day plan. • Developing a program governance model and identifying preliminary synergy opportunities. • Collaborating with senior executives of both companies to develop an operating model that identified a vision, goals, and guiding principles of the new entity, and to assess the market and industry environment to capitalize on current opportunities and plan for long-term growth. • Assessing the market and industry environment to capitalize on current opportunities and plan for long-term growth. • Organizing workshops for leadership to foster a united front on the vision and goals. • Evaluating the strengths of each organization to determine how the integrated entity could benefit most from shared services.
Benefits	The client achieved a successful deal closure. Leadership was equipped with the necessary information to make important decisions on Day 1, and the 100-day plan accelerated post-merger operating activity. Clarity around the new entity's operating model enabled meaningful discussions with the parent company on what services should be shared versus retained.

Due diligence/merger integration—Top global property and casualty insurance company

Issues	A global P&C insurance company purchased a specialty line insurer and sought assistance with its integration planning and due diligence. The company needed to develop a strategy to combine the operations and technology of the two global organizations with very different go-to-market strategies: one via a direct channel and the other using a dedicated agency force. The goal of the due diligence effort was to realize $95 million in savings through cost reductions and opportunities for synergy between the companies.
Approach	The PwC team worked with the client to divide the effort into two phases. In Phase 1, we assisted with the IT due diligence and integration planning across both organizations. We began with a current state assessment, which included a two-day workshop with the top 30 IT professionals from both organizations. PwC facilitated the discussions as they talked through scenarios for cost-cutting and synergy. Opportunities identified included: • Application portfolio rationalization of 10 policy administration systems. • Integrating PeopleSoft, HR, and the global network; merging data centers across three continents. Phase 2 focused on integration planning. Using the knowledge gained in Phase 1, the team helped the client work toward the larger goal of developing a portfolio of IT investments to achieve operational efficiencies. The team helped: • Develop a plan encompassing more than 200 projects across the North American and International business groups. • Work with the finance group to develop a cost accounting model for IT investments. • Collaborate with management to define the overall program management framework, governance process, portfolio management, and prioritization process model. • Plan for integrating the vendor management program, which covered five major outsourcing companies.
Benefits	The client broadened its understanding of the acquired company's technology capabilities and developed an ongoing strategy for post-merger integration. Additionally, the IT due diligence and merger integration planning helped support the entity in realizing operational efficiencies and growth opportunities within the first 18 months.

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"Deal or no deal: Methods, processes, and models for the new M&A environment," PwC FS Viewpoint, June 2012. www.pwc.com/fsi