Synergy™ INSIGHTS
SUPPLEMENT

THE FINANCIAL AND STRATEGIC PARADIGMS OF M&A

There are two basic paradigms that govern the combinations achieved through merger, acquisition, and divestiture activities: financial and strategic. The financial paradigm, focuses primarily on the standalone value of the transaction parties, and selectively on the additional value created vis-à-vis the synergies between the parties. This orientation is generally adhered to by financial buyers such as PE firms and holding companies, though some financial buyers do pursue achievement of post-transaction synergies, especially cost-cutting initiatives applicable to acquired businesses that were not previously as fiscally disciplined as might have been possible.

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The strategic paradigm deems the standalone value of the transaction parties to be foundational, but also attributes strong importance to the full range of applicable synergies in the combination. This approach will typically be pursued by strategic buyers to varying degrees, depending on the extent of true strategic vision possessed by the buyer.

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This contrast between the two paradigms may seem to be more a matter of degree than fundamental difference, but substantial disparity appears in the actual application of these two approaches in the areas of target profiling, post-transaction operational structure, value creation from completed transactions, and deal pricing.

Target Profiling

Because the financial paradigm focuses primarily on the standalone value of the transaction parties, and selectively on the additional value created in relation to the synergies between the parties, targets deemed worthy of consideration are generally those that have characteristics that are deemed valuable on a standalone basis or that could be acquired at a discount to the actual value, rather than in combination with the other party to the transaction. Such characteristics that will prove valuable in and of themselves include:

- Participation in industry segments with higher than typical margins or growth rates.
- Possession of higher than average margins or growth rates than peers within the same segment.
- Possession of unique technological advantages and/or market opportunities.
- Possession of robust but credible forward-looking performance projections.

These kinds of characteristics indicate superior present value as well as portend to the ability of a business to continue generating superior value on into the future.

In addition to such characteristics, financial buyers will generally like to see that a target acquisition is generally "healthy", other than having excess costs that can be cut, or high return opportunities that could be pursued, if not for the inability of the current owner to fund pursuit of such lucrative initiatives. In other words, financial buyers like targets primarily for their strengths rather than their weaknesses, except for the couple of aforementioned financially oriented kinds of flaws.

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This means that a more limited range of targets is available to financial buyers than for strategic buyers, since for strategic buyers both the strengths and the weaknesses of a target are sources of synergy value, where the buyer's strengths are found to be offsetting of the target's weaknesses and vice versa. For the appropriate strategic buyer, even a target with extreme and otherwise fatal weaknesses can be a highly desirable strategic acquisition.

Post-Transaction Operational Structure

Building from the innate distinctions in the two approaches, the financial and strategic paradigms of M&A require different orientations in post-transaction operational structures. Since financial buyers desire basically intact target management structures and uninterrupted continuance of target growth trajectories, they will typically seek to create minimal disruption of the target's business, save the kinds of disturbance innate in reduction of excessive operating costs.

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Not that strategic buyers revel in disrupting target business operations, but the pursuit of synergy creation via the mitigation of weaknesses and/or leveraging of strengths of either or both parties, carries the potential for more intrusion of the two parties' operations into one another. As such, the post-transaction integration activities of a strategic acquisition can range from almost none where except for some top-level headcount reductions, the two businesses continue to operate on a nearly standalone basis, to nearly complete integration in which the acquired business virtually disappears into the acquirer's existing operation and infrastructure. In the latter case, the acquirer may actually prefer to have the target's management not come with the deal, in contrast to the financial buyer who more typically prefers targets where management will remain in place post-transaction.

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Value Creation

In addition to the financial paradigm's view of the acquisition's post-transaction value creation being driven primarily through the growth potential of the target itself, the growth trajectory of the target's industry segment, and the trimming of excess operational costs (if present), the strategic paradigm also fully embraces the synergy-driven opportunities for creating value through the combination of the two parties. Due to their full acknowledgement of the value drivers appreciated by financial buyers, as well as the more all-encompassing pursuit of synergy as a vehicle for value creation, strategic buyers can achieve post-transaction value creation that exceeds that possible for financial buyers, assuming an adequate job is done of integrating the synergies. This greater value creation potential allows the strategic buyer to derive value (where applicable) from the target's:

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- Participation in industry segments with higher than typical margins or growth rates.
- Possession of higher than average margins or growth rates than peers within the same segment.
- Possession of unique technological advantages and/or market opportunities.
- Achievement of synergies created by two parties' mitigation of one another's weaknesses and/ or the leveraging of one another's strengths.

Deal Pricing

As can be expected from the potential differences in value creation between the financial and strategic paradigms, the two perspectives also differ in terms of the deal pricing model and relative magnitude of prices that can be afforded to be paid.

In both approaches, the standalone value can be determined through a standard valuation model (such as a discounted cashflow analysis) that accounts for the target's historical financial performance, and takes into account the target's reliable future projections. Both financial and strategic buyers will typically also consider two standard categories of synergy:

- Application of the acquirer's know-how to opportunities in the target's business for reduction of overhead (Taylor's Synergy #5).
- Creation of a combined improved financial structure in which the acquirer is able to provide capital for the target's high return opportunities that could be pursued, if not for the current inability of the target to fund pursuit of such lucrative initiatives (Taylor's Synergy #4).

However, in addition to the sources of value creation stated above, strategic buyers will be able to gain value through whichever are applicable of the additional 23 categories of cost and revenue-related synergies identified in Taylor's model, ***The Twenty-Five Categories of Synergy***, shown on page six.

CATEGORIES OF QUANTIFIABLE BENEFITS COMMON TO THE 25 SYNERGIES FOUND IN TAYLOR COMPANIES' SYNERGY MODEL

GENERAL ARENAS OF SYNERGY	SPECIFIC CATEGORIES OF SYNERGY	QUANTIFIABLE BENEFITS*					
		RE	RP	CR	CA	MI	PE
BUYER OR SELLER	1. Eliminating Overhead and Improving Utilizations			■		■	
	2. Selling Potential Realized Due to Removal of Manufacturing Constraints	■				■	
	3. Achieving Operational Critical Mass	■	■			■	
	4. Combined Financial Structure Is an Improvement					■	
	5. Applying Superior Know-How to the Business	■	■	■		■	
	6. Obtaining Superior Technologies	■	■	■		■	■
	7. Obtaining Future Benefit	■	■	■		■	■
	8. Corporate Culture Is Improved	■	■	■	■	■	■
COMPETITORS & PEERS	9. A Competitor Is Acquired	■		■			
SUPPLIERS	10. Procurement – Economies of Scale			■			
	11. Achieving Backward Integration		■			■	
CUSTOMERS/ MARKETS	12. Achieving Forward Integration		■			■	
	13. New Products/Services for Existing Customers	■		■	■	■	
	14. Creation of One-Stop Shopping for Customers	■	■		■	■	
	15. Obtaining Superior Products/Services	■	■			■	
	16. New Customers for Existing Products/Services	■			■		
	17. New Distributors/Distribution Channels for Existing Products/Services	■					
	18. Image With Customers Is Improved	■	■			■	
	19. Image With Mutual Customers Is Strengthened	■	■	■		■	
	20. Continuing to Supply a Key Customer	■	■				
	21. Obtaining Superior Markets					■	
REGULATORY ENVIRON.	22. Image With Regulators Is Improved		■		■		
FINANCIAL MARKETS	23. Financial Critical Mass Is Achieved						■
	24. Image With Market Analysts Is Improved						■
OTHER	25. A Target Is Acquired to Prevent Someone Else From Acquiring It		■			■	

*EXPLANATIONS OF QUANTIFIABLE BENEFITS

- ***Revenue Enhancement (RE)*** . . . . Creation of new business from existing or new customers.
- ***Revenue Protection (RP)*** . . . . Prevention of loss of business from existing customers.
- ***Cost Reduction (CR)*** . . . . Decrease in expenditures on recurring items.
- ***Cost Avoidance (CA)*** . . . . Elimination of need for spending on new items.
- ***Margin Improvement (MI)*** . . . . Increase of profits whether from cost reduction or not.
- ***PE Enhancement (PE)*** . . . . Sustainable increase in a public company's trading multiple

In Closing

From the foregoing, it is clear that for any given target an appropriate strategic buyer will be able to derive more value and can therefore afford to pay a higher price than can a financial buyer. Similarly, and if his cards are played properly, the target can expect to obtain a higher price from a strategic buyer than a financial buyer.

> ***Taylor has consistently helped acquisitive clients maximize value creation, and has repeatedly helped strategic sellers obtain optimal prices.***

In line with their dedication to maximizing value through mergers, acquisitions, and divestitures, Taylor Companies has chosen to specialize in applying the strategic paradigm for clients. Taylor has consistently helped acquisitive clients maximize value creation, and has repeatedly helped strategic sellers obtain optimal prices. During their nearly four decades of operation, 90+% of Taylor's acquisitions have been deemed successful, and Taylor's selling clients have received an average of 65% higher prices that were paid by financial buyers for similar companies during the same time frames.

WE WELCOME READER FEEDBACK

We are interested in your feedback and examples of synergy applied in acquisitions and divestitures with which you may have been involved. To share examples, or if you have questions, comments, or are interested in seeing a specific subject discussed, please contact us at SynergyInsights@tay.com, attn: Warren Bellis.

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