VOLUME THREE

Synergy™ INSIGHTS

A New Paradigm in Mergers and Acquisitions

A PUBLICATION OF
Taylor Companies

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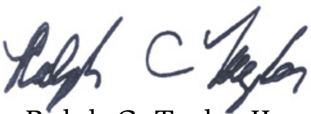
LETTER FROM THE PUBLISHER & EDITOR-IN-CHIEF

Ralph C. Taylor II

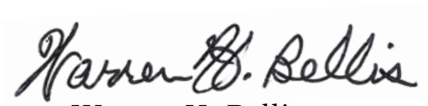
Warren H. Bellis

In the prior volumes of *Synergy Insights* we presented our understanding of synergy in relation to mergers and acquisitions, and the ways we have seen these concepts and principles play out in real-world transactions. As such, our discussions focused on the application of synergy to the achievement of successful transactions. However, Taylor Companies' 90+ percent rate of success in acquisitions can be attributed only in part to the thorough analysis of synergy in actual transactions.

Much of Taylor Companies' success can also be credited to a highly innovative application of synergy at the front-end of the acquisition strategy planning process. Our frequent discussions with CEOs and other C-Suite executives has lead us to the conclusion that this front-end application of synergy is unique, and of such great positive impact to the field of mergers and acquisitions, that we are devoting this volume of *Synergy Insights* entirely to the presentation of this methodology — a potential game changing new paradigm of mergers and acquisitions.



Ralph C. Taylor II
Chairman and CEO
Taylor Companies



Warren H. Bellis
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A NEW PARADIGM IN MERGERS AND ACQUISITIONS

For many decades now the mergers and acquisitions (M&A) world has been working to master the effective execution of mergers, acquisitions, and divestitures. Since 1987, when Harvard professor Michael Porter stated that only 25-50 percent of transactions are deemed successful, acquirers and their advisors have strived to understand why deals fail and implement better practices aimed at improving the M&A success rate. Without a doubt, an important component of better results is a more thorough understanding and vetting of transactional synergy, which is the extra value a deal creates beyond the mere standalone values of the parties involved.

Preoccupation with correcting the widespread underperformance of M&A may well be the reason that the potentially greater role of synergy in business has gone largely undiscovered. However, Taylor Companies, with a well-established track record of successful transactions, believes that more effective application of synergy to specific deals, while critically important, is not the "final frontier" in the domain of synergy. The ultimate and most powerful use of synergy is not in widespread use, yet it promises to revolutionize the world of M&A.

The Most Powerful Role of Synergy

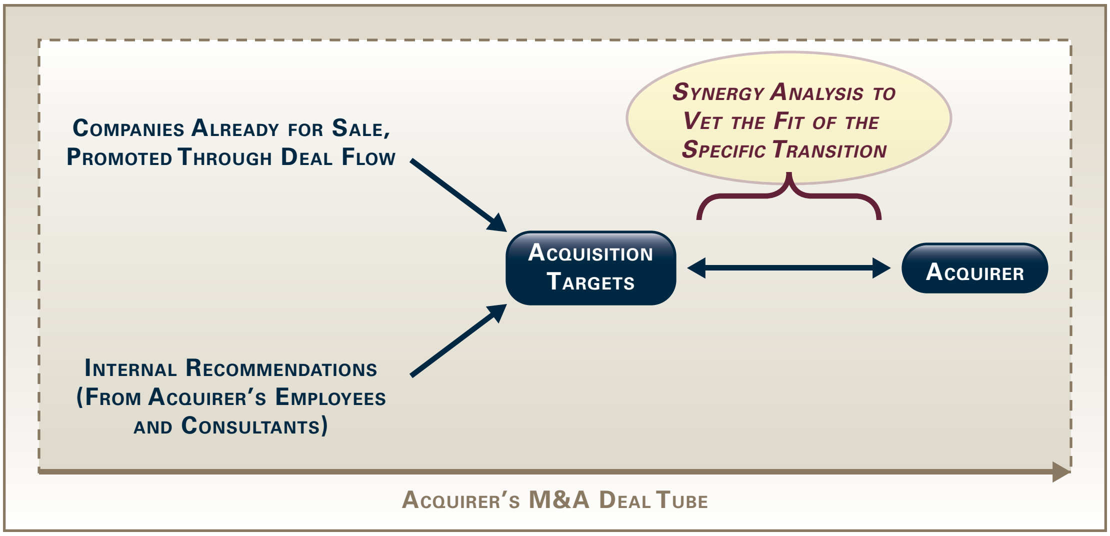
While more effective use of synergy on specific transactions will result in increased creation rather than destruction of related shareholder value, there is even greater benefit to be gained by applying the principles of synergy at an earlier stage. If these principles are utilized as the basis of the acquisition strategy planning process and before any targets have been identified, then much greater benefits will be realized.

There may be an immediate inclination to question the validity of this point, since the current paradigm focuses on use of M&A related synergy to vet specific transactions. Certainly that is a fruitful area of focus and one that will increasingly produce benefit as adoption of best practices increases. But for many years now, Taylor Companies has been using synergy to help clients formulate the underlying strategies upon which successful target identification depends.

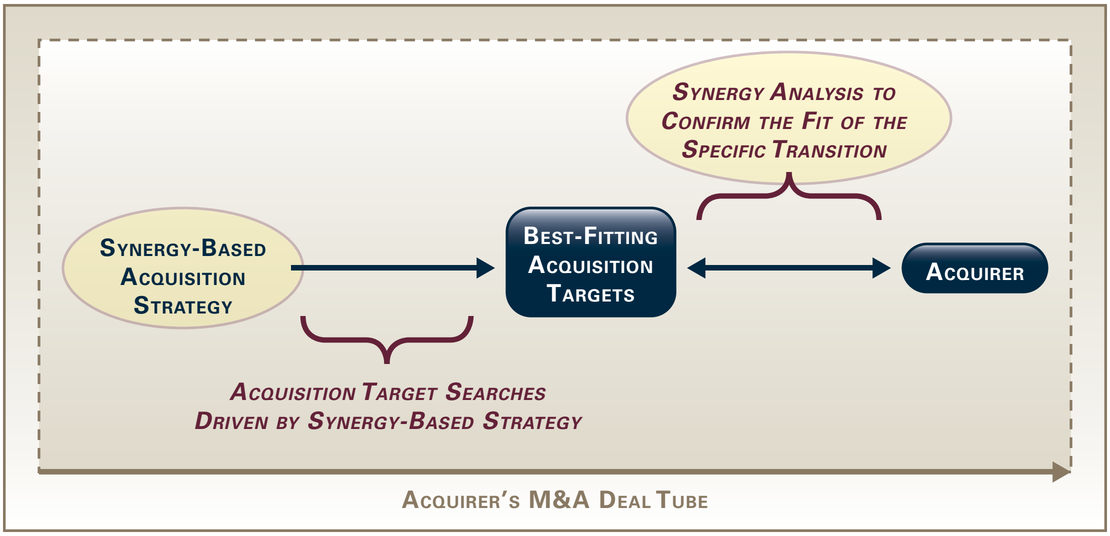
The application of synergy to strategy formulation requires a shift away from the traditional way of thinking, but this transition is easily made by a company's managers once they have worked through a few specific examples relevant to their own business.

Key Differences in the M&A Program

The differences that synergy-based acquisition strategy planning bestows on a company's M&A program are profound, far reaching and can be considered a new paradigm of M&A. The following diagrams illustrate the key differences between an M&A program based on this new paradigm and one relying only on the customary transaction focused use of synergy.



Current Paradigm *— Synergy is an after thought used only to vet specific transactions. Identification of best fitting targets is a matter of coincidence.*



New Paradigm *— Synergy drives the entire M&A process. In addition to vetting specific targets, synergy is used to formulate the acquisition strategy and proactively identify best-fitting targets.*

The profound differences indicated in the preceding diagrams are that the current paradigm ties target identification to what is available through the deal flow or to subjective opinion of what will fit, whereas with the new paradigm:

- All strategies capable of generating synergy value are identified,
- The strategies are ranked according to the magnitude of synergy each can deliver,
- The targets that fit the top ranked strategy are identified, and
- The targets for the top strategy are ranked according to their degree of fit with the strategy.

As a result, the most synergistic target is identified for the most synergistic strategy. This new approach has the potential to create a “laser beam” of focus in an acquirer’s M&A function compared to the more reactive, random and subjective character of the current paradigm of the M&A world. This higher order of focus can produce dramatic positive benefits for a company’s M&A program.

Benefits of Applying the New Paradigm to a Company's M&A Program

The new paradigm of applying synergy to early stage strategy development can create the following benefits compared to the current paradigm:

Current Paradigm	New Paradigm
Has resulted in a global 70-80% M&A failure rate	Contributes to a high success rate of acquired businesses
The focus is on available targets (already for sale) or on ***presumed*** good targets but not necessarily the best	The focus is on pursuit of the best (most synergistic) targets
Requires rushed reaction to what comes through the deal flow (increasing the chances of costly errors)	Enables a proactive, unrushed M&A approach
Requires time-intensive review of large umbers of targets to find a small number of actionable targets (only by coincidence are these best-fitting)	Minimizes the number of deals that must be reviewed to find the best-fitting actionable targets
The majority of deals done in the world produce little or no synergy value from acquisition funds spent (in many cases some of the pre-existing value of the buyer and/or seller is destroyed)	Ensures maximum creation of synergy from acquisition funds spent

USING THE NEW PARADIGM

When using synergy as the basis of formulating the acquisition strategy, the focus is on the acquirer itself rather than a particular acquisition target. Rather than considering a specific target, the various categories of synergy themselves are considered relative to their potential benefit to the acquirer. For example, as in the case of Taylor Companies' synergy 13, ***Obtaining New Products to Sell to Existing Customers***, an acquirer would ask which specific complementary products could be sold to its existing customers if those products were obtained through acquisition of another business. This is in contrast to the question that would be asked when determining if synergy 13 was applicable to a specific transaction: "What products does the target have that could be sold to the acquirer's existing customers?" Questions can be asked in a similar manner for each of Taylor's 25 Categories of Synergy to reveal the applicability of the synergy in general rather than in reference to a specific acquisition target.

This line of questioning is carried out in a group session with the discipline heads of each business unit within a company, with the result being a thorough discovery of those categories of synergy that can be pursued through acquisitions, strategic alliances, or joint ventures. Each one of these ideas or strategies will achieve synergy value if pursued through the appropriate kind of acquisition or alliance. This means the transaction will result in some additional value over and above the standalone value of the two parties involved.

Discipline heads will have thoroughly identified all synergies achievable through acquisition or alliance during the group sessions. The team must then estimate the additional value each applicable synergy will achieve if the ideal transaction is accomplished. Lastly, the opportunities are prioritized by the aforementioned ***optimum theoretical values*** that can be created from the ideal acquisition or alliance.

To estimate the optimum theoretical value of a synergy pursuable through acquisitions one must first determine the kind of value the synergy will achieve. The maroon-colored boxes in the following table indicate the kinds of synergy value that can most commonly be achieved by each of Taylor's 25 Categories of Synergy.

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

Once the appropriate benefit has been pinpointed for a particular synergy, the proper computational formula can be selected and the synergy value estimated. Each synergy is rendered into a net present value to consider multiple years of annual synergies (usually five) and then compare each applicable category of synergy on an ***apples-to-apples*** basis.

By comparing all applicable synergies to each other, a prioritization of the synergy opportunities can be made for an overall company across all its business segments; the results of such an exercise are illustrated in the following sample table.

Synergies Ranked by Net Present Synergy Value				
Company Division and Synergy Opportunity (Abbreviated)			Net Present Synergy Value	
			5-Year	2-Year
Division A	14a –	Creation of 1-stop shopping	274.27	-8.72
Division A	13a –	New product for existing customers	226.38	-12.11
Division C	13a –	New product for existing customers	203.81	8.54
Division A	21a –	Obtaining an attractive new market	160.02	1.08
Division B	05a –	Transfer of know-how	139.01	67.54
Division A	16a –	New customers for existing products	126.42	-10.36
Division B	21a –	Obtaining an attractive new market	98.69	2.54
Division B	13a –	New product for existing customers	91.46	4.9
Division B	16a –	New customers for existing products	61.4	0.07
Division C	21a –	Obtaining an attractive new market	42.32	0.61
Division B	13b –	New product for existing customers	36.46	0.25
Division C	13b –	New product for existing customers	34.54	0.31
Division A	24a –	Improved image with market analysts	28.24	2.58
Division A	14b –	Creation of 1-stop shopping	28.19	-13.21
Division B	24a –	Improved image with market analysts	26.51	7.16
Division A	21b –	Obtaining an attractive new market	18.68	3.1
Division C	14a –	Creation of 1-stop shopping	17.98	-2.9
Division C	09a –	Acquisition of a competitor	17.14	-0.2
Division C	05a –	Transfer of know-how	16.19	-0.67
Division B	13c –	New product for existing customers	14.45	1.91
			1662.16	52.42

The table above shows the ranking of synergy opportunities identified across three of a company's divisions. *The opportunities are ranked according to the 5-year net present values of each of the synergy opportunities. The 2-year NPVs are shown as a basis for also considering the shorter term value accretion potential of each opportunity.*

This prioritization can serve as an extremely powerful tool for determining where to focus the company's acquisition budget and in what sequence. Also, it creates a means for objectifying such decisions so as to most effectively communicate the priorities to the entire organization. In its entirety, the prioritized list of synergies is a snapshot of a company's opportunities for unleashing captive shareholder value. At least as can be pursued through acquisitions or alliances, the prioritized list can serve as a roadmap for steering the business towards achieving its full potential.

Usually the synergy opportunities in the list are pursued through acquisition or alliance in order of priority focusing on achieving the greatest synergy for the transaction funds to be spent. However, there may be chances to cluster the top value synergy opportunity with less valuable opportunities further down in the list if all of the clustered synergies could practically be achieved through a single kind of acquisition. For example, it is logical that an acquirer could ***obtain new products to sell to its existing customers*** as well as obtain the additional production required to ***increase production capacity utilization*** through the same acquisition.

Whether clustering is possible or not, appropriate acquisition target search profiles are formulated depicting the characteristics of the actual targets that can deliver the corresponding synergy. With these profiles as a point of reference, searches are conducted to find the best fitting targets. Each target is scored according to its fit with each characteristic of the corresponding profile, and the list of targets is prioritized according to each target's aggregate fit across all characteristics; as a result the best fitting targets for each profile are pinpointed.

These top ranked targets would be the best fitting and most synergistic acquisitions or partnerships that could possibly be pursued by a company using this new paradigm of M&A. The present M&A paradigm, by comparison, focuses merely on the targets already for sale or deemed "good" targets, but not specifically on best fitting or most synergistic.

As a result, the potential benefits of using the new approach compared to the existing one are:

- A highly focused M&A strategy that is fully prioritized relative to synergy creation,
- An optimally efficient M&A function that proactively pinpoints the best fitting/most synergistic targets rather than sifting through deal flow generated targets to determine whether or not adequate fit/synergy exists,
- A strategic template with which deal flow generated targets can be quickly compared to determine degree of fit, thus preventing excessive consumption of time and effort on weak targets, and
- Proactive identification of acquisitions or partnerships that generate the greatest possible returns on the invested capital.

THE BEST FITTING / MOST SYNERGISTIC TARGETS ARE NOT FOR SALE

For all the benefits that the new paradigm of M&A bestows, there is one significant potential hindrance: it is almost never the case that the best fitting/ most synergistic target is already for sale. However, for as long as Taylor Companies has been focused on best fit and synergy creation for its acquisition clients, it has also been perfecting the science of getting companies to agree to sell, even when not already on the market. In fact, Taylor has statistically been able to get half of all targets to agree to sell even when not already on the market. Therefore, as the following insights will reveal, the time and effort spent in using the new paradigm is not merely a theoretical exercise disconnected from practical results, but a proven method of creating the optimum outcome in acquisitions.

Through its decades of experience in acquiring targets that are not already for sale, Taylor has concluded that successful pursuit of targets not already on the market is based on four key considerations, which follow.

Approaching the Right Party

Only certain individuals have both the authority to decide to sell a business and the objectivity to determine if it is in the shareholder's best interest to sell. Determining the key decision maker(s) that satisfy both conditions is a critical first step in acquiring a business that is not already for sale.

Assurance of Confidentiality

Decision makers of companies not already for sale generally dread the thought that rumors might arise that they are considering a sale of their business. This issue alone will keep a target from considering sale-related inquiries from non-trusted outside parties. Two key factors are at play here. If an advisor approaches the company on an acquirer's behalf, the advisor will have a much harder task if it is a well known firm whose name appears in the public eye. The automatic assumption is that a publicly visible firm will have a harder time maintaining confidentiality. The second factor has to do with who makes the initial inquiry; if the approaching party is already trusted and respected by the potential seller, there is a dramatically greater chance that the inquiry will meet with curiosity instead of rejection. Sensitivity to these two factors has lead Taylor to protect its name from becoming widely known in the public domain, as well as adopting the routine practice of always having a trusted and respected confidant of the seller make the initial approach to the business' key decision maker(s).

Compelling Deal Logic

A compelling logic of the deal automatically accompanies transactions in which the fit and magnitude of synergy is optimal. The decision makers of not-for-sale companies will not likely be intrigued enough to consider a transaction unless his/her company fits well with the acquirer's business.

Resolution of the Soft Issues

Even if a target's key decision maker agrees with the logic of the deal and feels safe enough to consider an inquiry, the effort is not likely to culminate in a completed transaction unless he/she feels good about selling the business. How a key decision maker feels about selling has to do with more than just the logic of the deal; usually potential sellers have soft issues that also contribute heavily to whether or not the idea of selling creates a positive or negative sentiment. For example, the seller may fear loss of legacy or damage to the employees on the assumption that a sale of the business would automatically be accompanied by a name change and folding of operations into the acquirer's facilities.

Soft issues would logically be strong factors in private targets but can be significant forces in public companies as well, as would be the case when, for instance, a potential seller's key decision maker would seek to maintain the present location of the company in an effort to care for the employees or the community in which the company was a dominant employer.

Soft issues are likely to become deal breakers if solutions cannot be conceptualized and effectively communicated to the seller. But detecting the soft issues and effectively communicating the solutions can be challenging unless a third party confidant of the seller can assist in the detection of the issues and delivery of the remedies.

IN CLOSING

Employment of the new paradigm in mergers and acquisitions, along with application of the most effective means of getting businesses that are not already on the market to agree to sell, will bestow a powerfully focused and highly pragmatic approach for transforming an acquirer's acquisition program into a maximally efficient, cost effective and value creating enterprise. In light of these benefits, and with widespread adoption of the new paradigm, it is reasonable to expect that the high failure rate of M&A in the world could be recast as a high global success rate with corresponding high levels of value creation instead of value destruction and lost opportunity.

IN THE NEXT VOLUME

There is a big difference between selling a business and merely putting it up for sale. In the next volume we will discuss the keys to obtaining the highest price for a business being sold.

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:

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Taylor Companies

Taylor Companies' mission is to generate wealth and fulfillment for our clients, associates, and shareholders by building trusted relationships worldwide with those who share strategic vision and integrity. Taylor will continue to be the best in our industry at confidentially and strategically producing optimal results, and through our ongoing success, support those organizations that enrich humanity.

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