

## “Urge to merge” fever hits consumer business industry:

Is it right for you and your  
company’s business strategy?



M&A activity is a complex  
and trying process;  
be sure you're covering  
all the angles

Take even a fleeting look at the issues confronting the Consumer Business industry today and it's no wonder there's increased exploration of business combinations or divestitures as possible solutions. As an industry executive, you're aware of these key obstacles and potential challenges, including:

- Difficulty in globalizing operations
- Worldwide overcapacity
- Continuation of sluggish economic recovery
- Competing in a mega-retailer driven model
- Dealing with rising energy costs
- Addressing growing health and safety requirements
- Handling the product innovation imperative
- Riding the wave of new technologies
- Keeping pace with changing consumer tastes and demands
- Managing brands for optimum success
- Building brand equity in a land of private labels

It's only natural that more and more manufacturers and packaged goods companies are thinking about doing deals that might enable them to more efficiently

address these issues and expand operations, brands or product offerings to achieve greater critical mass. Alternately, some companies are considering divestitures to prune product portfolios or spin-off unrelated assets to gain financial and competitive advantage.

### Consumer business M&A activity on the rise

Look no farther than the Procter & Gamble acquisition of Gillette, Colgate's sale of detergent brands, the Heinz/HP Foods merger, Sara Lee's spin-off of its apparel division, and Energizer's purchase of Schick. These are all sterling examples of recent transactions that created new opportunities or solved thorny issues. Whether targeting competition to achieve economies of scale through acquisition, or sustaining core offerings by defending their brand by divesting unrelated businesses, these companies entered the deal game to reach outcomes that they didn't expect to achieve through organic growth alone.

M&A activity is on the rise for Consumer Business companies. You may recall that food industry transactions have dominated consumer M&A activity in recent years, and it's thought that consumer products might now follow that same path. This is particularly anticipated among companies that are willing to pay high prices for premier

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assets because of the synergy potential of combining the entities. Investors are demanding growth both on the top line as well as the bottom line. Achieving growth in revenues is challenging in today's economy, but M&A may provide upside for the bottom line.

### Investor relations

In general, we haven't seen the same level of deal activity as we saw in the 1990s, but the appetite for M&A is slowly coming back. In particular, there's been a noticeable return of the corporate or "strategic buyer." This is significant because it tells us that companies are ready once again to use M&A as an important strategic tool in their growth planning. However, rather than getting caught up in the acquisition frenzy we saw in previous decades, corporate buyers appear to be more cautious and disciplined when making M&A decisions and entering a bidding process. However, it's also worth noting that while strategic buyers outnumber financial buyers—or private equity investors (PEIs)—the level of PEI activity has improved significantly over the past two years, with PEI firms sometimes outbidding corporate buyers, or at least aggressively influencing the valuation dynamics of an auction process.

A very interesting development in private equity began emerging in 2004. Because many PEI firms continue to have large amounts of capital available for investment, multiple PEI groups have been forced into bidding situations for attractive assets, particularly in the middle market arena, and walking away as losing bidders. As a result, many PEI firms have now turned to the pooling, or "clubbing," of PEI funds to raise very large amounts of capital so they can collectively engage in much larger transactions and have a greater chance of completing a deal. As of the second half of 2005, three of the 10 largest LBOs ever announced are actually club deals.

Another recent trend points to the pairing up of a PEI with a strategic buyer. This approach makes for a powerful combination when one considers that the private equity group gains synergies it wouldn't have had before and the corporate buyer achieves financial wherewithal it might otherwise not have thought possible. Terms of ownership may vary widely and the relationship may be built to dissolve rather quickly after mutual

goals have been achieved, e.g., a pre-arranged buy-out or IPO. But the upshot of the arrangement is the same for both parties: enhanced competitive position in bidding on the deal.

### Portfolio pruning vs. Portfolio ruining

There are also important benefits to knowing "when to hold 'em and when to fold 'em." Many consumer product companies are acknowledging the wisdom of divestiture or spin-off strategies when one or more units of an existing or merged entity are under-performing or simply don't fit any longer with the larger business plan. As recent Kraft and Wrigley actions exemplify, one company's constructive spin off can be the other's sales booster. Wrigley acquired Kraft's Life Savers and Altoids candy businesses, which Wrigley believed was a solid fit with their core chewing gum lines and fit Kraft's intention to sell off select, non-core interests.

This upsurge in activity suggests growing confidence among corporate officers, governing bodies and investors about the economy. There's also the need to grow top lines; most smart companies have already squeezed out all extraneous costs as a way to get there, so now they're working the other side of the equation to increase revenues and profits. It's important for you, the C-suite executive, to understand these trends and therefore where the competition is coming from.

Now, the question is, does a purchase, consolidation, buy-out, or spin-off make sense for you and your consumer business company? You're looking to add customers and secure flexibility in your supply chains, distribution networks and marketing initiatives. Could a well-strategized deal be the right answer? In addition, new accounting rules just around the corner may have substantive impact on business combinations, so if you've been thinking about doing a deal, the recommended timing may be sooner rather than later.

### Deal with the risks or risk the deal

In the race to get deals done quickly, some companies bypass the due diligence believing that they "know" the target and therefore do not need to invest the time and money in carrying out a thorough diligence process. Companies need to consider risks

associated with improperly executing the deal, including the loss of customers or market share, liabilities and exposures, unintended accounting and tax implications, integration obstacles and hurdles, hidden costs, unexpected outlays, or delays in executing on the strategy—all of which result in a higher cost to acquisition. Even worse, a company's brand name and reputation can be tarnished.

With that in mind, M&A activity of any kind is a highly complex endeavor. To achieve the expected results, it requires a high level of commitment, dogged determination to scope out all the details and what-ifs, creativity, responsiveness, and an ability to deal gracefully with near-constant change, pressure and frequent frustration. If this article does nothing more than serve as a cautionary tale about the need to investigate all the angles before you act, then it will have done you a big favor.

Corporate marriages—and separations—can look very attractive when inked in big letters on newsprint. The dealmakers are rightfully proud as they smile out from the news photos about what they've accomplished, and investors are often inspired by the strategic charm and intelligence of the transaction. Current research tells us, however, that the majority of mergers fail due to errors in the approach and execution of the merger. Specific reasons for failure are varied, but may include: wrong partner, poor process leadership, untenable cultural differences, inability to deliver expected value, too far removed from core competencies.

In short, any M&A specialist worth his or her credentials will tell you that proper planning, due diligence, execution and post-integration efforts are all mutually important in completing a deal that truly achieves the desired results. After the heady—and often disappointing—transactions that marked the late 1990s and early months of this decade, sharp consumer business executives and their M&A advisors will take a sober step back to review what went wrong with some of those deals and how those lessons can be applied to their current situation.

Additionally, consumer business executives are dealing with new regulations, including the inherent implications of FASB's recently issued Exposure Draft on the accounting for business combinations looming. There's also

the constant focus on the importance of, and requirements for, having their financial house in order. New regulatory reporting and certification requirements are ensuring proper internal controls and compliance processes are in place to support transparency of financial record keeping and integrity of players involved in deals.

And corporate boards have become much more involved and active at the strategic level in reviewing the rationale and plans for a major transaction. Details that they once would have left to the lead executives involved in the deal are now scrutinized with intensity and vigor, questions are asked and management's decisions pondered before approval.

**Enhanced value through enhanced execution**

How can you improve the likelihood of achieving your desired results? How can you and your advisors determine that during the execution of the deal synergy opportunities are transferred from "value envisioned" to "value captured"?

A huge component of maximizing the value of a transaction is minimizing the associated taxes. Additionally, the precedents installed for tax and accounting purposes must

withstand the most exacting scrutiny from the regulatory and investment community. Properly constructing a deal, which includes aligning all business and tax strategies—both domestic and international—can lead to potentially huge tax savings, and ultimately, a significant return on investment.

While appropriate minimization of tax burdens is a critical step to ROI, it is just that—a step, and one of many. A systematic approach within a flexible framework will help to maintain focus on key issues and value drivers.

Consider carefully addressing the following issues from all sides:

- Deal strategy
- Target screening
- Due diligence (financial, tax, operations)
- Deal structure
- Valuation
- Tax planning
- Human resources
- Operations integration
- Systems integration

The goal, stated in its simplest form, is to plan, structure and manage a strategic platform and overall integration effort that helps our client meet current and future commitments to shareholders, employees, customers, and suppliers.

There are pitfalls, of course, for even the most well thought out plans, but most can be avoided with a little extra planning. Here are a few frequently cited examples:

**Communicate a clear understanding of the value of the transaction and plan accordingly**

—The deal's purpose and specific objectives should be clear to all stakeholders. Paint a visual picture of how the "new" consumer business company will be better off—greater customer reach, increased revenues, cost-effective resourcing, enhanced competitiveness, and improved opportunities for employees.

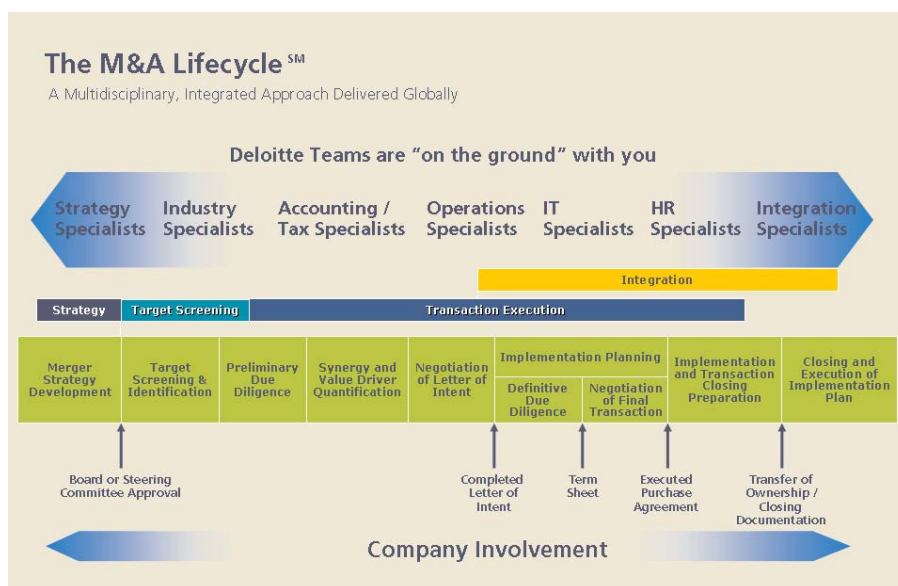
**Consider what investors care about**

—As consumer business industry observers, they're interested in growth expectations, cyclical, competitive dynamics, and regional vs. global business strategies. Strategically, they're looking at leadership, market position, relative profitability, distribution clout, and growth plans overall. Financially, they will want to know that a deal takes financial targets, earnings consistency, balance sheet strength, and liquidity into account. Address these in communicating your vision.

**Create an integration plan that can be accomplished quickly**

—Build a detailed plan that involves both big and small tasks. Create a "clean team" of employees from both organizations to work on the integration process. Antitrust rules prohibit sharing of certain confidential information before the deal has undergone extensive regulatory review. Members of the clean team are exempt from this requirement and can develop the plan while reviews are underway. Involve senior management in this process, too. Last but not least, try to choose the best aspects of both companies for the new go-forward plan, and don't let politics, tradition or personalities confound those decisions.

**Continue to serve your customer**—Don't lose sight of what keeps you in business in the first place. Make sure most of the company is focused on driving revenues and supporting the existing "core" business strategy.



At Deloitte, we help our clients through a multidisciplinary approach that puts teams of specialists "on the ground" with the client throughout the combination process—from deal strategy and consumer business industry outlook, to accounting, tax, legal and operations due diligence and on through HR and IT integration.

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**Address employee concerns**—Don't take valued human resources for granted by sweeping their questions under the rug. Communicate openly and honestly, addressing concerns about the new culture of the newly forming entity and take steps to blend employees from both companies early on.

**Plan for an effective post-integration strategy**—Another lesson of the period of excess in the late 1990s was that you simply can't take your eye off of the core business, because to do so threatens the very basis for the reason you are doing the deal! Savvy dealmakers keep their focus on running the business and draw on external experience, knowledge and skills to help implement the integration process. Building a strategic platform will help lead to seamless integration and may also provide a foundation to future deal activity. There are four key steps in effective management and flawless execution of integration efforts:

1. Destination Definition—set up a readiness plan and process to establish an end-state vision.
2. Determine the degree of integration to capture key synergies, especially management and culture, prior to deal consummation.
3. Set "people" expectations and communicate merger progress to both employees and stakeholders.

4. Prepare a timeline that organizes all activity around Day One readiness, including HR and communications effectiveness plans.

Creating a well-defined structure will be beneficial, because it will allow the newly formed entity to investigate and explore continuously new targets and opportunities. Naturally, all of these skills don't usually exist within the companies involved in the transaction, but outside advisors can bring the skills and experience to help increase the likelihood that these steps all go smoothly.

### Is it worth the "premium paid?"

In the final analysis, most M&A activity requires an end result that is somewhat greater than a break-even proposition in order to be deemed a success. That is, you almost always start in a hole when you put a deal together. Therefore, for the deal to have true shareholder value, the transaction has to yield positives in areas such as benefits of scale, unique synergies, improved talent resources, exponential marketing opportunities. It's critical to ask yourself this question: "Will completion of this deal result in achievement of benefits that will offset the premium that is being paid to make it happen?" If the answer is yes, then the follow on questions are "How are we going to get there—specifically?" and "How soon?"

While there can never be any hard and fast assurances that a particular M&A transaction will work out as planned, there are some paths to the end result that are more clearly marked and anticipated than others.

Sophisticated consumer business executives will take thoughtful time to determine they're on the right path all the way to the desired destination.

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