Cross-Border PMI for Value Creation

Nomura Research Institute
Consulting Division

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NRI

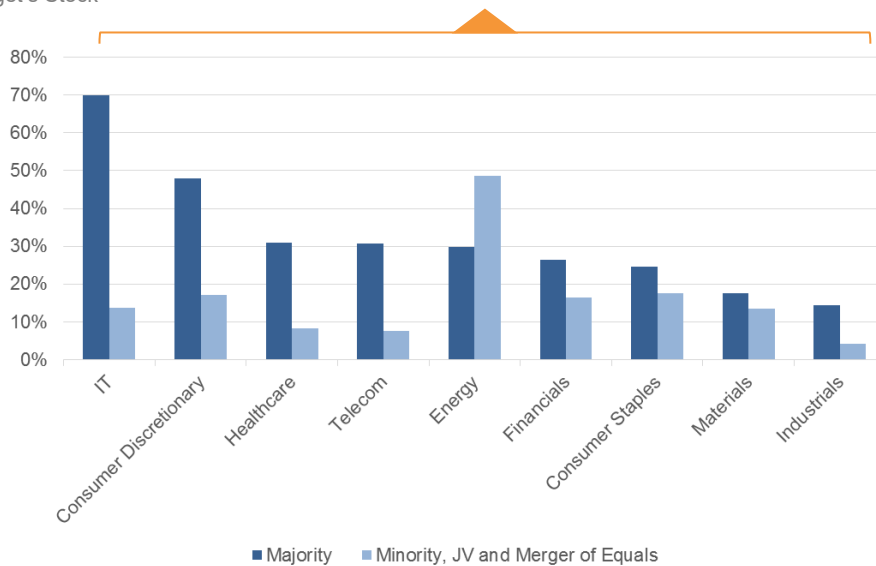*Share the Next Values!*

Agenda

■ **Why PMI?**

■ NRI's PMI Solution

In fact, in the past decade Japanese buyers have been paying around 30% price premium in majority deals across different industry verticals

Valuations Are Higher in Majority Deals

- *Overall, Japanese buyers are paying **at least around 30% price premium on majority transactions across most sectors***

- ***Minority deals etc are lower**, possibly reflecting **risk of synergy creation** and **governance***

Deal Owner in
Japanese Multinationals
(Consumer & C&I products)

Median Premium on Target's Stock[1]

Legend: ■ Majority ■ Minority, JV and Merger of Equals

X-axis categories: IT, Consumer Discretionary, Healthcare, Telecom, Energy, Financials, Consumer Staples, Materials, Industrials

Y-axis: 0% to 80%

Strategic Investors' Concerns over the Success of Deals

"...traditionally, we **prefer full buyout of crucial assets**, paying higher premium in return for control to drive synergy. Meanwhile, in recent years we are also seeing **increasing number of strategic minority deals** particularly in **high-tech or new applications**, where existing shareholders eg funds wish to stay in the game."
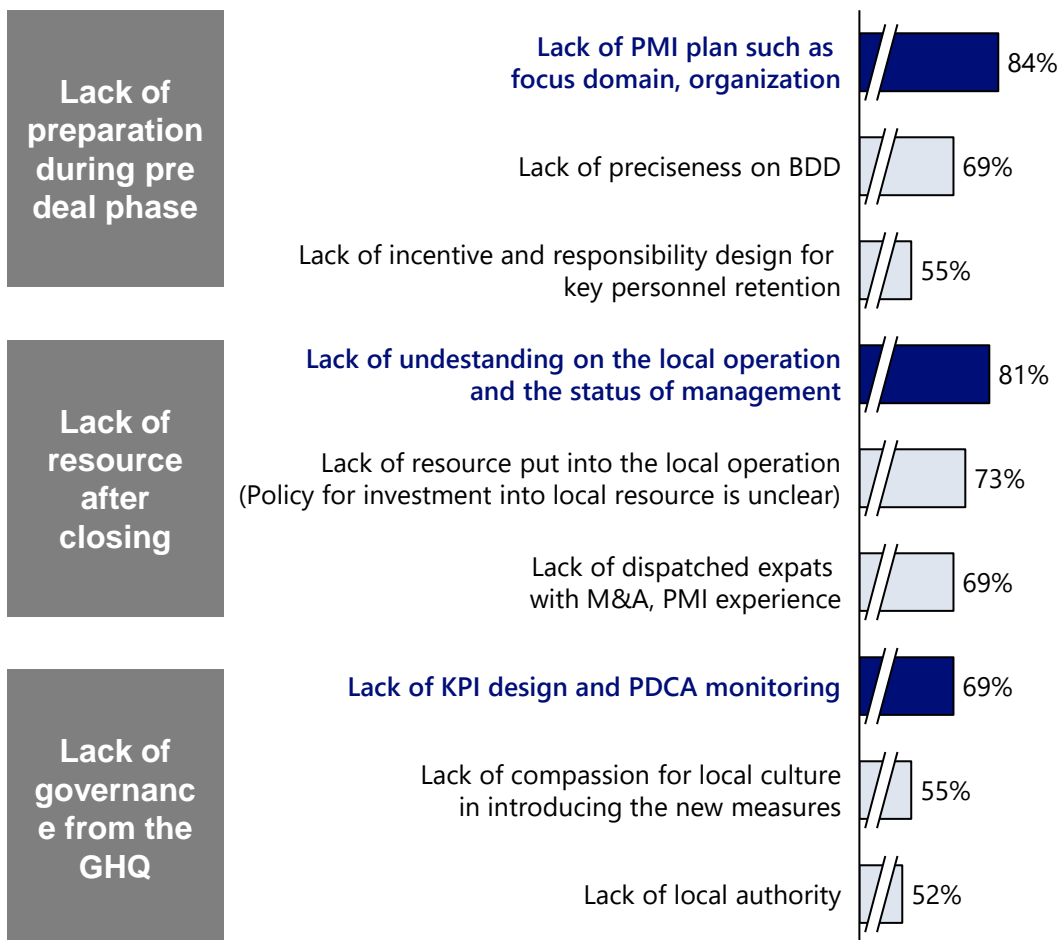
"In either case, our executives are equally concerned – for majority deals, **whether target's business plan and synergies can be achieved in order to support valuation and price premium**; and for minority transactions, whether we are **equipped with the rights and tools to drive synergy and protect investment at all**."

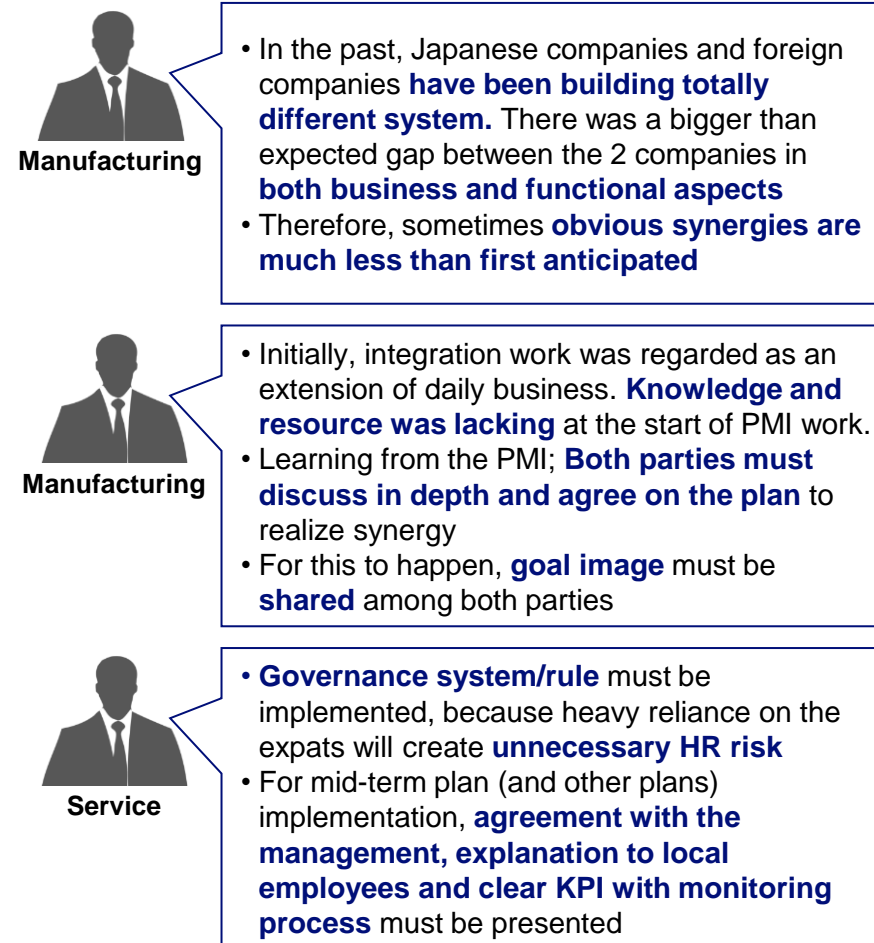[1] Median Target Stock Premium, one day prior to announcement

However, many Japanese buyers are not fully ready for, or capable of, driving a successful cross-border PMI

Typical Challenges in Cross-Border PMI

Lack of preparation during pre deal phase

- Lack of PMI plan such as focus domain, organization — 84%
- Lack of preciseness on BDD — 69%
- Lack of incentive and responsibility design for key personnel retention — 55%

Lack of resource after closing

- Lack of undestanding on the local operation and the status of management — 81%
- Lack of resource put into the local operation (Policy for investment into local resource is unclear) — 73%
- Lack of dispatched expats with M&A, PMI experience — 69%

Lack of governance from the GHQ

- Lack of KPI design and PDCA monitoring — 69%
- Lack of compassion for local culture in introducing the new measures — 55%
- Lack of local authority — 52%

Opinions of NRI Clients on Cross-Border PMI

Manufacturing
- In the past, Japanese companies and foreign companies **have been building totally different system.** There was a bigger than expected gap between the 2 companies in **both business and functional aspects**
- Therefore, sometimes **obvious synergies are much less than first anticipated**

Manufacturing
- Initially, integration work was regarded as an extension of daily business. **Knowledge and resource was lacking** at the start of PMI work.
- Learning from the PMI; **Both parties must discuss in depth and agree on the plan** to realize synergy
- For this to happen, **goal image** must be **shared** among both parties

Service
- **Governance system/rule** must be implemented, because heavy reliance on the expats will create **unnecessary HR risk**
- For mid-term plan (and other plans) implementation, **agreement with the management, explanation to local employees and clear KPI with monitoring process** must be presented

NRI 3
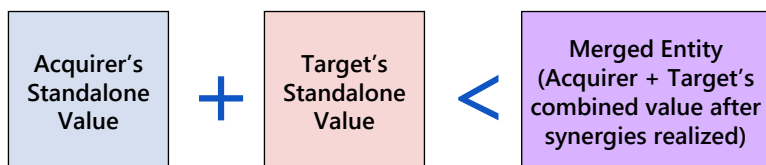
60% of the M&A deals have deteriorated the shareholder value. Proper deal management and PMI is important to avoid such risk.

The Issue

M&A deals are successful when:

$$\text{Acquirer's Standalone Value} + \text{Target's Standalone Value} < \text{Merged Entity (Acquirer + Target's combined value after synergies realized)}$$

However:

60%

of M&A deals destroy shareholder value* (including in-in)

Because:

Despite the importance of accurately identifying and calculating company synergies, diligence work frequently results in an **overly optimistic view** of the synergy opportunities, and companies **underestimate the effort required to realize the synergies**

Key Focus Areas to minimize risks

Synergy assessment

- Accurately calculate the potential synergies during valuation using sensitivity analysis, to simulate scenarios of optimistic and pessimistic views
- Incorporate the pessimistic view into valuations and bids, to minimize the risks
- Include the resources and investment required to realize the synergies into the valuation and integration plan

Realizing synergies

- Synergies identified pre-deal should be converted into targets and projects with deliverables at deal close
- PMO should track and monitor the projects and results against the synergy targets to assure the estimated value is realized during the PMI process
- Allocate the proper amount of resources to manage and execute synergy projects to realize value

Missed Opportunities

- The merged company should collaborate to identify any missed opportunities for synergies on the revenue and cost side using proven frameworks
- Revenue upsides can include complementary products, geographies, and customers, patents / IP, etc.
- Cost savings can include supply chain efficiencies, shared IT, lower SG&A costs, R&D synergies, etc.

The challenge of ROI / TSR enhancement lies in all steps across deal flow

Phase	Pre-Closing	Post-Closing	
Deal Flow	*Deal Closing* ✖	*PMI* (100-Day Plan) ✖	*Post PMI*
Common Issues	✖ "BLACKOUT" BETWEEN DA[1] AND CLOSING	✖ MISSING OF VISION AND STRATEGY GUIDANCE	✖ INEFFECTIVE PDCA & EXPAT-DEPENDENCY

"BLACKOUT" BETWEEN DA[1] AND CLOSING

‣ **WHAT HAPPENS?**
Buyside Deal Team often places **too much emphasis on reaching definitive agreement** itself, with little or no preparation for post-closing events

‣ **YOUR RISK?**
In majority transaction, buyer loses precious opportunity window to prepare integration and key men retention   (ie **time loss and higher future communication cost**);
As for minority investor, **without appropriate "protections"**, estimated synergy or return on investment may have **lower chance of delivery**

MISSING OF VISION AND STRATEGY GUIDANCE

‣ **WHAT HAPPENS?**
Buyers tend to focus on urgent consolidation work of finance and accounting[2], or easy-to-deliver quick-win actions eg co-visit of clients, neglecting the **importance of long term value driver – vision and strategy**

‣ **YOUR RISK?**
Vision and strategy alignment is the cornerstone of long term partnership. Without shared understanding (including the process leading to such consensus), integration work might only focus on short term view & deliverables;

Eventually, buyer might **miss long term growth storyline and necessary actions to drive value creation, hurting total shareholder return (TSR)**

INEFFECTIVE PDCA & EXPAT-DEPENDENCY

‣ **WHAT HAPPENS?**
Agreed initiatives and protocols are **often without PDCA** in post-PMI operations; also, in many cases, key information exchange and decisions
are reported / made by **expats from Japan**,
creating a **closed loop and "black box"** in management

‣ **YOUR RISK?**
Momentum of integration and sense of trust may be eventually lost and hard to rebuild

[1] Definitive Agreement

[2] Depending on timing and contents of deal, finance & accounting may have very high priority in PMI project

Source: NRI
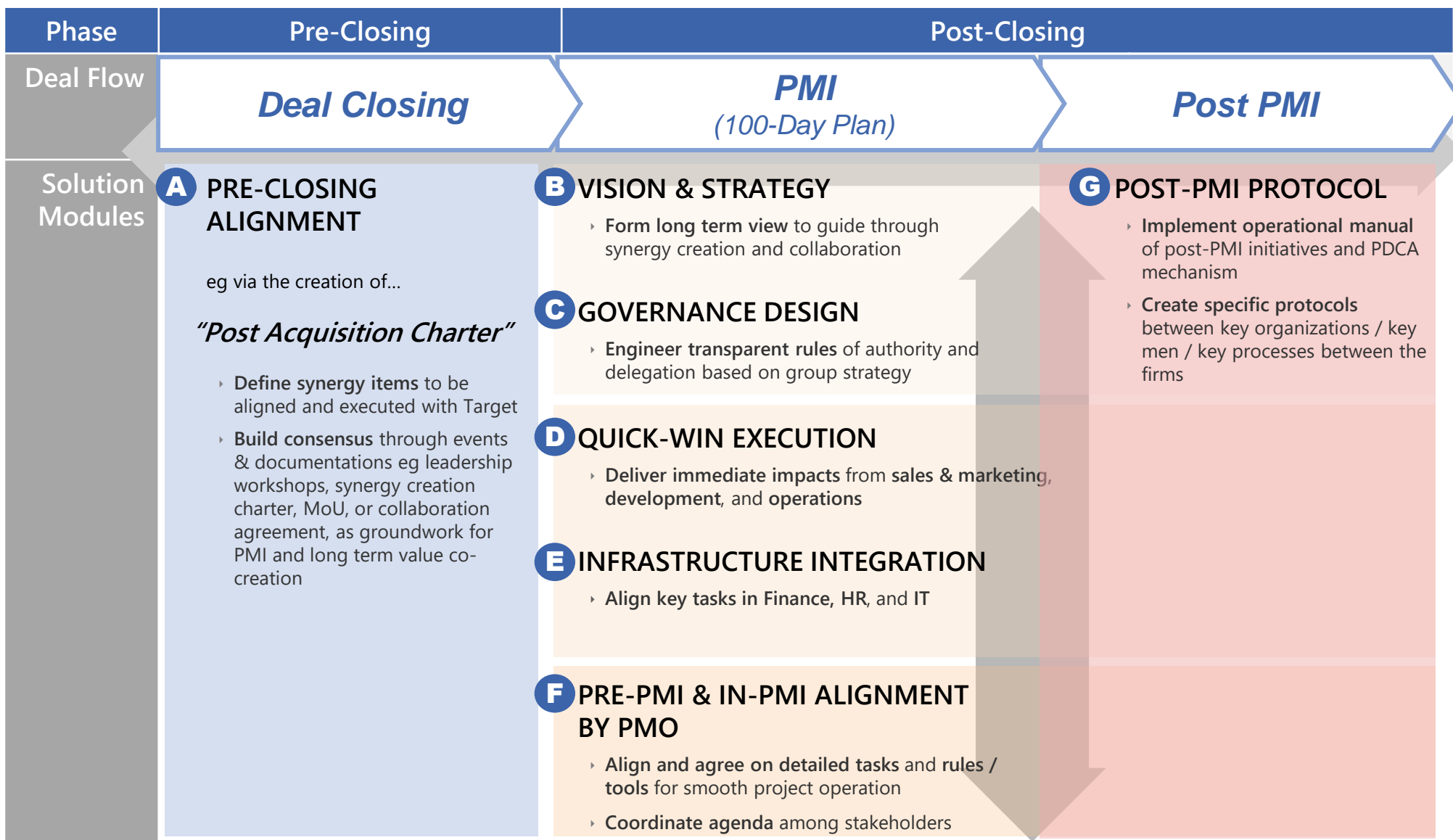
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Agenda

■ Why PMI?

■ NRI's PMI Solution

NRI has a proven framework to assist clients with PMI. Operating model is crucial and needs to be aligned with the business strategy.

Key action items in PMI

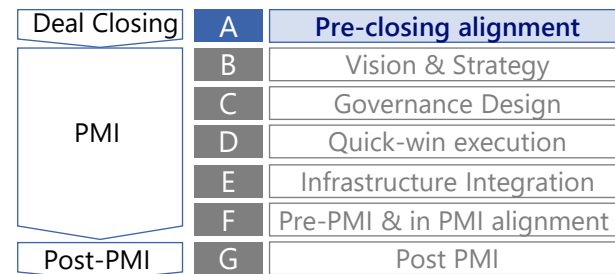|		Key action items
Management Strategy	Mission/Vision/Value	• Communicate mission/vision/values of buyer to each business unit and corporate organization • Communicate mid & long-term vision and strategy with execution teams
	Financial Ambition	• Need to plan and execute quantified synergies prior to deal • Breakdown the quantified synergies to executable level by BUs or functional team.
	Positions and Brand	• Assess the target branding value and strategize the branding for the future
Business Model	Markets	• Define the target market utilizing target's customers, channels and product/service • Strategize the new market entry by maximizing the deal synergy
	Customers and Channels	• Design the customer portfolio for short, mid and long term considering cross sell opportunities • Prioritize the customer based on the future state business model
Operating Model	Core Business Process	• Design and implement target operating model by using buyer's standardized model or enhanced target's model to provide standardized KPIs and maximize the cost synergies
	Operational & Technology Infrastructure (IT)	• IT infrastructure including ERP, BI, HCM, Demand management, etc. is a key component in TOM which will support entire operating model and is most time and money consuming to implement in PMI
	Organizational Structure	• Design new organization structure if necessary, to follow the new role and responsibilities or comply with new company policy
	Risks & Controls (Governance)	• Implement financial controls (SOX, etc.) and delegation of authority based on the buyer's guideline to minimize the risks
	People & Culture	• Cultural gap could be a potential barrier for PMI. Cultural assessment should be performed to minimize the risks of PMI

Source: NRI

NRI's Approach for PMI

Seven modules to fully align pre-closing, in-project, and post-PMI operations

Phase	Pre-Closing	Post-Closing	
Deal Flow	**Deal Closing**	**PMI** *(100-Day Plan)*	**Post PMI**

Solution Modules

A PRE-CLOSING ALIGNMENT

eg via the creation of...

"Post Acquisition Charter"

- ‣ **Define synergy items** to be aligned and executed with Target
- ‣ **Build consensus** through events & documentations eg leadership workshops, synergy creation charter, MoU, or collaboration agreement, as groundwork for PMI and long term value co-creation

B VISION & STRATEGY

- ‣ **Form long term view** to guide through synergy creation and collaboration

C GOVERNANCE DESIGN

- ‣ **Engineer transparent rules** of authority and delegation based on group strategy

D QUICK-WIN EXECUTION

- ‣ **Deliver immediate impacts** from **sales & marketing**, **development**, and **operations**

E INFRASTRUCTURE INTEGRATION

- ‣ **Align key tasks in Finance, HR**, and **IT**

F PRE-PMI & IN-PMI ALIGNMENT BY PMO

- ‣ **Align and agree on detailed tasks** and **rules / tools** for smooth project operation
- ‣ **Coordinate agenda** among stakeholders

G POST-PMI PROTOCOL

- ‣ **Implement operational manual** of post-PMI initiatives and PDCA mechanism
- ‣ **Create specific protocols** between key organizations / key men / key processes between the firms

Introduction of each module

Leading to optimal PMI design aiming at mutual understanding/respect and long term integration

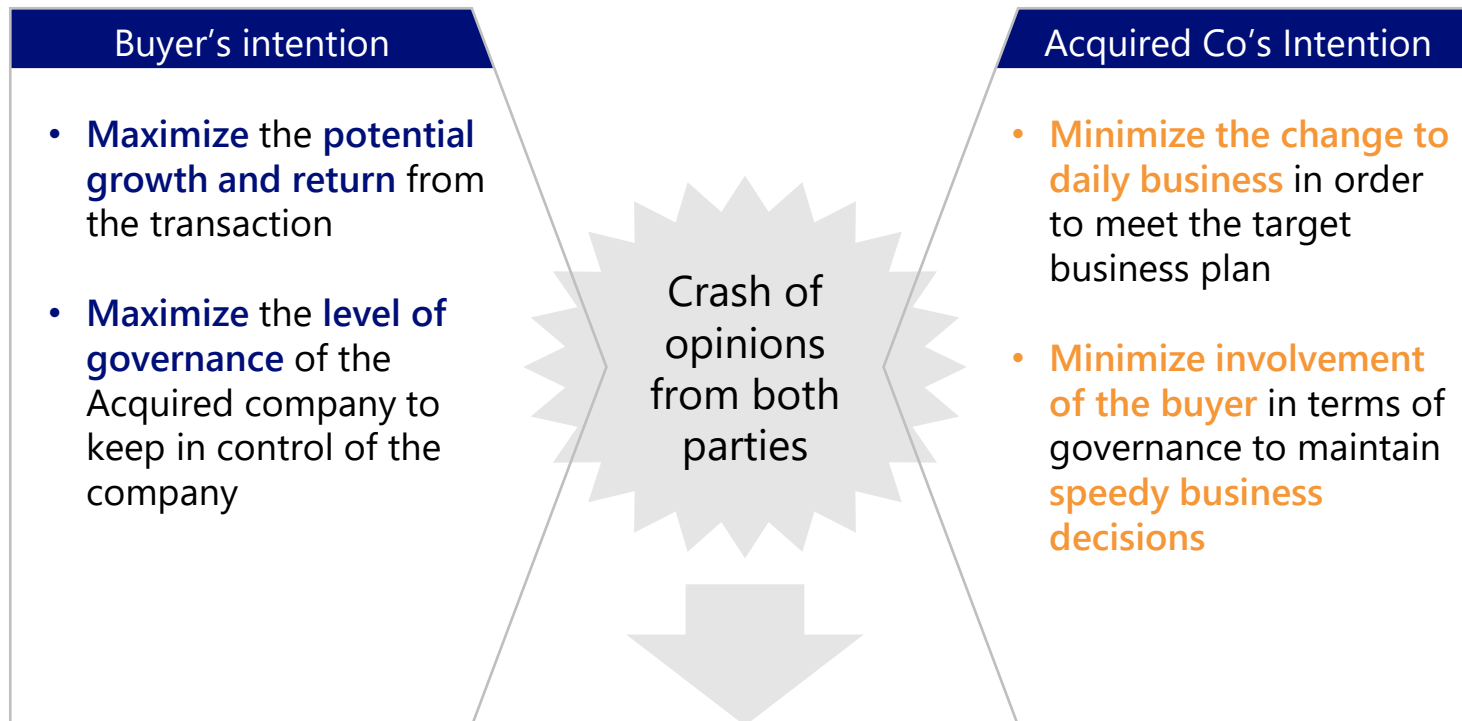| Deal Closing	A	Pre-closing alignment
	B	Vision & Strategy
PMI	C	Governance Design
	D	Quick-win execution
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	F	Pre-PMI & in PMI alignment
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Issues to be Addressed During Pre-Closing Alignment

	Majority Transaction	Minority Transaction
Vision / Strategy	• Build a common understanding of the **Buyer's strategic objectives** of the transaction • Agree on a preliminary range of targets to **achieve the 5-year business plan**	• Build a common understanding of the **Seller's expectation towards the Buyer** • Agree on clear targets to **achieve the 5-year business plan**
Governance	• **Agree on the principal of governance**	• **Agree on the extent to how much control the Buyer will possess**, i.e. how many BOD members may be dispatched to the Seller's board, voting / veto rights and other issues associated with BOD operation
Synergy	• **Build some synergy hypothesis and major directions** which may be achieved from the transaction	
100 days plan	• **Select key members of the Team / WGs from both the Acquired co. and the Buyer** to promptly commence the 100 days plan development process from Day 1. • Set **tentative agenda** for each WG.	• Same as the majority case, however, **inclusion of such item in a document (e.g. Strategic Cooperation Agreement)** is recommended for assurance

Source: NRI

Deal Closing	A	Pre-closing alignment
	B	Vision & Strategy
PMI	C	Governance Design
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NRI's Approach for PMI

ANRI will support to facilitate the discussion in order to develop "Post Acquisition Charter", which includes items captured in previous page

■ **A. PRE-CLOSING ALIGNMENT: leading to optimal PMI design aiming at mutual understanding/respect and long term integration**

Buyer's intention

- **Maximize** the **potential growth and return** from the transaction

- **Maximize** the **level of governance** of the Acquired company to keep in control of the company

Crash of opinions from both parties

Acquired Co's Intention

- **Minimize the change to daily business** in order to meet the target business plan

- **Minimize involvement of the buyer** in terms of governance to maintain **speedy business decisions**

Value of NRI: NRI will facilitate the discussion as a third party team to create *a fair and agreeable post acquisition charter* to *build consensus between the Buyer and the Acquired Co.*

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NRI's Approach for PMI

Guiding long term value creation via thorough alignment of vision and future strategies – framing the fundamental mindset

Vision & Strategy as Key Guidance in Integration Work

Business Goal

Buyer's Vision and Future Strategy

Integration of Vision and Strategic Direction

Time
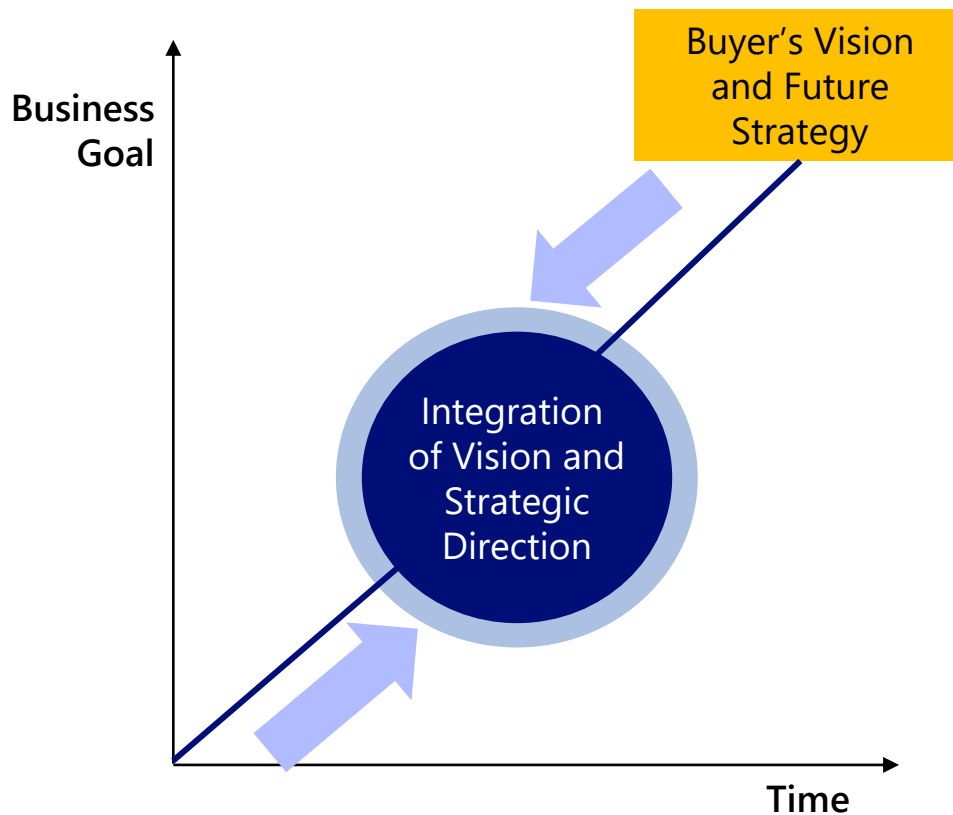
TOP DOWN

- **What to aim for** (to-be) based on **customer needs/requirements and differentiation** viewpoints?
- What **key strategies** shall be taken?

Vision & Strategy WG

Aligned at PMO

BOTTOM UP

- How to fully leverage **go-to-market, technical, and operational strengths** from both firms?
- How to address **immediate customer needs** eg orders?

Individual WGs

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Guiding each individual WG and initiative/action discussion to ultimately fulfill shared vision and strategic goal

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Vision & Strategy ---- Strategic Pillars & Targets ---- Action Plan

Vision/Strategic Goal	Strategic target [Level1]	Performance Target [Level2]	Action [Level3]
State to be achieved	Primary strategy (Strategic Pillars)	State to be achieved [Level 1]	State to be achieved [Level 2]	Action

Achieving as Number One Company in the US	*Realizing the Growth of OEM business…*	*Ensuring quality required by key (loyal) costumers (from LTV analysis etc)*	*Securing the quality of final products*	*Procuring proper raw materials for XXX, XXX products*
⋮	⋮	*Establishing reliable supply chain in XXX, XXX*	~~*Implementing standardized manufacturing process, particularly XXX and XXX*~~	*Enhancing uniformity of products*
		⋮	⋮	⋮

Set up Meaningful Objective of Business
Ex) Doubling sales volume by 20XX

Set up Strategic KPI
Ex) "Share of specific customers' procurement" to reach 10% by 20XX

Set up KPI for Each Target
Ex) "Percentage of products meeting standard quality" to reach 99.9% by 20XX

Set up Progress KPI for Each Action
Ex) "Percentage of purchased raw material items from suppliers" to reach 80% by 20XX

Ensuring high transparency in decision making across management levels

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Key Considerations When Framing Governance Structure and Operational Details in Cross-Border Deals

Buyer Global Headquarter

4 Company core KPIs and clear **linkages with executive team incentives** to be defined

GHQ Board Meeting

GHQ Executive Officers

Buyer Regional Headquarters

HD Co.

Appoint and delegate

Target's Board of Director

Appoint and delegate

Executive Officers

2 BOD reserved matters and **executive officer authorities / report lines** are clearly defined by documents

1 Buyer to discuss with target and other stakeholders (eg co-investor) and determine **to which extent Buyer GHQ, RHQ or BU would like to position Target in group governance**

3 To consider **relationship and balance with other RHQ or business unit**, eg based on maturity of business operations, capability of executive team, interactions with other regions/BUs etc

Target Region / Business Unit

Region / BU

Region / BU

Deal Closing	A	Pre-closing alignment
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NRI's Approach for PMI

Output images of governance related discussion/alignment materials during assignment

← **Strategic / Management Level** ———— **Daily Operation Level** →
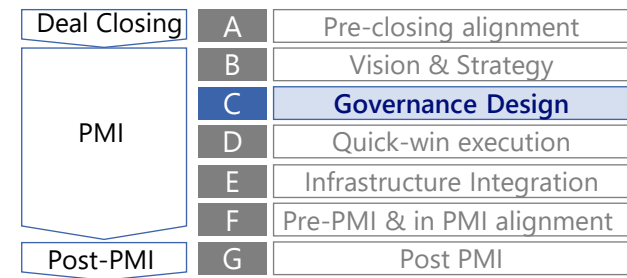
Appropriate Positioning of Target in Future Group Ops

Re-align responsibility and authority/delegation based on buyer's guidance and target's capability / culture / expectation

Major Degree of Responsibility & Authority — *Not Exhaustive*

Report Line Design to Remove Blackbox in Daily Ops

Re-aligning report lines to enhance governance towards newly acquired management team

Images of Report Line Design
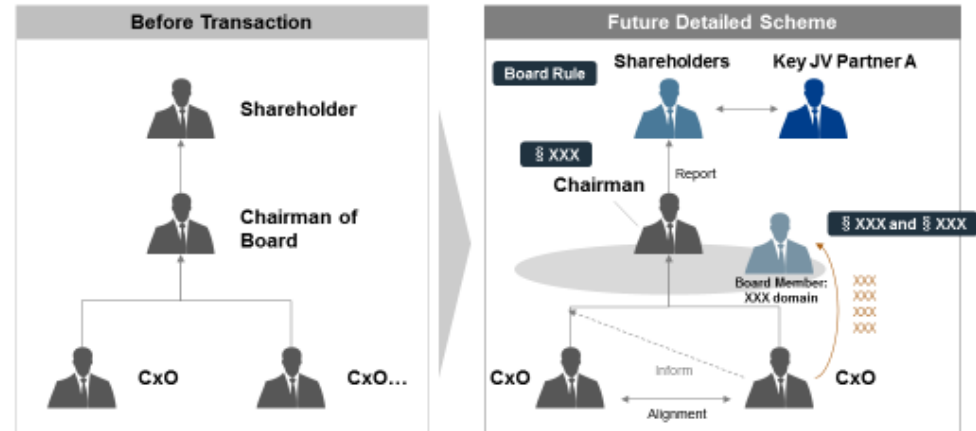
To be planned by NRI and buyer deal team, and to be fully aligned with Buyer and Target's top management

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NRI's Approach for PMI

Detailed guideline of collaboration platform / organization and key process can also be tailored to meet integration needs

← *Strategic / Management Level* ———— *Daily Operation Level* →
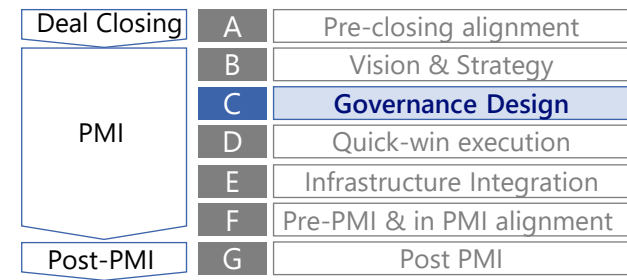
Design of Integration/Collaboration Platform

Creation of synergy platform (organization) consisted of core members from key functions from both sides

Alignment of Key Cross-Functional Process/Protocol

Detailed guidelines for co-sales activities
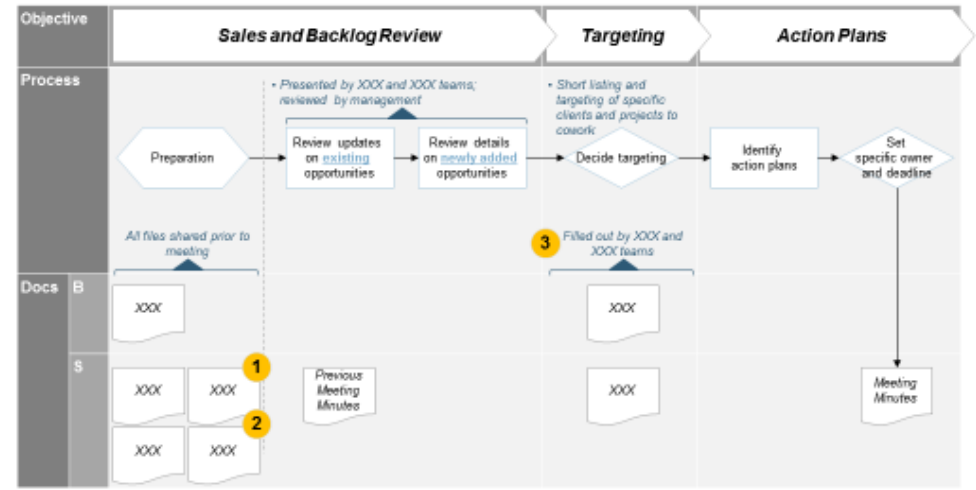
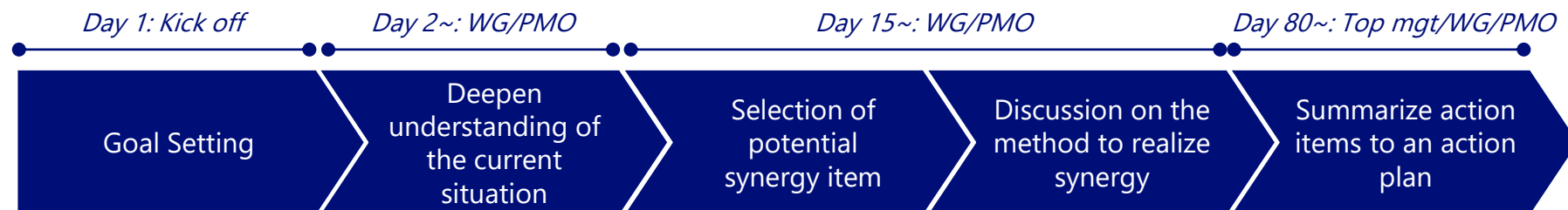*To be created by process owners and closely aligned with Buyer and Target during the course of integration project*

Deal Closing

A	Pre-closing alignment
B	Vision & Strategy
C	Governance Design
D	**Quick-win execution**
E	Infrastructure Integration
F	Pre-PMI & in PMI alignment
G	Post PMI

PMI

Post-PMI

NRI's Approach for PMI

QUICK-WIN EXECUTION
(eg sales & marketing, development, operations)

Key Aspects of WG Related to Quick-Wins

Day 1: Kick off — *Day 2~: WG/PMO* — *Day 15~: WG/PMO* — *Day 80~: Top mgt/WG/PMO*

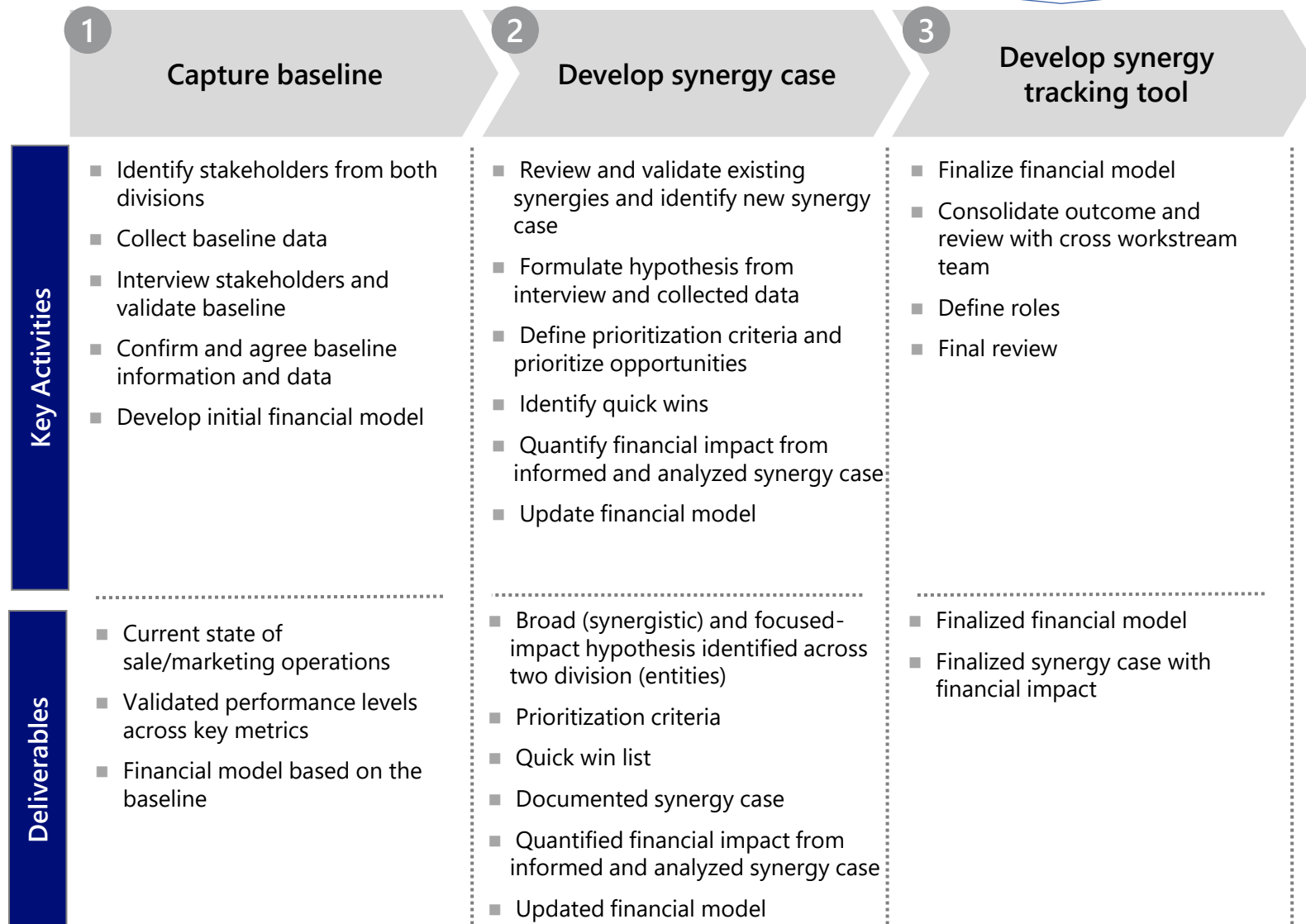|	Goal Setting	Deepen understanding of the current situation	Selection of potential synergy item	Discussion on the method to realize synergy	Summarize action items to an action plan
Sales and Marketing	• The goal of WGs **depends on the Vision/Strategy** derived by the **management team.** • If **quantitative KPI target is set** by the management team, WG shall **discuss the feasibility and align with the given target** • If not, WG shall **discuss the quantitative KPI target**	• Products • Clients • Competitors • Future sales plan	• Cross-selling	• Shall be discussed within each WG. Key points which should be covered are: - Year-by-year quantitative targets (If applicable) - Timeline and detailed action - The owner of each task	
R&D		• Available resource • Strength (Technology / patent) • Development roadmap	• Sharable resource • Future research and development strategy (Co-development etc)		
Purchasing		• Direct / Indirect purchasing quantity and source	• Sharable purchasing items • Future purchasing strategy		
Production		• Machines • Processes • Production costs for each goods	• Best practice that may be introduced to one another　(Kaizen)		

NRI will take dependencies of each WG into consideration when designing the WG structure

|		
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NRI's Approach for PMI

A focused 3 step approach will guide to identify the synergy opportunities and develop the synergy tracking tool

	① Capture baseline	② Develop synergy case	③ Develop synergy tracking tool
Key Activities	- Identify stakeholders from both divisions - Collect baseline data - Interview stakeholders and validate baseline - Confirm and agree baseline information and data - Develop initial financial model	- Review and validate existing synergies and identify new synergy case - Formulate hypothesis from interview and collected data - Define prioritization criteria and prioritize opportunities - Identify quick wins - Quantify financial impact from informed and analyzed synergy case - Update financial model	- Finalize financial model - Consolidate outcome and review with cross workstream team - Define roles - Final review
Deliverables	- Current state of sale/marketing operations - Validated performance levels across key metrics - Financial model based on the baseline	- Broad (synergistic) and focused-impact hypothesis identified across two division (entities) - Prioritization criteria - Quick win list - Documented synergy case - Quantified financial impact from informed and analyzed synergy case - Updated financial model	- Finalized financial model - Finalized synergy case with financial impact

Source: NRI

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Deal Closing	A	Pre-closing alignment
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NRI's Approach for PMI

NRI could cover IT infrastructure integration as well as HR and finance infrastructure integration
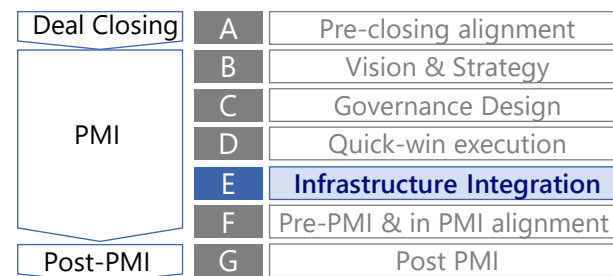
■ E. INFRASTRUCTURE INTEGRATION (eg HR, Finance, IT)

Key Agenda to be Covered During Infrastructure Integration

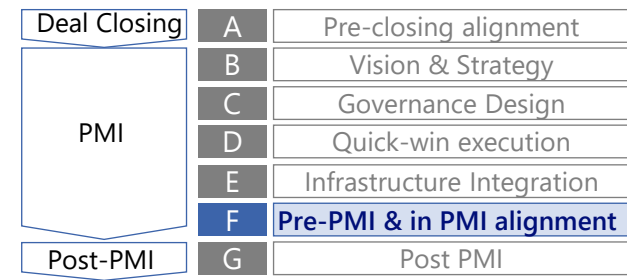| HR	Finance	IT
• **Retention of and Protocol with Key Management** – *Roles & responsibility, reporting line, retention/compensation of key management, succession plan etc* • **Structure and Fundamentals of General HR System** – *Overall HR guideline/strategy, job grading, salary table, appraisal scheme, promotion, labor relationship etc* • **Talent Management** – *Training / development program, rotation, key talent pooling, etc* • **Cross-Cultural Integrations** – *Communication plan, sharing and introduction of history / philosophy / core values, integration events etc*	• **Closing Works** – *Closing account, PPA etc* • **Financial Reporting Standard and Consolidation** – *Overall Finance guideline/strategy, Local accounting principle and IFRS, consolidation package etc* • **Budgeting & Reporting** – *Budget rules, development of new budget and mid/long term forecast, reporting format & rules etc* • **Quick-Win Implementation** – *For instance, optimization of group's debt financing structure, consolidation of auditor services etc*	• **Integration of IT Infrastructure** – *Overall IT guideline/strategy, front office system (eg sales & CRM, product marketing eg PLM), back office system (eg ERP, accounting, identification & security, communications), operations (eg MES) etc* • **Co-Procurement of Software and IT Devices** – *Cost reduction potential by co-procurement etc*

Source: NRI

Finalizing the right (and realistic) agenda setting, resource allocation, and tool design

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Key Aspects of Pre-Kickoff and In-Project Alignment

	To do	PMO role	
WG set up	• Both the Acquired Co. and the Buyer **nominate members** of each functional WGs, who are **capable to understand and discuss about synergy effects**	• **Facilitate the discussion in deciding the members.**	
WG Kick off	• WG members to **discuss and agree on the goals** of the WG, which should be **aligned with the vision/strategy provided by the top management**	• **Facilitate the discussion in deciding the goal of the WG**	 WBS to describe the goal and the tasks of each project within WG
Monitoring	• Progress of the WG shall be tracked to make sure that the **WG is functioning to reach the goal.** • **Any guidance from the top management** shall be provided, if necessary	• **Prepare tools** for tracking • **Request WGs to submit the trackers** (usually, weekly) • **Discuss with the top management team** for any guidance with WG activity	 Tracker to monitor progress of WG

Source: NRI

NRI approach for PMI

The IMO will facilitate meetings to monitor and report the status of tasks on a regular basis

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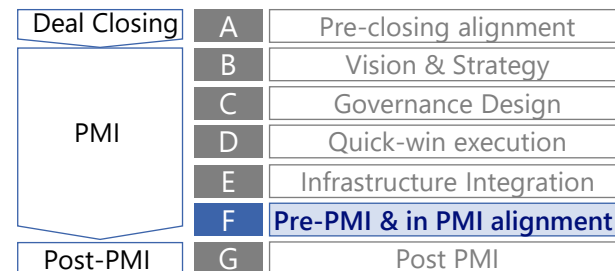
Meeting Objectives

1. To provide transparency on PMI tasks and activities to leadership
2. To manage WGs and cross-functional topics with decisions/guidance from management

Day 100 Task Progress Chart

# of tasks	Not Started	WIP	Complete	N/A	In total
1. Business Development	-	10	15	13	25
2. Operations	-	5	42	-	47
3. Governance	-	2	9	1	11
4. IT	1	8	10	7	19
5. HR	-	3	11	-	14
6. Finance&Accounting	-	17	72	-	89
7. Legal	1	11	30	1	42
8. Communication	1	12	9	-	22
in total	3	68			269

%		WIP	Complete		In total
1. Business Development		40%	60%		100%
2. Operations	0%	11%	89%		100%
3. Governance	0%	18%	82%		100%
4. IT	5%	42%	53%		100%
5. HR	0%	21%	79%		100%
6. Finance&Accounting	0%	19%	81%		100%
7. Legal	2%	26%	71%		100%
8. Communication	5%	55%	41%		100%
in total	1%	25%	74%		100%
Last week	2%	30%	68%		100%

Sample Output

Working Group — Key Integration Activities (Samples)

1. Business Development
- Meetings and workshops to prioritize potential synergies (customer access, cross-selling, alliances and partnerships)

2. Operations
- Identify any operational synergies (tools, methodology, talent)

3. Governance
- Establish reporting lines including monthly reporting
- Finalize governance policies and Delegation of Authority (DoA)
- Conduct fit and gap assessment of policies and rules

4. IT
- Develop "IT Strategic Plan" to maximize synergies
- Comply with IT internal audit guideline

5. HR
- Ensure all employees have minimal disruption from Day-1 (salary, benefits, etc.)
- Achieve post-merger cultural integration

6. Finance & Accounting
- Finalize system for reporting on financial metrics
- Define reporting guidelines and compliance (US GAAP / IFRS)

7. Legal
- Ensure business-as-usual environment with minimal disruption from Day-1
- Support smooth deal handling, including legal document review

8. Communications
- Develop and execute communication plans for all stakeholders
- Develop PR plan with press releases and external / internal communications

Sample Activities

Source: NRI

NRI approach for PMI

Integration Management Office will establish and maintain the integration governance to ensure that the integration is on track and the objectives are met
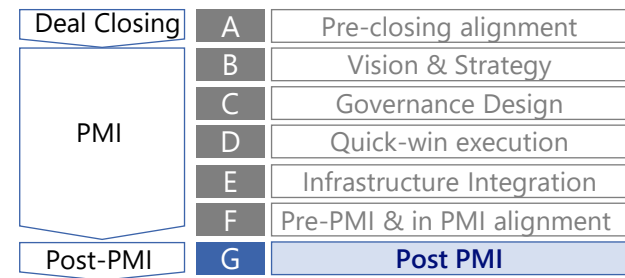
Illustrative

Steering Committee

Decision Portfolio　　Status overview　　Executive dashboard

Integration Management Office (IMO)

Project Database & PMO

Status reports　　Program Dashboard　　Program Issues Log　　Dependencies　　Detailed master plan

Project Staffing　　Communications Matrix　　TSA Tracking　　Org Design　　Roadmap

Work stream Level

Sales
Marketing
Call Center
R&D
Supply Chain
Finance
IT
HR
.
Etc

Charters　　Target Op Model　　Task Plan　　Issue Log　　Dashboard

Source: NRI

Deal Closing	A	Pre-closing alignment
	B	Vision & Strategy
PMI	C	Governance Design
	D	Quick-win execution
	E	Infrastructure Integration
	F	Pre-PMI & in PMI alignment
Post-PMI	G	**Post PMI**
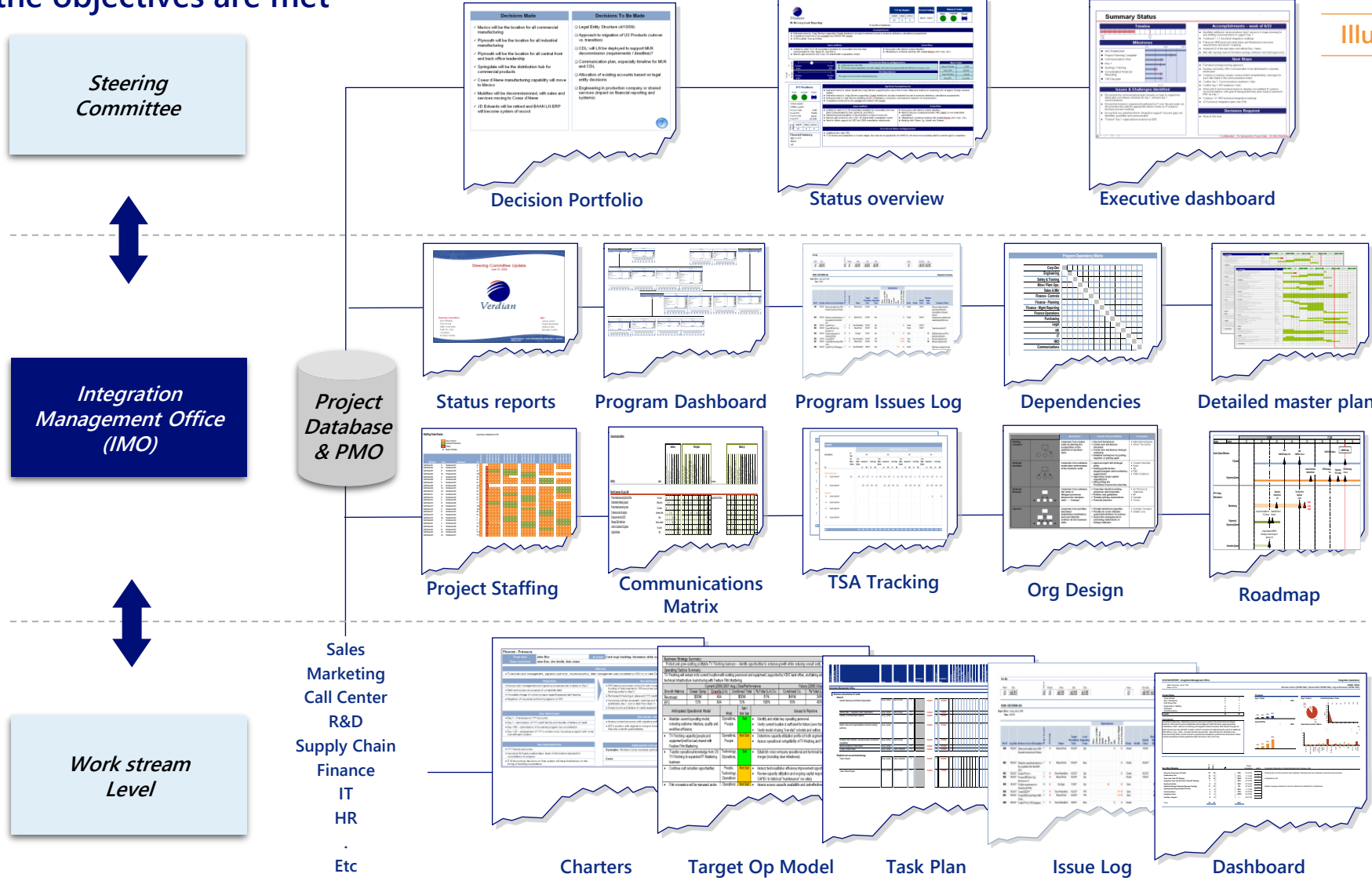
NRI approach for PMI

Implement a set of clear, back-to-normal
(ie no redundant organization or dual owners)
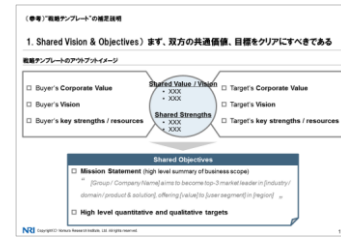# operation rules for long term integration

Delivering Transparency in Post-PMI Operations

Shared Vision & Objectives	Market Intelligence	Growth Aspiration	Initiative Planning	Governance Structure

Mutual understanding of <u>foundation of partnership</u>

- *Philosophy*
- *Vision*
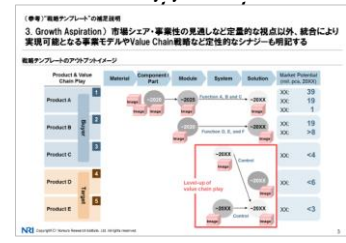- *Scope and objective of business etc*

Sharing view on market <u>dynamics & value drivers</u>

- *Market landscape of demand and supply*
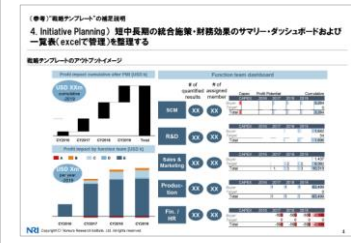- *Trend and innovation*
- *Competitive*
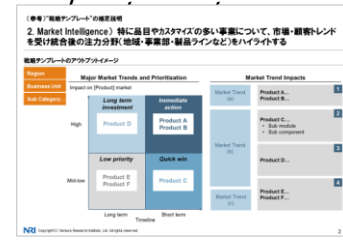
Outlining growth and <u>value creation strategy</u>

- *Customer needs*
- *Key strategies & tactics*
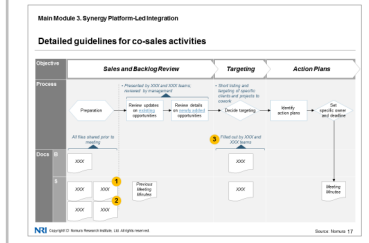- *Target market share and topline*

Defining key initiatives <u>during and post PMI</u>

- *List of initiatives by business / geography / function domain*
- *Priority and ownership*
- *Status and impact etc*

Ensuring transparency in <u>long term, daily operation</u>

- *Governance structure*
- *Authority and delegation*
- *KPI and PDCA etc*

Nomura to deliver a **fully aligned, highly operational handbook** at the end of PMI, helping buyers establish a **consistent & transparent operation model**

Source: NRI

Share the Next Values!