

Mergers & Acquisitions in Brazil Pre and Post Deal Integration

2008-2009



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Introduction

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M&A Deal Integration

Despite the general economic global downturn, the Brazilian merger and acquisition market in 2008 still witnessed a volume of transactions which, although lower than 2007, was similar to 2006. This demonstrates that the Brazilian economy is less sensitive to volatilities in foreign markets than it was ten years ago. A stable political environment as well as solid economic fundamentals is important to attract foreign investments to Brazilian companies. Similarly, Brazilian offshore investments have increased considerably as businesses have expanded abroad. The number of mergers and acquisitions involving Brazilian companies grew by 25% in 2008, as compared to 2007, and exceeded the 2000 record set at the time of the “Internet bubble”. Investors in developed economies are keenly focused on prospects in emerging countries. Brazil stands out by offering opportunities for business expansion and returns on investment through a mature business and legal framework in a stable environment.

In the midst of the global turmoil, PricewaterhouseCoopers selected 100 CEOs deeply involved in Brazilian deals to quiz them on the main barriers and critical success factors in capturing deal value.

Clearly there are many challenges in achieving the synergies, planning the integration and managing key-people before, during and after the merger. The “pre-deal” provides a snapshot into the investments needed to meet the objectives, requirements for laying out the business rationale, the drivers, the strategy of integration and the short-term synergies. Due diligence efforts have focused closely on legal, financial, accounting and tax aspects; little or no attention is given to change management and investment in intellectual capital, so critical to the success of the Deal.

This study takes a deep dive into the critical themes involved and provides a roadmap to the pitfalls and critical path for planning a successful merger or acquisition and the post-deal integration in Brazil.



Survey methodology

The Post-merger or Acquisition Integration survey comprised of interviews with 100 Brazilian companies that recently underwent mergers or acquisitions. The focus was on the pitfalls and critical success factors during the integration phase. The interviews were carried out in the second half of 2008.

Companies of all sizes were involved and, in some cases, the executive surveyed was directly responsible for the integration process, rather than the CEO.

The results provide a useful roadmap for companies planning to embark on a Brazilian acquisition or merger, as it clearly lays out the challenges to be expected and the practical measures to capture the value of the Deal.



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Executive summary



The pre-deal phase presents the most arduous challenges

Approximately 57% of the interviewees stated that most of the effort made during the M&A process is focused on the pre-deal phase, mainly in drawing up the contract, the management of cultural differences and the determination of the offer to be proposed for the target-company.

Synergy mapping is frequently not developed

Only 38% of the interviewees believe that they had correctly measured the financial and operational synergies before deciding on the merger and/or acquisition. The survey indicated that 62% had not properly formalized these.

Managing expectations and operational integration are left to the post-deal

Half of the CEOs affirm that their next acquisition will give added attention to the management of the expectations of employees and to the planning of operational integration (processes, people and IT).

Integration expenses are significant and should not be underestimated

Almost half of the participants said that they experienced significant financial disbursement in the efforts of achieving integration, which increased as a result of delays and inadequate planning.

Flight of intellectual capital in the integration process can reach 25%

On average 25% of the employees decide not to remain with the company because of contractual policies established by the new management, which means critical loss of intellectual capital.

Integration timelines tend to stretch

The time necessary for the integration phase is longer than planned, particularly due to corporate cultural clashes and the embedding of the new strategies, according to almost 40% of the participants

Senior management support – a critical post-deal success factor

Among the critical success factors mentioned by the CEOs, the highest score was given to the continuity of the support of senior management in the period of integration, not always present in an M&A process.

The Survey's top pitfalls and critical success factors of the pre and post M&A integration:

Top 8 pitfalls	Percentage of answers	Top 8 critical success factors	Percentage of answers
Integration timeline	23	Detailed planning	35
Cultural differences	21	Analysis of synergies	25
Internal communications	19	Team integration	12
Management of expectations	15	Negotiation of value and contract	10
Operational integration (persons, IT, processes)	9	Assessment of risks	7
Contractual matters	6	Acceptance of the new culture	5
Financial investment	5	Monitoring of results	4
Delays in closing the deal	2	Effective communication	2

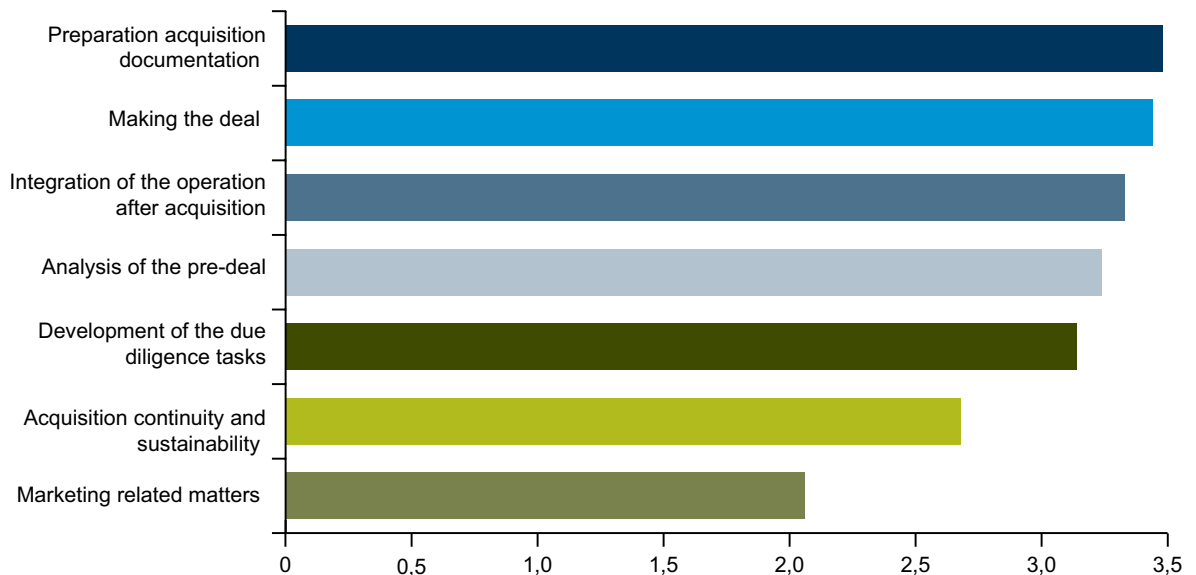
Source: Survey on Integration in Merger & Acquisitions 2008 PwC - 100 CEOs

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The pre-deal phase presents the most arduous challenges

According to the interviewees, an adequate analysis to clearly identify possible cultural, operational and commercial risks is not made; therefore, the takeover point (Day 1) and integration phase (100 days) can reveal serious drawbacks to the deal continuum that are less tangible, such as the relationship between the employees of both companies and their respective suppliers and customers. Resource budgets must include the investments to be made for the operational and cultural alignment of both companies, allowing them to capture the value of the Deal.

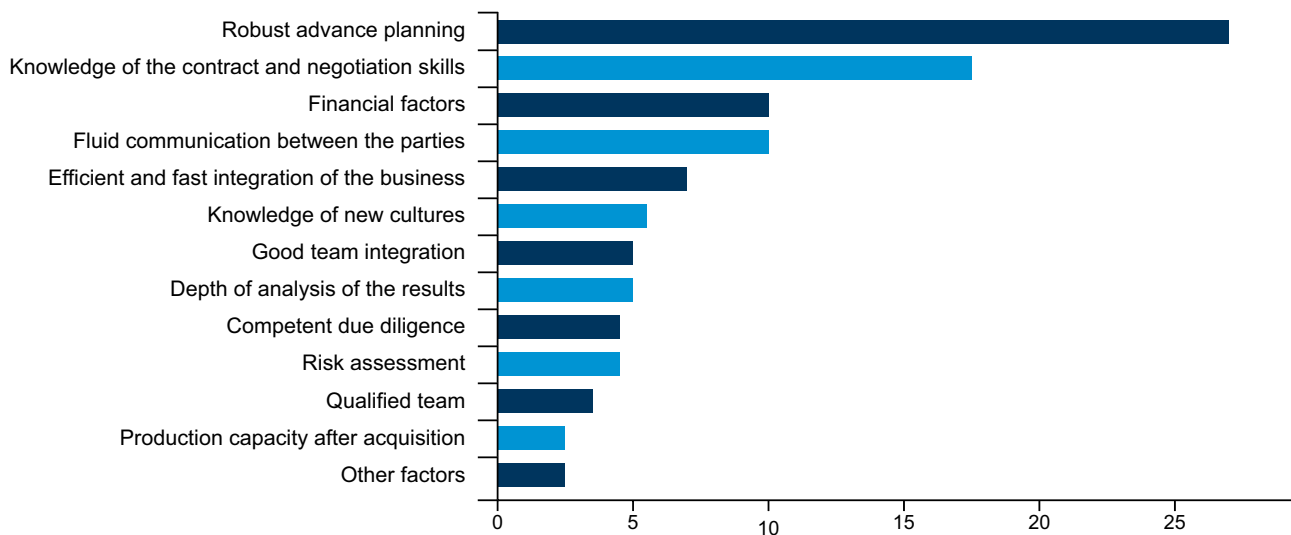
Aspects of the deal continuum that present higher degrees of complexity:



(scale: 1 to 5 reflects increasing complexity)

The financial, accounting and tax due diligences cannot be the only factors that are taken into consideration in the analysis of a target company. The CEOs indicated that the acquirer must look beyond the numbers. A more careful analysis of the intangible aspects of a transaction in the pre-deal phase is fundamental.

Critical success factors before closing the deal:



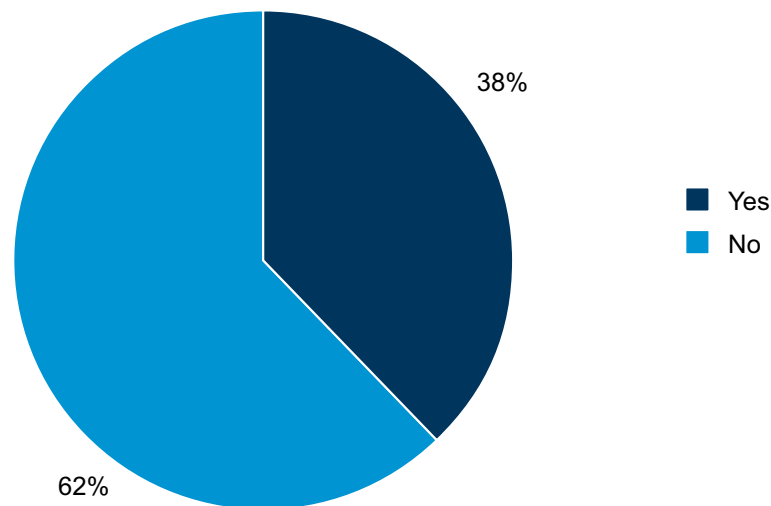
A successful formula to obtaining a complete and careful analysis of all aspects involved is to recruit two different teams in the pre-deal phase: one dedicated to the financial, tax and accounting matters and the other dedicated to the cultural, commercial and management aspects. After the conclusion of the work, both teams will be able to evaluate together the complexity of the integration, allowing more precise determination of the volume of investments necessary within the 100 days after the takeover.

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Synergy mapping is frequently not developed

The strategic merger or acquisition decisions, in addition to detailing the financial and operational synergies, must also lay out the plan of integration of personnel, information systems and business processes. The survey indicated that only 38% of the interviewees had mapped the synergies that could be obtained after the merger. The majority had not performed an evaluation and had no action plan to realize the expected gains. In these cases, the capture of the value of the transaction is negatively affected and the probability of not meeting stockholders expectations is increased.

Mapping and measurement of the synergies before the transaction:



The CEOs who had mapped the synergies used their own teams or external consultants, by focusing on operational and financial gains through improved cash flows, production processes and sales leveraging. The operating and financial synergies were not generally assessed for large purchasing contracts, the supply chain, cultural differences and future management models. These analyses could quickly assure gains crystallize and motivation and morale are boosted as the integration process advances.

An adequate mapping of synergies is fundamental and if not carried out precisely may be detrimental in achieving the synergy gains, both from the point of view of economies of scale and increased returns.





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Managing expectations and operational integration are left to the post-deal

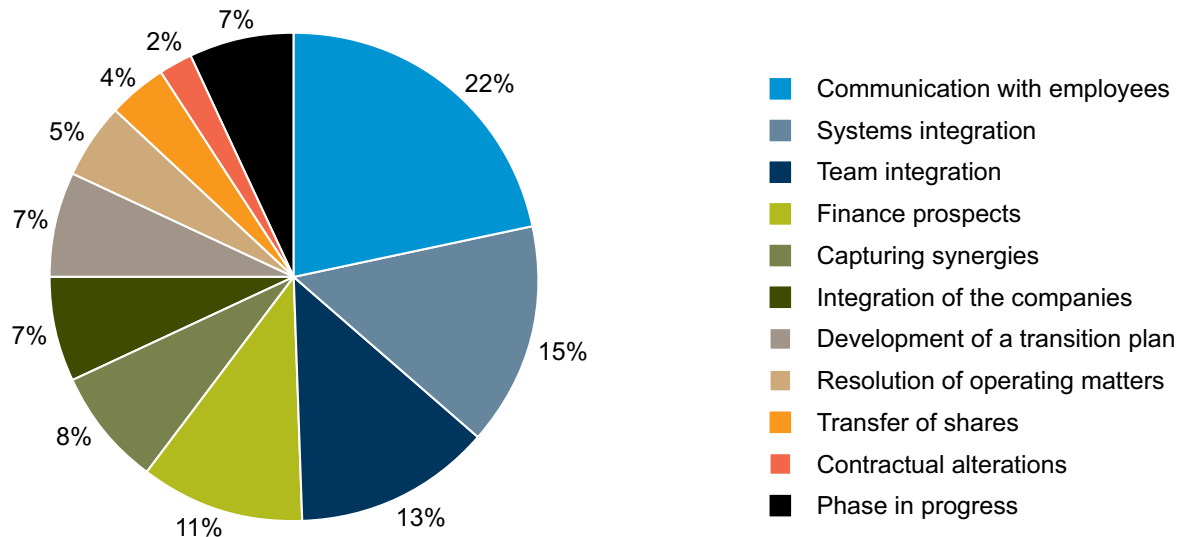
When questioned about the most critical factors during integration planning, half of the CEOs pointed to the importance of managing employee expectations and operational integration. Looking to improve deal efficiencies in the future, the interviewees plan to give this matters more attention next time around.

In the opinion of the CEOs, capturing transaction value necessarily involves more effective internal communication about the reasons for the deal, developing business transparency and more clarity around the disclosure of the new mission and vision of the new company. Once the employees are informed, they can better manage their expectations, which, in turn, contributes to a better acceptance of change integration.

The implementation of a single culture, through identification and minimization of gaps of knowledge in the new structure, linked to a well-planned process of integration, results in a good formula for the success.

Employee reactions to a merger and change integration challenges cannot be measured through spreadsheets. A successful deal must promote a participative process in determining actions needed, which take into consideration the opinions of the integration project management team.

Day One deal concerns:



The process of communication should include all the aspects related to the merger, focusing on the integration of systems and teams. The future scenario should be shared with all areas (Operations, Supplies, Finance, Strategy, Market/Competition etc.) and openly discussed to motivate personnel, minimize insecurities and show that the success of the operation depends on the individual efforts of all employees.

The reaction and collaboration of employees during the process of integration depends on the adequate monitoring of expectations and the understanding by all of the objectives of the merger and of how each should behave in this period of changes. Most of the time, the team responsible for managing the integration process (Integration Management Office - IMO) starts its work in the Systems area, then moving to the business processes and so on. In general, attention to people management and cultural clashes are not high on the list of priorities, which risks affecting the creation of deal value.

To obtain the expected value, a cultural assessment of each company should be made to better measure the challenges of the integration for the managers and employees. The identification of cultural differences will allow knowledge gaps to be mapped and determine the level of complexity in the implementation of the strategy of integration. The cultural differences should be the basis for the development of the plans of integration of people, processes and systems.

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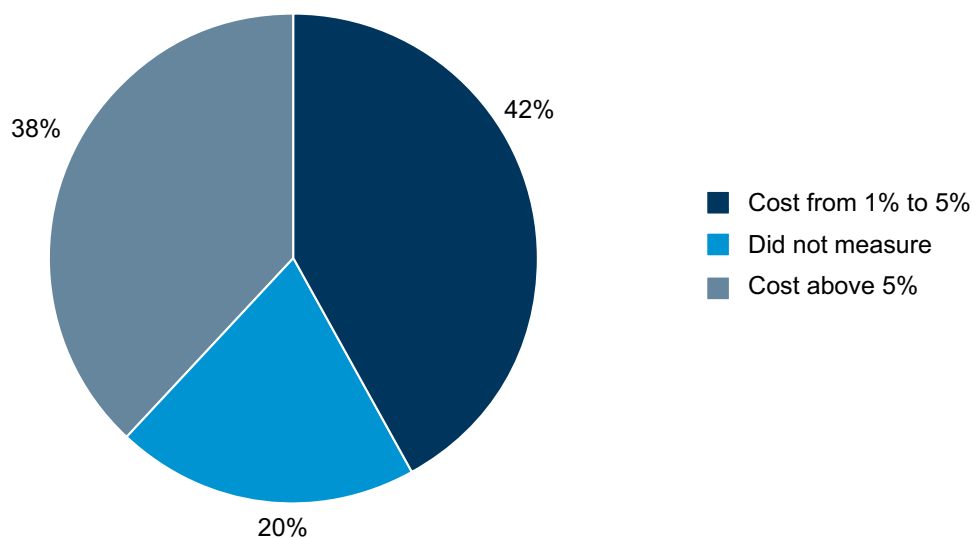
Integration expenses are significant and should not be underestimated

The integration costs after an acquisition or merger may be considerable and may vary in accordance with the ability of the company to plan adequately the measures that will bring immediate benefits.

More than half (58%) of the CEOs interviewed had not measured or used tools to control integration costs. The lack of effective controls is a factor of concern when the objective is to capture the value of the deal in the shortest period of time and at the lowest possible cost.

Amongst those that recorded the costs of integration, 42% affirmed that these costs vary between 1% and 5% of the cost of the deal of which 13% was spent on restructuring the Information Technology environment.

Estimate of costs of the process of integration of the companies:



The CEOs most commonly mentioned costs involving IT environment integration. Generally these costs are higher because of the need to align management software in integrated management systems (Enterprise Resource Planning - ERP) to meet the needs of changes arising from the merger. However, managing a merger and at the same time the replacement of the management systems can easily generate a change management conflict. At times it is more efficient to first order employee ideas and operate under different IT environments, and wait for an appropriate time to replace the systems, which will be demanding of all involved.

Investments priorities must also be controlled to establish a balance between critical and non-critical projects. In some cases, the replacement of a system is not a critical to the operations and may consume important resources at the expense of other areas that demand more immediate actions.

Investments should be budgeted and controlled through the mapping of the integration activities that are most critical to the success of the operation and which enhance post deal competitive advantage. The resources should be at first directed to the development of a competitive management model that allows the company to obtain the maximum benefit in the new business environment.

The budget should prioritize personnel costs (hour/man), management processes (time estimated to perform the process), acquisitions (information systems/ infrastructure), dismissals/terminations (labor costs), and training (reducing cultural gaps).

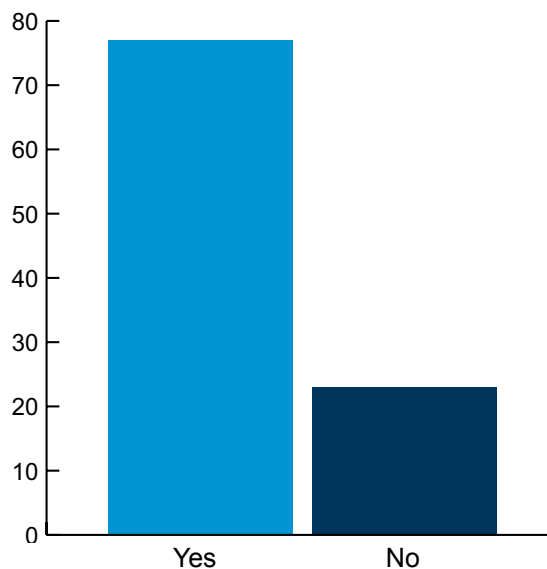
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Flight of intellectual capital in the integration process can reach 25%

The Survey indicated that, on average, 25% of managers decide not to stay with the company due to contractual policies established by the new management. Dismissal of professionals may represent a considerable additional cost. Intellectual capital is lost at a time when expertise and historical knowledge of the operations is most needed.

The greatest challenge during the integration is to design a plan to retain key senior and middle management who have knowledge of the operations of both companies and can put the operational and financial synergies into practice. Loss of the human capital is difficult to measure and may mean a longer return on the investment than initially planned. Dismissals costs are tangible, are not insignificant and must be fully contemplated in determining the Deal purchase consideration.

Percentage of managers who stayed after the merger:





Employees of both companies have to handle an overload of functions, because, in addition to carrying out their routine tasks, they also need to assume activities related to the transition. Inevitably, in this phase, companies need to seek external help or even contract new employees. Generally, this is an unexpected cost, but it may and should be estimated and negotiated as part of the cost of the transaction.

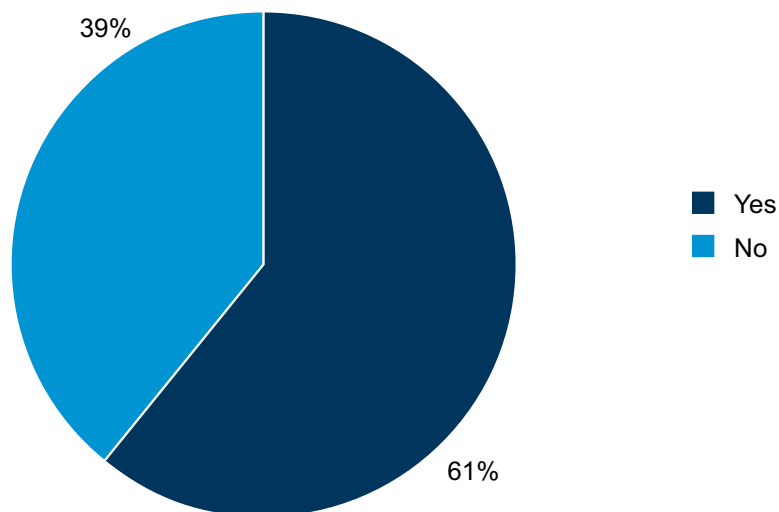
An objective assessment must be effected to identify the significant competencies (technical and business expertise, leadership and management) at the time of the transition. In parallel, the company should develop a plan to retain the professionals evaluated as key to the transition, at least in the first six months after the merger. The intellectual capital is a valuable asset of the company.

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Integration timelines tend to stretch

Nearly 40% of the interviewees affirmed that the integration took longer than expected. The main reasons for the delays are the complex structures of integration associated with the lack employee understanding and awareness of the objectives of the merger.

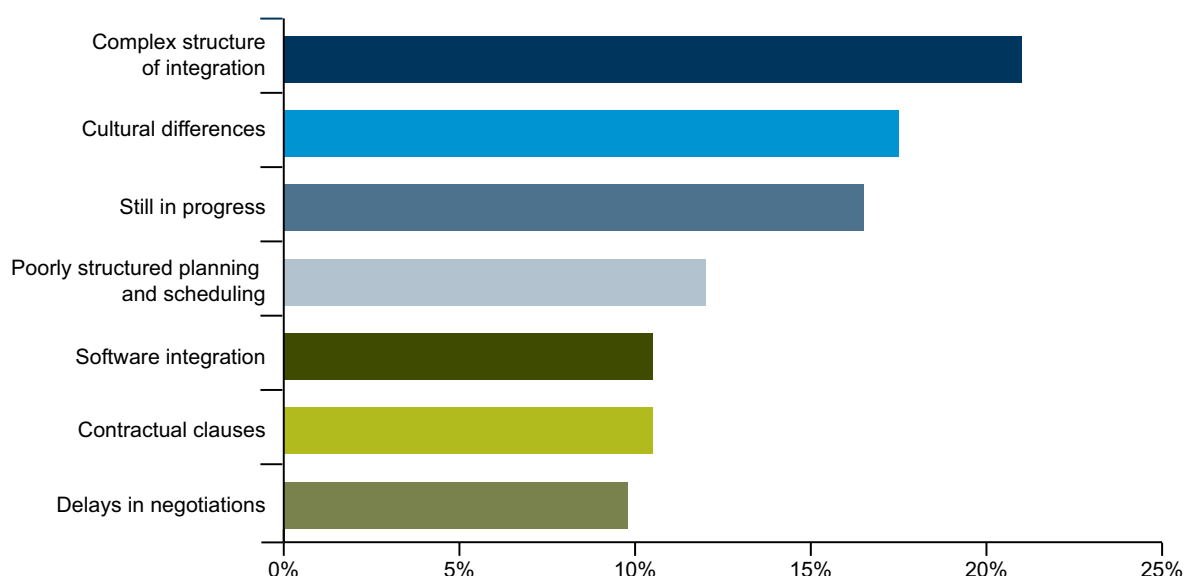
Did the integration take place within the expected timeframe?



The answers to this question make it clear that it is necessary to invest more time in evaluating cultural differences. Due diligence of the cultural aspects in the pre-deal phase is fundamental to minimize the risks of the integration. Another factor that affects the time estimated for the integration is inadequate planning. If the professionals responsible for carrying out the integration are not involved in the strategic and operational planning, there will invariably be a delay in the time for the conclusion. The CEOs mentioned the low level or lack of qualification of the integration teams and of a perspective of the combined companies involved as factors that generate delays in the execution and conclusion of the integration process.

An effective integration among operational teams may make communication easier and avoid duplication of activities and unnecessary efforts, providing an adequate forum to map the relationship between the various work fronts. An Integration Management Office (IMO) is responsible for these actions, the objective of which is to minimize the impact and meet the stipulated objectives. In the opinion of the CEOs, such measures could have optimized the time and costs in the post-acquisition phase.

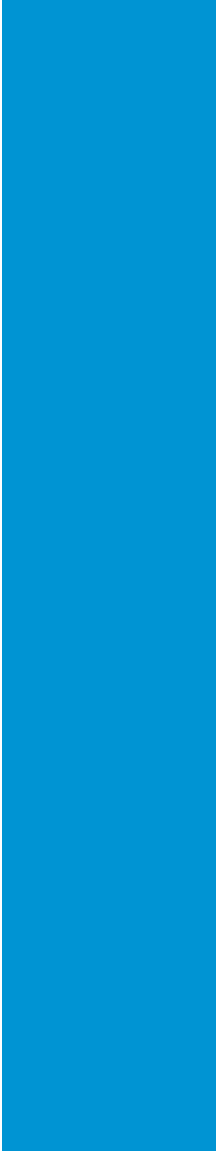
Main causes of delay in the time expected for the integration:





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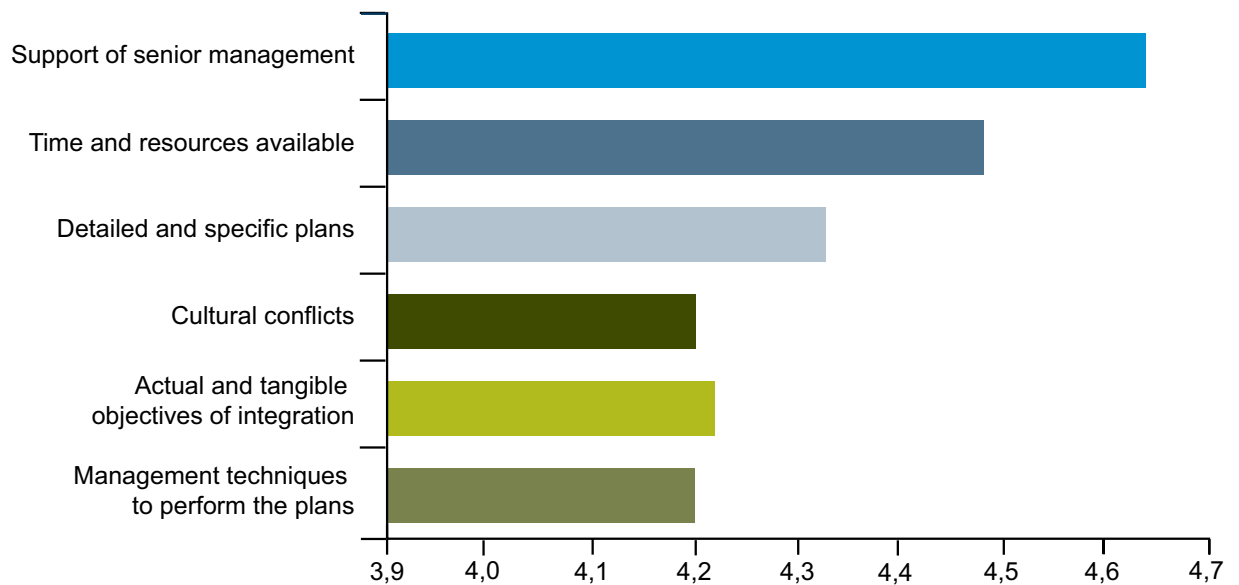
Senior management support – a critical post-deal success factor



The objective is to capture the value of the deal in the shortest length of time possible, with the lowest risk of disruptions to operations and at the same time respect cultural factors internal and external to the transaction. A successful deal requires adequate planning, identification of the cultural differences, strategic considerations and, not least, robust senior management support after its completion.

The CEOs were asked to indicate, on a scale from 0 (not critical) to 5 (critical), the primary success factors to the deal; the strong support of senior management after the closing of the deal came out tops. Surveys made in other countries have shown that in 70% of the cases when the participation of senior management in the process of integration was light or non-existent, this was a risk factor to successful integration.

Greatest challenge to the post-deal:



The CEO must control the personal anxieties of senior management as these can directly affect the performance of the integration team. In many cases the CEO responsible for closing the deal gets away from the integration process without realizing that this phase is where most of the deal value is captured, therefore a strong support from high management is essential to achieve the targeted financial and operational gains.

Senior management should provide moral, financial and logistic support for the integration teams to develop and implement the plans in a structured and organized manner, including aspects of management, such as communication (internal and external), changes, persons, costs and risks.



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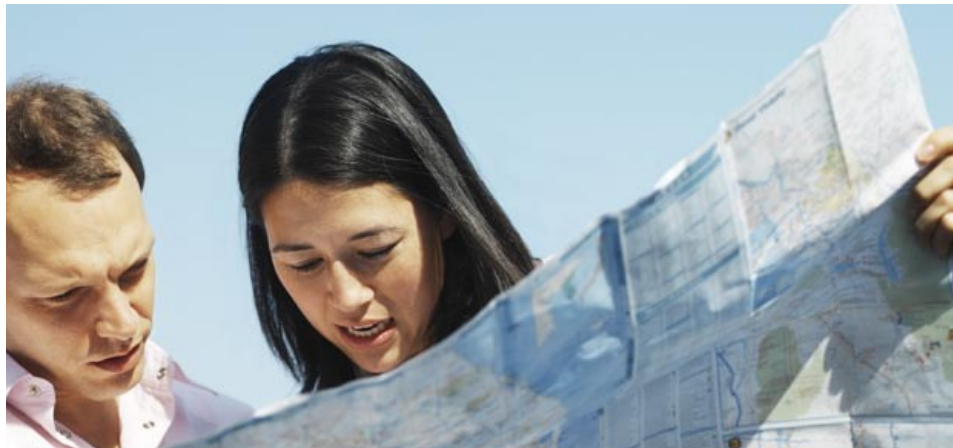
Concluding remarks

Successfully merging companies depends on efficient change management techniques, the implementation of which involves determining the needs, vision, tools and management of human resources including compensation. These comprise the primary set of critical success factors in a process of integration.

The Brazilian survey makes it clear that, in most cases, companies form only one operational team that is responsible for the analysis of the tax, accounting and financial aspects of the target-company during the pre-deal phase. In these circumstances, a second team should be formed, which, in parallel, would focus on the essential aspects for a change integration.

Change management should focus on three different phases. Firstly, the pre-deal effort – establishing a formal process for the rationale and drivers, the definition of the main milestones, the model and strategy of integration, the capture of short-term synergies, the mapping and plan of retention of key-persons and a realistic estimate of costs and timelines. Secondly - dedication to the 100-day plan, considered as critical to capture the value of the deal. This plan consolidates all the short, medium and long-term actions through activities and workshops aiming to map actions to mitigate risks of an unsuccessful integration. The secret is to insert in this plan a “business as usual” attitude which is as important as, or more important than, the integration itself. Thirdly, the last phase - monitoring the action plan, management of benefits and change, providing a complete control of scope, terms and costs and, at the same time, providing tools and information for the construction of an innovative vision for the new company.

These three phases, in summary, embody the successful implementation through a detailed integration plan focused on the tangible and intangible benefits of a deal. Critical to the success is to assure this plan is prepared before the announcement of the deal, allowing the leaders and operational teams time to plan the pre and post-deal, its impacts on its people and provide a strategic and operational vision of the future business.



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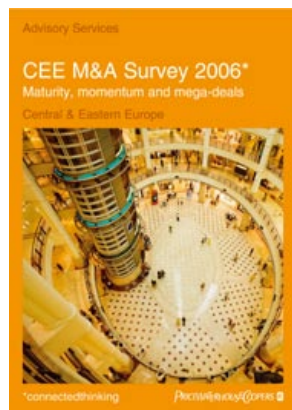
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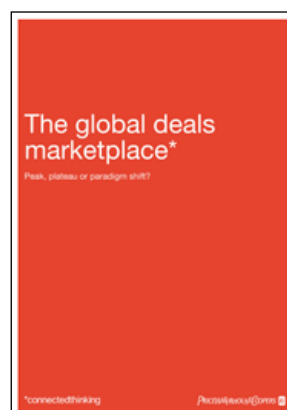
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CEE M&A Survey 2006



The global deals marketplace



Successful deals are made,
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