Mergers, Due Diligence and Integration

Interview preparation summary · SC track

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INT.KA.1.a · Should we buy it

Test the strategic rationale for an acquisition (scale, scope, capability or defensive), say what must be true for it to create value, and compare buying with building or partnering.

A deal needs a reason that can be tested, not a slogan. Four rationales recur. Scale: combined volume lowers unit cost through purchasing, plants or overheads. Scope: new products, customers or regions sold through a shared base. Capability: technology, people, brand or licences that would be slow or risky to build. Defensive: stopping a rival or disruptor from owning the asset, or responding to a shrinking core. For each, ask what must be true, how big the prize is, whether the company could capture it by building, partnering or contracting instead, and what waiting would cost. Buying beats building when time, scarcity or the chance of failure matter; partnering beats both when the need is narrow or the owner will not sell. Frameworks mislead when a deal rests on several vague rationales at once, or on diversification, which shareholders can achieve more cheaply themselves. Strong answers pick the one rationale that carries the value and size it. The usual mistake is listing all four without testing any.

WORKED EXAMPLE: BUY OR BUILD A COLD-CHAIN CAPABILITY

Harrowgate Logistics, an invented UK haulier, wants refrigerated storage. It can buy Fenwick Cold Storage for 120m plus 10m of integration cost. Or it can build: 54m of spend over three years with a 60% chance of success. While it builds, it forgoes 15m a year of profit for the three years. If the build fails it buys Fenwick anyway at the same all-in 130m. Convention: ignore tax and discounting, and treat the delay cost as 45m whatever happens. Which route is cheaper in expectation, and how sure must the build be to win?

Answer: Buy. Expected build cost is 151m against 130m, and the build only wins if the chance of success is above about 76%.

> **Interview tip:** Frame the choice as buy, build or partner, price each in one line, then give the probability at which your answer would change. It shows you can commit to a view and say what would overturn it.

INT.KA.1.b · Should we buy it

Run a commercial due diligence on a target: test the market, customers, competitors and management forecast, and turn the findings into a base case and a view on price.

Commercial due diligence asks outside-in whether the target's story is true, using evidence management did not write. Four blocks. Market: size, growth, structure and what drives demand. Customers: concentration, retention by cohort, reasons to buy, price sensitivity, and calls with customers you choose, including lost ones. Competitors: share trend, price moves, entrants and substitutes. Forecast: split the plan into price, volume, mix and new customers, then compare each with the market and with history. The sharpest test is implied share: if the plan grows much faster than the market, who is losing the share and why. Rebuild a base case and a downside from the evidence, and let the deal price rest on those, not on the plan. A hockey stick (flat history, steep plan) needs a named cause. Accounts, tax and legal title are other workstreams. The usual mistake is a long fact pack with no view: always end with a so-what for value.

WORKED EXAMPLE: TESTING CARROW DENTAL SUPPLIES' PLAN

Carrow Dental Supplies, an invented distributor, has revenue of 48m. Its plan reaches 84m in four years. Its market is 600m and has grown 5% a year. In data-room cohorts, existing customers' revenue has held at 92% a year, and new customers have added about 6m of revenue a year. Is the plan credible, and what base case would you use? Convention: ignore tax; new customers join at the end of each year.

Answer: The plan is not credible as it stands. Evidence supports about 55.7m of revenue in four years against 84m planned, so price off the lower number.

Interview tip: Say the so-what in the first sentence: the plan needs a share gain the evidence does not support. Then give the three numbers (15.0% against 5%, 8.0% to 11.5%, 55.7m) as proof.

INT.KA.1.c · Should we buy it

Value a target at overview level using multiples and cash-flow logic, bridge enterprise value to equity value, and size and risk the synergies to set the most a buyer should pay.

Valuation in a case interview is a range with a reason, not one number. Trading multiples (enterprise value to EBITDA, or price to earnings) of comparable listed firms give a starting range; transaction multiples add a control premium. Choose peers by growth, margin and risk, and adjust for size or concentration. A discounted cash flow (DCF) values future cash flows at a rate that reflects risk; the logic matters more than the model, because terminal value is often most of the answer and moves sharply with growth and discount rate. Enterprise value (EV) is what the business is worth to all investors; subtract net debt and debt-like items such as pension deficits to reach equity value. Synergies are then sized, risked by probability, phased, and net of one-off costs; cost synergies are more reliable than revenue synergies, and the buyer should pay away only a share of them. A private equity buyer asks a related question: do EBITDA growth, debt repayment and the exit multiple reach the hurdle, often around 20% a year? The usual mistake is paying away all the synergies.

WORKED EXAMPLE: PRICING BRANTLEY CONTROLS

Brantley Controls, an invented UK maker, has EBITDA of 20m and net debt of 35m. Listed peers trade at 8x to 10x EV/EBITDA, with a midpoint of 9x. A buyer sees 6m of run-rate cost synergies, rates the chance of delivery at 70%, expects one-off costs equal to 1.0x the run-rate (6m), and would value the synergies at the same 9x. It will pay away at most half of the net synergy value. What is the most it should offer, as EV and as equity? Convention: ignore tax and timing.

Answer: Offer up to about 196m EV, or 161m for the equity, with a standalone value of 180m EV and 31.8m of risked net synergy value.

Interview tip: Walk the sequence aloud: standalone range, risked synergies, share you will pay, bridge to equity. Name the discipline too: you keep at least half of the synergies because you carry the delivery risk.

INT.KA.2.a · After the deal

Plan the integration of an acquired company: day one, the first 100 days, synergy delivery and phasing, culture and retention, and explain how costs and benefits build over time.

Most of the value in a deal is won or lost after signing. Day one is about continuity: legal entity and reporting lines settled, customers and staff told what changes and what does not, and key people named to roles. The first 100 days set up an integration office, an owner and a baseline for every synergy initiative, early quick wins, a decision on the structure of the combined organisation and a retention plan for the people and customers who carry the value. Synergies follow a pattern: one-off costs come first and benefits build over two to three years, so a plan should show phasing, cumulative cash and payback, not only a run-rate. Revenue dis-synergies, such as customers lost during disruption, must be netted off. Culture is a business risk: decide which way of working wins and say so, because a merger of equals in name leaves people unsure who decides. Integrate hard where the value is (procurement, plants, back office) and lightly where the target's value is its independence. The usual mistake is announcing a synergy number with no named owner.

WORKED EXAMPLE: SYNERGY PHASING FOR THE CALDER MERGER

Two invented UK service businesses merge into Calder Group, with combined revenue of 300m. The plan has run-rate cost synergies of 12.0m, realised 25% in year 1, 60% in year 2 and 100% in year 3. One-off costs are 1.2x the run-rate, spent 60%, 30% and 10% over the three years. Disruption is expected to lose 2% of combined revenue each year from year 1 at a 25% contribution margin. When does the cumulative net benefit turn positive? Convention: ignore tax and discounting.

Answer: Cumulative net benefit turns positive in year 3 (+3.3m), and the steady-state benefit is 10.5m a year after the 1.5m dis-synergy.

Interview tip: Say that costs lead and benefits lag, give the year of payback, and add the dis-synergy that the headline number leaves out. Then name the two things you would protect in the first 100 days: the synergy owners and the customer relationships.

INT.KA.2.b · After the deal

Evaluate a divestiture or carve-out: compare selling with holding, find stranded and standalone costs, plan the separation, and choose a buyer route.

Companies divest to focus, to raise cash, to give a business a better owner, or because a regulator requires it. A carve-out is harder than it looks because the unit shares systems, people and contracts with its parent. Reported divisional profit is struck after allocated head-office cost, which is not what a buyer will experience: the buyer values EBITDA after its own standalone costs, and the seller is left with stranded costs, the overhead that stays behind when the unit leaves. The sell-or-hold test compares proceeds plus the value of any stranded costs removed (net of one-off cost) with the value of keeping the unit's contribution. Practical issues include transitional services agreements (TSAs) under which the seller supplies IT or payroll for a period, separating shared contracts, tax, pensions and key people. Buyer routes are a trade buyer (often pays most, but may face competition review), a private equity buyer (fast, certain) or a spin-off or listing. The usual mistake is pricing off reported divisional profit.

WORKED EXAMPLE: SELLING THE TALLIS MARINE DIVISION

Ashgrove Group, an invented industrial firm, considers selling its Marine division. Marine earns 33m of EBITDA before group allocations. The group allocates 9m of head-office cost to it; only 3m of that disappears if Marine goes, so 6m is stranded. A buyer would need 6m of standalone cost and would pay 8x its EBITDA. Ashgrove's own shares trade on 8x. Removing the stranded cost would take one-off costs of 6m. Should Ashgrove sell? Convention: ignore tax, and assume the stranded cost can be removed in full.

Answer: Sell only with a credible plan to remove the 6m of stranded cost: that gives 258m against 240m for holding, otherwise the sale is 24m worse.

> **Interview tip:** State the headline in one sentence: the sale works only if stranded costs go. Then give the two numbers (216m offered, 240m hold value) and the action that closes the gap.

INT.KA.2.c · After the deal

Choose between an alliance, a joint venture and an acquisition, set the protections a joint venture needs, and diagnose why deals fail using what had to go right.

Full ownership is not the only way to get a capability or a market. A contractual alliance (distribution, licensing, co-development) is quick, cheap and reversible but gives little control. A joint venture (JV) is a separate company owned by the partners: it suits a market that needs a local partner, a large investment that is better shared, or a target that will not sell. Its weaknesses are shared control, partners with different goals, leakage of intellectual property and no clear way out, so a JV agreement needs decision rights and reserved matters, a deadlock rule, an IP boundary and an exit mechanism such as a put or call option at a formula price. Deals fail for recurring reasons: overpaying so that the premium exceeds the synergies actually delivered, a rationale that never held, integration that loses people and customers, and plans that need many things to go right at once. Test a deal by listing what has to be true, multiplying the odds, and finding the delivery level at which the premium is lost. The usual mistake is assuming each assumption is certain.

WORKED EXAMPLE: WHAT HAS TO GO RIGHT FOR THE WEXLEY DEAL

Wexley Chemicals, an invented European group, plans to buy Ashdown Coatings for 480m. Ashdown is worth 400m standalone, so the premium is 80m. The plan has 14m of run-rate EBITDA synergies valued at 8x, with 12m of one-off cost. The deal case needs five things: synergies delivered on time (80% likely), key customers retained (90%), key staff retained (85%), the market forecast holding (85%) and systems integration on schedule (75%). Treat them as independent. Is the deal safe? Convention: ignore tax and timing.

Answer: The deal is not safe: all five conditions hold only 39% of the time and a delivery shortfall above about 18% wipes out the value created.

> **Interview tip:** Show that you can turn a story into a test: list what must be true, give the joint probability, then name the delivery level at which the premium is lost and a way to protect the price.

Summary of the Charta interview-preparation topic. Companies and figures in the examples are invented. Draft content, not yet expert reviewed.