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Executive MBA
Mergers & Acquisitions

The role of divestitures as part of an active portfolio management in the strategic planning process considering the implications of an economic downturn

A Master's Thesis submitted for the degree of
"Master of Business Administration"

supervised by
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Affidavit

I, **MAG. (FH) PETER MUELLER**, hereby declare

1. that I am the sole author of the present Master's Thesis, "The role of divestitures as part of an active portfolio management in the strategic planning process considering the implications of an economic downturn", 88 pages, bound, and that I have not used any source or tool other than those referenced or any other illicit aid or tool, and
2. that I have not prior to this date submitted this Master's Thesis as an examination paper in any form in Austria or abroad.

Vienna, 12.06.2010

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Signature

It takes time to learn what is important,
it takes more time to truly understand what is important,
and it takes even some more time to live for what is important.

For my beloved daughter Carina

Special thanks to my wife Monica and all my friends in business and private who have supported me with their advice.

Contents

1 Abstract

The Master Thesis demonstrates the importance of divestitures as part of an active portfolio management strategy in the strategic planning process. The work focuses on the analysis of the strategic planning process, an active portfolio management and how divestitures can create value. Furthermore the paper reflects the implications of the economic downturn and the impact on the M&A dynamics and valuations. The thesis is supported with relevant literature and illustrates examples and the crucial indicators for a successful divestiture to create value.

Every acquisition needs to be built on a solid and well thought through strategic framework and needs a disciplined and structured approach to create sustainable value. This is at the same extend valid for divestitures. The required discipline can be achieved through an integrative planning process to review M&A opportunities as part of an active portfolio management. Empiric evidence shows that divestitures create value and a balanced portfolio approach creates most value.

An economic down-turn results through various factors in lower valuations due to uncertainty and slower growth but empiric studies shows that divestitures have a better probability of success in a down-turn and create substantial value for buyer and seller.

Overall the thesis concludes that

1. Strategic Planning Process facilitates the right strategic choices
2. Active portfolio management with a balance M&A approach creates value
3. Understand the view of the buyer delivers better results
4. Downturn pressures the sales price but can still make sense strategically
5. Downturn mergers outperform upturn ones
6. And the M&A market is Alive in an Economic Crisis

In summary, a difficult economic environment might impact the validation and the achievable sales price, but most important is to realize a better price than the discontinued cash flow when you would keep the business.

2 Executive Summary

Usually acquisitions are not doing two things. First, acquisitions are usually not fixing problems in your core business or helping a low-growth business to create value merely by buying a high-growth business. Secondly, many of the acquisitions are exposed not delivering the synergies they are expected to deliver.

Every acquisition needs to be built on a solid and well thought through strategic framework and needs a disciplined and structured approach to create sustainable value. The same applies for divestiture which is the main topic of this thesis.

The required discipline can be achieved through an integrative planning process to look at M&A as part of an active portfolio management on an ongoing base and clear pre-defined performance indicators and strategic parameters.

While acquisitions are always attracting the major interest in the M&A business, divestitures are playing a significant role in the successful development of a corporation addressing the different life cycles of various brands and businesses to balance the right mix in a company.

The current global crisis and recession leads to higher discounts of valuation of companies and offers a unique opportunity to create value through acquisitions for buyers. The thesis addresses the situation in particular from a seller side and is looking for an answer what a weak economic environment means for a strategically right divestiture. Lower valuation should not result in acquisitions just because of assumed favorable prices, risk profile and long-term perspective needs to be understood and well embedded in the strategies of the company.

The historical long-term average of takeover premiums is around 30%[1] and peaked out in the recent boom years to a median takeover premium of 52.7%, and fell to 32.9% in the first quarter 2010, much closer to historical average.[2]

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[1] Koller T., Goedhart M., Wessels D. (2005): Valuation: Measuring and Managing the value of companies, p. 159
[2] Citibank (2009): Executive M&A Summary, December 2009 Edition, Citibank Report, p. 2

The difficulty to raise the funding, and the risk of unfavorable market outlook and declining demand are the facts of the real economy in difficult times.

This fact of falling premiums in a weak environment is driven by 3 factors:

- Dented consumer confidence
- Significant slow-down of consumer demand
- Shortage of credit.

A seller of a business or a part of a business, in particular a brand and a related business and assets, needs to understand these factors, the thinking of a buyer and has to follow the principles of a strategic based portfolio analysis with discipline.

It is crucial, even more in difficult times, to anticipate the behavior and thinking of a buyer and to follow the basic rules to create value for his own business by making portfolio decisions based on a holistic and sound analysis which results in better strategic choices to divest the selected business at the right value for the sustainable success of his remaining business.

The thesis results in the following take away's helping to make better decisions:

1. Strategic Planning Process facilitates the right strategic choices
2. Active portfolio management explained in this thesis in 5 steps with an pro-active, disciplined approach towards divestitures creates value for the company
3. Put yourself in the shoes of the buyer
4. Downturn pressures sales price but still makes sense strategically
5. Downturn mergers outperform upturn ones
6. The M&A market is Alive also in a difficult economic environment

Empiric studies confirm that companies with a balanced portfolio management, taking care of their core business, acquiring and divesting based on strategic, sound framework create the most value. Divestitures are a significant strategic element of successful companies. It's not about winning a battle, it's about winning the war.

3 Introduction

“The phrase mergers and acquisitions (abbreviated M&A) refers to the aspect of corporate strategy, corporate finance and management dealing with the buying, selling and combining of different companies that can aid, finance, or help a growing company in a given industry grow rapidly without having to create another business entity.” [3]

This master thesis serves as a guideline on how to integrate M&A with particular focus on divestitures as part of an active portfolio management in the strategic planning process of a corporation to create value for a company. The steps of an active portfolio management in regards to M&A are explained and illustrated with examples, the criteria and indicators for a successful divestiture are outlined. The work considers the implications of a global economic downturn on divestitures and displays on examples the sensitivity of various decisions and timings followed by conclusions for the daily business.

The history of M&A goes back to the late 1800’s in the US and since then several M&A waves have been seen. In the 1960’s the booming industry was the motor for M&A, the controversial restructuring wave of mid 1980’s and the increasing globalization leading to the area of mega-deals in the 1990’s.

Mergers and acquisitions have become a global phenomenon. The increasing globalization of the market place, the break-down of communism with the fall of the iron curtain and opening of emerging countries, the barrier-free business with one common currency in the European Union but also industrial overcapacities and cost pressure were leading to an acceleration of M&A activities.

Then - the global economic down-turn. The collapse of the financial and real estate market in the US has plunged the world in the biggest global crisis and recession since the 30ies.

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[3] Wikipedia (2009): Mergers and Acquisitions: http://en.wikipedia.org/wiki/Mergers_and_acquisitions; download: February 12th,2009

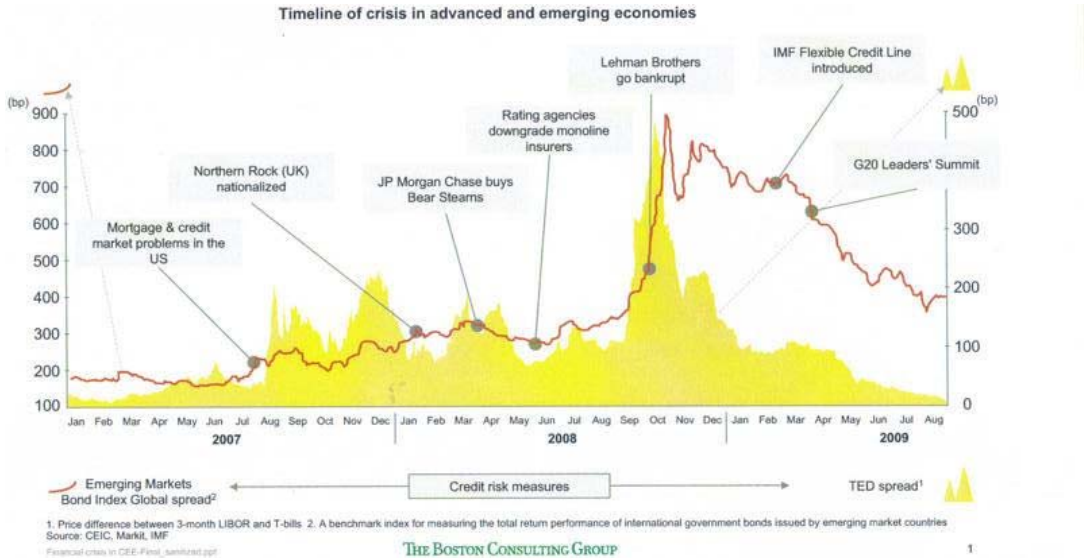

Figure 1: "The Current Crisis", Boston Consulting Group, Presentation 10/2009

The economic crisis started in 2008 and has destroyed tremendous value, the Real Gross Domestic Product decreased by 2.2pp globally in 2009 and 3.9pp in the Euro-Zone.[4] The crash in US property market triggered a leverage crisis in the subprime-mortgage securitization market. This in turn triggered a global liquidity crisis, which itself contributed to a solvency crisis among some banks and a dramatic increase in the pressure to deleverage. Consequently, this led to further declines in asset prices, and the whole cycle repeated itself. It was inevitable that such enormous financial dislocation would lead to significant collateral damage in the real economy. Falling asset prices and the prospect of an economic slow-down has dented consumer confidence. Lower demand and a shortage of credit driven by the liquidity squeeze and combined with company's measurements to reduce investments, conserve cash and reduce costs and lay off workers even strengthened these sentiments.

The graph (figure 1) refers to TED spread. "The TED spread is the difference between the interest rates on interbank loans and short-term U.S. government debt ("T-bills").The size of the spread is usually denominated in basis points (bps). For example, if the T-bill rate is 5.10% and ED (interest rates on interbank loans) trades at 5.50%, the TED spread is 40 bps. The TED spread traded historically within the range of 10 and 50 bps

[4] World Bank (2010): http://web.worldbank.org/WBSITE/EXTERNAL/NEWS/0,,contentMDK:22446580~pagePK:64257043~piPK:437376~theSitePK:4607,00.html; download: May 1st, 2010

with a long-term average of 30 bps, until 2007. A rising TED spread often presages a downturn in the U.S. stock market, as it indicates that liquidity is being withdrawn. The TED spread is an indicator of perceived credit risk in the overall economy. This is because T-bills are considered risk-free while LIBOR reflects the credit risk of lending to commercial banks. An increasing TED spread is a sign that lenders believe the risk of default on interbank loans is increasing.

The graph in the above table illustrates now that in the course of 2007, the subprime mortgage crisis boosted the TED spread to 150-200 basis points. The downgrading of financial institutions through rating agencies drove the TED spread beyond 300 bps breaking the previous all-time high after the Black Monday crash of 1987. Finally the Lehman Brothers bankruptcy rocket the TED spread to another new high of 465 basis points.

The other comparison on the graph is the Emerging Market Bond Index Global Spread ("EMBI Global"), a benchmark measuring the total return performance of international government bonds issued by emerging markets, and the increasing spread underlines the strained money market situation during the crisis in emerging markets.

The index tracks total returns for traded external debt instruments in the emerging markets introduced by JPMorgan in 1992. The EMBI Global includes U.S. Dollar denominated Brady bonds, loans, and Eurobonds with an outstanding face value of at least $500 million and covers 27 countries.

Brady bonds were created in March of 1989 in order to convert bonds issued mostly by Latin American countries into a variety of new bonds after many of those countries defaulted on their debt in the 1980's. At that time, the market for sovereign debt was small and illiquid, and the standardization of emerging-market debt facilitated risk-spreading and trading. In exchange for commercial bank loans, the countries issued new bonds for the principal sum and, in some cases, unpaid interest. Because they were tradable and came with some guarantees, in some cases they were more valuable to the creditors than the original bonds.

The key innovation behind the introduction of Brady Bonds was to allow the commercial banks to exchange their claims on developing countries into tradable instruments, allowing them to get the debt off their balance sheets and this reduced the concentration risk to these banks."[5]

In summary the subprime crisis caused a recession in the real economy that has turned into a wave of bankruptcies and defaults. While the crisis starts softening and economic growth is beginning to regain moment, the development is not expected to be coming back to previous growth rates before 2012 according to EIU and other economic institutes and leading international banks. Hundred thousands of jobs were lost in this period and governments around the globe have invested massive money to save distressed industries and companies all on the back of the tax-paying population in the world and eroding funds for important and transformational initiatives in the social or educational area and developing markets. Consumers are at the center of every economy and are currently not ready to spend their way back to better times. Consumers are developing new behaviors to the situation, to cope with the economic crisis, when it comes to their shopping and spending behavior. See below a study from BCG Consumer Sentiment Survey 2008-09 done in March 2009 indicating the percentage of respondents who agree or strongly agree on the following spending tactics.

Spending tactics	US	Europe	Japan	Developing Markets
Cut spending on nonessential items	81	72	87	59 – 82
Defer major expense that can wait	82	74	69	53 – 75
Buy more products on promotion	75	80	70	31 – 75
Spend more time in store to find the best price	71	71	61	33 – 69
Shop in discount stores more often	70	59	70	36 – 71
Trading down	48	56	NA	NA

Figure 2: Consumer Sentiments, 2009 BCG Global Reports on Consumer Sentiment, April 2009

[5] Wikipedia (2010): http://en.wikipedia.org/wiki/Brady_Bonds, download: April 30th 2010

As so often the history gives us a solid base to learn – it's about us to listen and apply this knowledge. Let's hope that greed give way to more rationalism and social responsibility. Or as Wilhelm Schulz, European head of M&A at Citi-Group said recently in an interview, "we can see signs of a return of strategically driven deals".

But a crisis is a chance, a new starting point and so it will be also for the M&A market. And the M&A business already re-gained momentum in 2009. Despite the difficult and sluggish start in 2009, a strong last quarter lifted the announced global M&A volume to nearly $ 2.1 trillion in this year. The final two months of 2009 exceeded $ 200BN, the first time this occurred since September – October 2008. More than 100 deals bigger than $ 1 BN were announced in the fourth quarter of 2009, the largest quarterly result since the third quarter 2008. 4 out of the 10 largest deals in 2009 were announced in the last two months of 2009. Only one of the 10 biggest deals in 2009 involved a European company. Europe's M&A market suffered a steep decline, while the US experienced a late-year surge and Asia and Japan assumed larger roles as both buyers and sellers.[6] Companies in the US and Western Europe facing sluggish economies are looking further for a field of growth, helping produce a record first quarter 2010 for deal-making in Asia and rising interest in cross-border transactions. [7]

Deals worth $89.4BN were announced in the Asia-Pacific region (excluding Japan) in the first quarter 2010. That is almost double last year's level and a slight increase on the 2007 peak. The region counts for around 20% of M&A activities and reflects the highest level in seven years [8]

6 out of the 10 largest deals in the fourth quarter 2009 were either in Energy or Industrial transactions. The last few months in 2009 reflected also a strong increase in the number of $ 1BN+ deals strongly driven by the Media, Telecom and Technology sectors, while Financial Institutions transaction was worth (with 18%) around the half contributing to M&A volume in the second HY 2009 compared to the July 2008 – June 2009 period. [9]

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[6] Executive M&A Summary (2009): December 2009 Edition, Citibank Report, p. 2
[7] Thomas H., Saigol L. (March 31st, 2010): Financial Times, p. 25
[8] Merger Market Online Report, April 2010
[9] Executive M&A Summary (2009): December 2009 Edition, Citibank Report, p. 2

Oracle, the world 3rd largest software producer acquired Sun Microsystem, one of the leading producers of servers and software for $ 7.4 BN in summer 2009. Panasonic acquired Sanyo for $ 4.5 BN overtaking Sony as leading high-tech group in Japan. And HP took over the network company 3Com for around $ 2.8BN to challenge the market leader Cisco. Amazon, Google, Cisco, Facebook and My Space made also strategic relevant acquisitions in 2009 in the value of several hundreds of million Dollars.[10]

William Vereker, Nomura's head of investment banking for Europe, Middle East and Africa explained in an interview to the Financial times in March this year, "we expect M&A activity in the US and Europe to continue to be slow, whereas in Asia where growth and macroeconomic fundamentals are more positive, we expect a further increase in M&A activity. M&A offers one of the few ways corporate can gain immediate exposure to these markets."[11]

That was the rationale behind the $35.5BN acquisition of UK's Prudential of AIA, the Asian Business of the US insurer AIG. The deal formats a business of double the size of the current UK group and builds the largest insurer in Asia & Pacific.

Since growth rates are higher in emerging markets and overall macro-economic forecasts looking better in the Asian and Pacific regions, cross-border and cross-regional transactions are clearly rising.

Access to emerging markets was one of the strategic reasons for Kraft's £ 11.6BN takeover offer for the UK confectionery producer Cadbury. The combined group has significantly increased the revenues generated in emerging markets and expects growing portfolio share from markets like Brazil, Russia, China, India and Mexico.[12]

The global M&A volume increased in the fourth quarter 2009 by +32% or $ 153BN compared to the previous quarter and +20 % or $ 104BN vs. Q4/08. Still full year 2009 was down 28% versus 2008, and around 50% compared to the peak year 2007. [13]

[10] Steinschaden J. (29.12.2009): Kurier,"Hightech-Riesen auf Einkaufstour", p. 13
[11] Thomas H., Saigol L. (March 31st, 2010): Financial Times, p. 25
[12] Thomas H., Saigol L. (March 31st, 2010): Financial Times, p. 25
[13] Citibank (2009): Executive M&A Summary, December 2009 Edition, Citibank Report, p. 2

Recent billion dollar acquisition as of Texaco or Kraft's take-over of the UK confectioner producer Cadbury beginning 2010 have shown that big acquisitions and M&A re-started earlier than maybe expected and will continue being a major factor in our business world.

Overall, talking to investment bankers you can hear that they expect the flow of cross-border deals to continue in 2010, as companies which were building cash funds during the crisis through cost and cash flow initiatives will look for acquisition opportunities to strengthen their position, shifting their country portfolio towards emerging markets or entering new markets to accelerate growth.

Michael Boublik, chairman of Americas M&A at Morgan Stanley, said: "There is no question that companies are actively seeking top-line growth and that they survey the globe for regions and markets that have differentiated growth prospects. This trend will continue to drive the increased level of cross-border M&A that is becoming more prominent".

Cross-region transactions in emerging markets also dominated the first quarter 2010, with Bharti Airtel, the Indian telecommunication company paying $ 10.7BN to acquire the African assets of Kuwait-based Zain, after having failed twice to acquire South Africa's MTN.

Brazil had a similar busy start into 2010, both with in-country and cross-regional transactions by companies seeking growth opportunities, such as Mexico's America Movil's acquisition of Carso Global Telecom SAG de CV, a stock swap transaction in the value of $ 27.5BN.

Deal-making between different regions comprised more than 27% of first quarter activity in 2010, the highest since beginning of 2008, according to Mergermarket.[14]

The value of global M&A overall rose by 6% to $ 442BN in the first quarter of 2010, boosted by the surge of deals in Asia with an increase of almost 93 % compared to the same period last year. In contrast European M&A activity weakened for the fifth

[14] Thomas H., Saigol L. (March 31st, 2010): Financial Times, p. 25

consecutive quarter as sovereign debt worries deterred corporate acquisitions and the deal value fell by 5.7% which represents the slowest start in the year for Europe since 1998. [15]

But not only big ticket items based on sound strategic and global strategic are kicking off. The retreat of private equity has eased pressure on valuation multiples, making deals more attractive. The economic turmoil has good potential to build more opportunities to create superior value.

A consequence and learning of the crisis will be that the underlying strategic rational, financial discipline and transparency of the transactions are re-gaining importance in the decision-making process.

[15] Thomas H., Saigol L. (March 31st, 2010): Financial Times, p. 36

4 Background on M&A

Mergers, divestitures, joint ventures, and other change-of-ownership transactions or business models are important ways for a corporate to reallocate resources and execute strategies.

Easy, good deals are hard to come by, if they exist at all. Most successful deals result from highly disciplined deal making and sometimes just good luck.

“Typically, based on strong empirical evidence, acquisitions create value for sellers. On average the target shareholders receive a 30 % premium over their stock’s pre-announcement market price.

On the other hand, empirical studies showing the reaction of capital markets to M&A announcement find that the value-weighted average deal lowers the acquirer’s stock price between 1 – 3 %.”[16]

“Even more studies of Mark Mitchell and Erik Stafford find that acquirer’s underperform comparable companies by 5 percent during the 3 years following the acquisitions.”[17]

A recent report from Citibank indicates that the median takeover premium of 52.7% in the recent peak years fell to 32.9% in the first quarter 2010, much closer to historical average.[18]

The following graph shows the increasing trend EBITDA multiple from 2003 onwards, exceeding multiples of previous years in 2005 and peaked in the year 2007. The transaction multiples were higher in 2007 than during the internet bubble from 1995 – 2000.

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[16] Moeller B., Schlingemann F.P., Stulz R.M. (2003): Do Shareholders of Acquiring Firms Gain from Acquisitions? NBER working paper no. W9523, Ohio State University
[17] Mitchell M.L., Stafford E. (2000): Managerial Decisions and Long-Term Stock Price Performance, Journal of Business 73 pp. 287 – 329
[18] Citibank (2009): Executive M&A Summary, December 2009 Edition, Citibank Report, p. 2

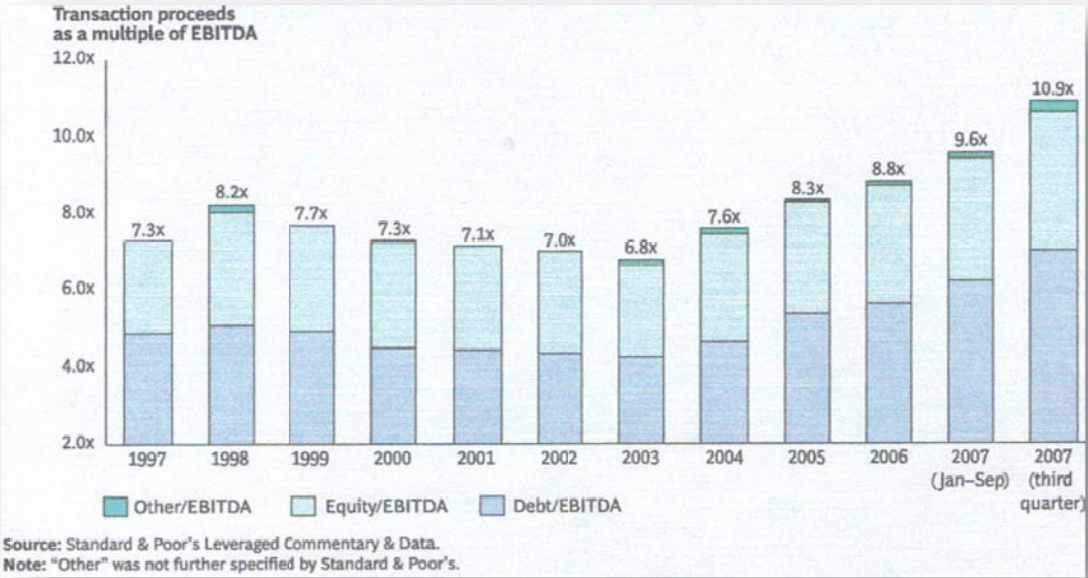

Figure 3: EBITDA multiples peaked in 3rd Quarter 2007, Boston Consulting Group, White Paper (2007)

The reality is that M&A activity, measured by the volume or numbers of transactions, has remained remarkably robust. The primary change was that in the course of the global economic meltdown private equity's share of total deal value has dropped dramatically.

The decline triggered by the credit crunch created substantial opportunities and a great environment for corporate investors with lower number of competition on the deals followed by less inflated valuation multiples.

Remember, the recent peak years in M&A in 2007-08 had private equity funds as driving force behind the increase, with a growing share of the total value of deals from 5% in 1998 to 40% in June 2007, this reflects an eightfold increase in less than 10 years.[19]

The 2007 mid-year meltdown of the debt market was spurred by a strong decline in private equity activity and reduced dramatically the private equity share of deals.

[19] Boston Consulting Group, (2007) "The Return of the Corporate Buyer", p. 9

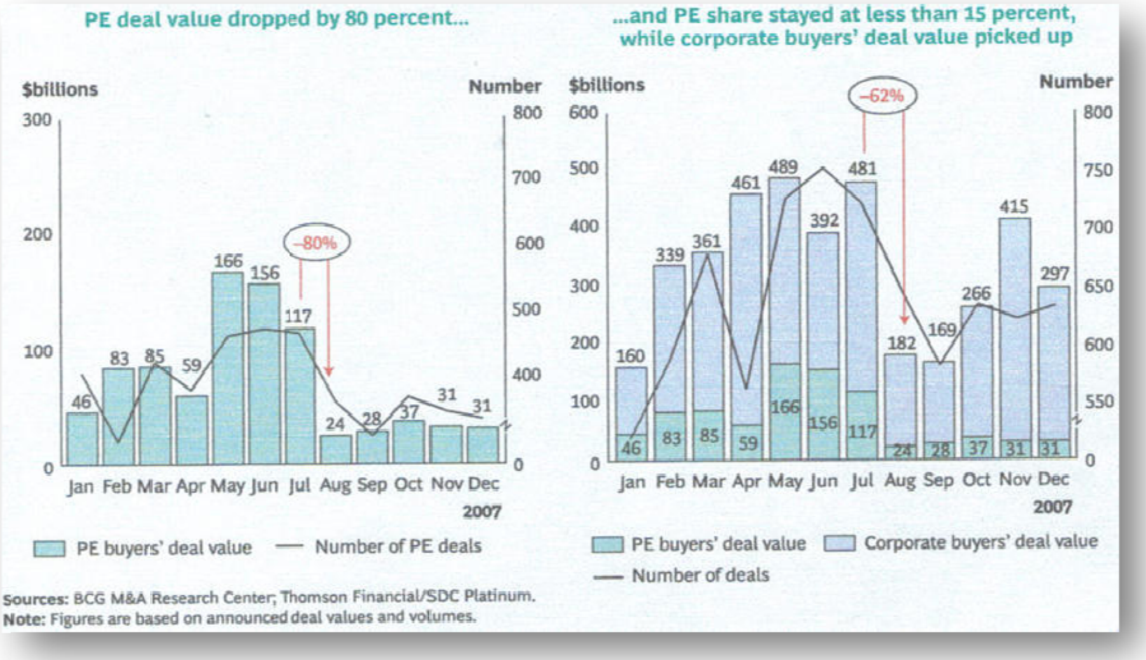

Figure 4: Private Equity Deal Value and importance dropped during the crisis, Boston Consulting Group, White Paper (2007)

However, private equity firms scaled back their M&A activities in the current environment but experts don't expect that this signals a long-term withdrawal. Private equity funds will remain a powerful and permanent force in the market over the long run.

In the previous graph (Figure 4) we can see that between July and August 2007 the private equity deal value dropped sharply by 80% and the private equity share declined below 15 percent while corporate buyer's deal value picked up significantly in the second half of 2007.

In difficult times like during this credit crunch when fund availability for private equity firms is eroding, strategic corporate investors with strong cash flow position are regaining momentum. However, particular in difficult times it is crucial to understand what transaction creates value and makes strategically sense.

Therefore, it is important to distinguish what separates value-creating from value-destroying transactions and academic research pin-points 3 characteristics:

1. Strong operators are more successful. *"Acquirers whose earnings and share price grow at a rate above industry average for three years before the acquisition earn statistically significant positive returns on announcement."*[20] *"Similar results are achieved when using the market-to-book ratio as a measure of corporate performance."* [21]
2. Low transaction premiums are better.
3. *"Being the sole bidder helps as more companies attempting to buy the target drives the price up."*[22] In consequence the conclusion is to avoid auctions which lead to a competitive bidding situation.

Statistical evidence demonstrates that typical acquisitions will not create value for the buyer. However, the specifics of each transaction matter more than the summary statistics, consequently we have to ask the following questions:

- Are we operating superior in the market and can we translate our superior performance in the acquisition target
- Has the acquisition the right strategic-fit and is it complementary to our base
- Do we have a disciplined process not to overpay
- Are the assumptions on synergies realistic, both cost and revenue ones
- How successfully will the integration be managed and do we have enough resources, capacities and the right capabilities planned
- Does the management put the right focus and attention
  - To plan the right resources and capabilities and set an ambitious but realistic time-frame
  - To support the integration efforts delivering the cost and revenue synergies as planned in the acquisition proposition
  - To secure the base business momentum

[20] Morck R., Shleifer A., Vishny R. (1990): Do Managerial Objectives Drive Bad Acquisitions?, Journal of Finance 45 , 31 – 48
[21] Sevaes H. (1991): "Tobin's Q and the Gains from Takeovers", Journal of Finance 46, 409 – 419
[22] Mock R., Shleifer A., Vishny R. (1990): Do Managerial Objectives Drive Bad Acquisitions?, Journal of Finance 45 31 – 48
Datta D.K., Narayanan V.K., Pinches G.E. (1992): Factors Influencing Wealth Creation from Mergers and Acquisitions: A Meta-Analysis, Strategic Management Journal 13, p. 67 – 84.

In the current crisis in particular the projection of the future top-line opportunities became an increasing challenge to estimate market development and customer spending right.

A study of the Corporate Executive Board Company from November 2009 indicated that many assume that M&A activities are expected to kick start in the near term when economy moves from crisis to recovery, and the market seems ready. Large companies hold a record amount of cash they are keen to invest.

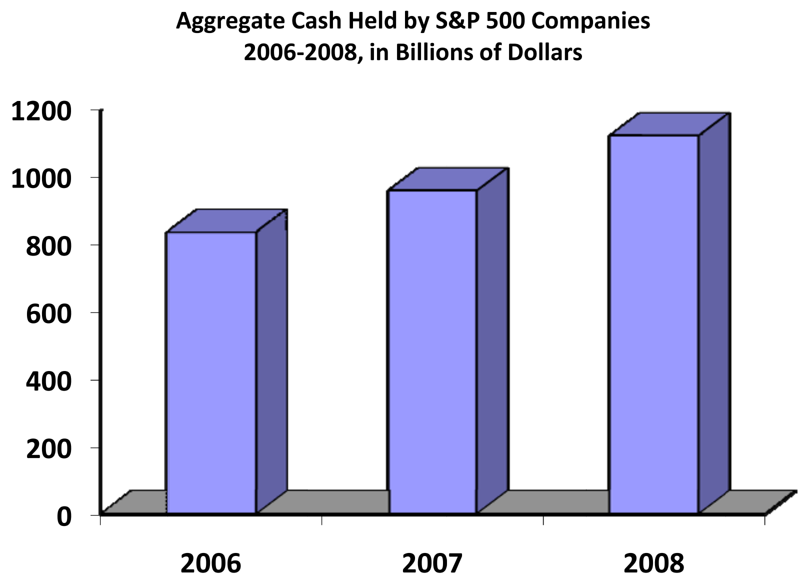

Figure 5: Aggregate Cash Held by S&P 500 Companies, 2009 the Corporate Executive Board Company, Benchmark the Deal Environment, Nov. 17th 2010, p. 4

The same 2009 Corporate Strategy Board survey shows that 70% of participating strategists believe the economic crisis will hit the bottom until Year-End 2009.

A quick look back, how the global turmoil started

The crash in the US property market triggered a leverage crisis in the subprime-mortgage securitization market. This in turn triggered a global liquidity crisis, which itself contributed to a solvency crisis among banks and a significant increase in the pressure to deleverage and this led to further declines in asset prices.

This enormous financial dislocation led to significant collateral damage in the real economy. The falling asset prices, the prospect of an economic slowdown resulted in severe decline of consumer confidence and lower consumer spending which caused lower demand and lower investments as well as cost pressure in the industry.

The subprime crisis caused a recession in the real economy that turned into a wave of bankruptcies and defaults.

It is obvious that the uncertainty about future demand increases valuation ambiguity for dealmakers driven by the fact that the overall market volatility and change in demand makes estimates of future sales more difficult and consequently the assessment of intangible assets is more uncertain in difficult economic times.

Uncertainty and expectation mismatches are the primary challenges companies face in doing deals in difficult or distressed situations.

The overall macroeconomic uncertainty, market volatility and more expensive deal financing makes valuation more challenging to resolve and leads to different price expectations between seller and buyer.

A study from the Corporate Executive Board ranked the following top mentioning as key barrier to deal making in these times:[23]

- Unreasonable seller price
- Uncertainty about market environment
- Financing constraints
- Uneasiness about distressed acquisitions
- Senior management conservatism
- Difficulty in target valuation
- Lack of attractive targets

[23] Corporate Strategy Board, Finance & Strategy Practice (November 17th 2009): Benchmarking the Deal Environment- Key Priorities for Deal Makers in 2010

This study also shows the following top 5 items are the key barriers to valuation:

- Uncertain demand projection 85%
- Defining a reasonable terminal value 41%
- Valuing intangible assets 32%
- Incorporating contingencies into the valuation 32%
- Changing customer behavior 27%

In summary M&A is an important way for a company to reallocate resources and execute strategies. In long-term observation the premium paid for an acquisition is a 30% premium, and after recent boom years with multiples beyond 50%+, the recent economic downturn brought down the multiples in the historical range of around 30%.

Weak economic situations make the valuation more difficult due to uncertain demand projections being the single biggest barrier for valuation as well as the key barrier for successful deal-making, together with unreasonable seller prices.

The global down-turn impacted the M&A market negatively, but still the market behaves robust and started to re-gain momentum in the last Quarter 2009, and in the first Quarter 2010. In this situation decisions are taken more cautious and companies evaluate better the strategic fit.

Private Equity Funds reduced significantly their share in the M&A volume due to the credit crunch, while strategically thinking companies with cash reserves increased their share in M&A deals attracted by lower competition resulting in lower multiples.

Several recent big-ticket acquisitions show that the M&A market is alive but that decisions are more rational and strategic with more realistic multiples.

5 Creating value trough divestitures in an integrated planning process

5.1 Strategic Planning - an integrated process including M&A

"The objective of a strategic plan is to set the direction of a business and create its shape so that products and services it provides meet the overall business objective." [24]

The question is how M&A, covering both, acquisitions and divestitures, can help to fulfill strategies defined in a long-term plan. But before developing and pursuing any strategy it is important that the management of a company defines the "Mission Statement" and the "Vision" of a Company. In other words "why does a company exist" and "what is the company striving for".

Business enterprises require continuity beyond the life span of a man or of any one generation. A business has to commit resources to an ever-longer future. It is in itself the result of commitments of the past and has, therefore, commitments to the past and the future. Unless grounded in a theory of the business what is the higher purpose, the vision, these commitments cannot be made rationally and sustainable. A vision frames the direction of a company and is accompanied with a set of values and operating principles describing how the company wants to achieve this vision.

The famous Peter F. Drucker describes that as follows: *"Business enterprises require a clear definition of the business purpose and business mission. It demands asking, what is our business and what should it be? Today's theory of the business always becomes obsolete, and usually pretty fast. Unless the basic concepts, on which a business has been built upon, are, therefore, visible, clearly understood, and explicitly expressed, the business enterprise is at the mercy of events. Not understanding what it is, what it represents, and what its basic concepts, values, policies, and beliefs are, it cannot rationally change itself."* [25]

Only a clear definition of the mission and purpose of the business makes clear and realistic business objectives possible. It is the foundation for priorities, strategies, plans

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[24] http://www.tutor2u.net/business/strategy/strategy_marketing.htm, download 2.1.2010
[25] Drucker P. F. (1973): Management: Tasks, Responsibilities, Practices, p. 75

and work assignments. It is the starting point for the design of managerial jobs and, above all, for the design of managerial structures. Structure follows strategy. Strategy determines what the key activities are in a given business. And strategy requires knowing "what our business is and what it should be". [26]

Theodore N. Vail (1845 – 1920) for the American Telephone and Telegraph Company (also known as the Bell System) answered as one of the earliest leaders in modern business what is the company's business about by saying *"Our business is Service"*. While this statement sounds so simple and obvious it clearly defined the higher purpose and overarching objective of the company "to create customer satisfactions" and built the strategic direction and operating principles. [27]

To answer the questions: "What is our business and What it will be to build a long-term vision" and then to communicate it is the first responsibility of top-management. The answer to these questions is always a choice between alternatives and it defines objectives, values, strategies, operating principles and the organization.

Now, strategies are the path to deliver against this mission statement and achieve the objectives following this higher purpose".

Strategy determines what the key activities are in a given business. Strategy requires knowing "what our business is about and what it should be". Finally actions lay-out "how to make the strategies happen" and to deliver tangible results. And this requires successful implementation and executions. It is like in decision making processes. Good decisions are only done when the execution has been successfully implemented. Very often good strategies don't deliver the goals because of lack of good execution. The Strategic Planning Process is putting the things as integrated plan together "Why do we exist, where do we want to go, how do we make it happen".

The future is not just happening. It requires decisions, implementation and action.

[26] Drucker P. F. (1973): Management: Tasks, Responsibilities, Practices, p. 75
[27] Drucker P. F. (1973): Management: Tasks, Responsibilities, Practices, p. 77

A Strategic Planning is facilitating and structuring this process, allocates resources and defines the work, which need to be started. Today, Strategic Plans are covering a 3 – 5 years time frame.

According to Peter F. Drucker Strategic Planning is the continuous process of making present entrepreneurial (risk taking) decisions systematically and with the greatest knowledge of their futurity, organizing systematically the efforts needed to carry out these decisions, and measuring the results of these decisions against the expectations through organized, systematic feedback. [28]

A defined structure, aligned and agreed among the company's leadership team manifests the commitment and discipline of the company to an integrated and continuous process and communicates internally the importance of the process.

Usually a typical Strategic Planning Process starts in late autumn with the first preparation. A typical time frame of a Strategic Plan could look as below and is built on four key pillars: business analysis, conclusions, strategy development and financials.

A Strategic Plan requires good understanding of the external world with all the challenges and opportunities and the internal strength and weaknesses. A Strategic Plan should address the answer to the question: "What should the company's business be about?" Consequently the targets of a Strategic Plan should be formulated as an ambition not only a roll-forward of an operational plan.

After the corporate "top-down" financial target setting the first phase focus on analysis and conclusions. The second phase starting in April/May concentrates on the "bottom-up" financial evaluation of the defined strategic framework.

Very often there will be a so called "strategic gap" to the top-down target, and the operating unit might re-work their strategic framework to identify initiatives to close the gap to the top-down target.

[28] Drucker P. F. (1973): Management: Tasks, Responsibilities, Practices, p. 125

However, the Strategic Plans first years do not need to become automatically the next year's budget.

Figure 6: Example of a Strategic Planning Calendar; Source: own development
Abbreviations: SP (Strategic Plan), AOP (Annual Operating Plan)

Strategic Planning can't be seen simply as a box of tricks, or a bundle of techniques. It is about analytical thinking and commitment of resources to action. It is not forecasting or masterminding the future.

"It is not dealing with future decisions but with the futurity of present decisions, and it is not an attempt to eliminate risk." [29]

In the first step the Strategic Plan focus on analytical and strategic thinking considering the external environment and the internal capabilities.

The graphic below (Figure 7) shows the integrated process of the Strategic Planning. The analytical tasks support the development of the goal and the business strategies. The Portfolio Analysis is one of the analysis pillars to identify portfolio gaps and potential divestiture candidates of the business (divisions, segments, brands).

There is a strong correlation between the external environment (e.g. retail environment), Marketing Effectiveness, Consumer Behavior, Competition and the Portfolio Analysis.

[29] Drucker P. F. (1973): Management: Tasks, Responsibilities, Practices, p. 125

The Goals of a company are very often related to growth and development of the profitability, and it is even better when the definition of the goal makes a reference to the outside world, like competition, to avoid an introversive setting of goals.

Important is also to cover in the overall strategic framework, what are the enablers to achieve the goal and to support the strategies. In times of an economic crisis the availability of cash might be a significant supporter of the business strategies, and the enabling strategies define how to make this happen, e.g. improvement of Cash Conversion Cycle. (days of accounts receivable plus days of inventory on hand minus days of accounts payables).

To summarize the Companies primary Goal or Mission Statement, the enabling strategies and business strategies with the respective strategic milestones and initiatives on one page gives a good overview and is an excellent tool for internal communication.

On the top of the one-pager the key take-away from the internal and external analysis can be reflected to show the reasons for the ability to win and to deliver against the goal.

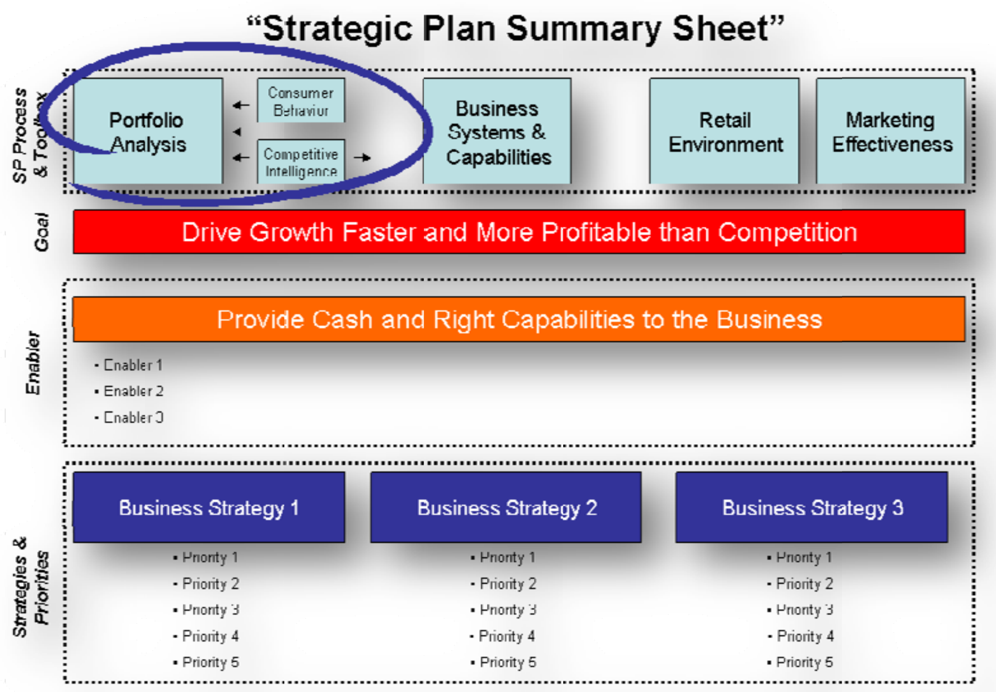

Figure 7: Portfolio Analysis as integrated part of the Strategic Planning, Source: own development

5.2 Value Creation from Divestitures

Any Strategic Plan with the ultimate aim to build a business and create value needs to include a systematic review of the business' portfolio.

"Evidence shows that divestitures create value for corporations, both in the short term, around their announcement, and in the long term. Companies employing a balanced portfolio approach of both acquisitions and divestitures have outperformed companies that rarely divested."[30]

Most studies looking at divestitures' impact focus on the short-term. A research from 2000 of 370 private and public companies[31] resulted in significant positive excess returns around the announcement of different types of divestitures. Another conclusion of the study was that most of the companies were divesting reactive to economic, technological or regulatory situations.

A benchmarking of the long-term effectiveness of different portfolio approaches from 200 large US companies from 1990 – 2000 [32] shows that companies with a passive portfolio approach which did not sell businesses or only sold poor performing businesses under pressure, underperformed companies with an more active portfolio approach. Too often companies divest as a reactive move following underperformance of the business and wait too long.

Also companies skewed either towards divesting or acquiring is performing worse than companies with a balanced portfolio approach. Very clear the best performers systematically divested as well as acquired companies as demonstrated in the following table.

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[30] Koller T., Goedhardt M., Wessels D. (2005): Valuation: Measuring and Managing the value of companies, John Wiley & Sons, p. 453
[31] Mulherin A., Boon A. (2000): "Comparing Acquisitions and Divestitures", Journal of Corporate Finance no. 6, p. 117 - 139
[32] Fallon W., McNish R. (2001): Trading the Corporate Portfolio, McKinsey on Finance, p. 1-5

Companies with a balanced portfolio approach created value 5 times higher than the original investment, while passive corporations in regards to portfolio management achieve only a value 3 times of the investment and single minded companies either skewed only towards acquisitions or divestitures resulted in 4 times higher value compared to the original investment.

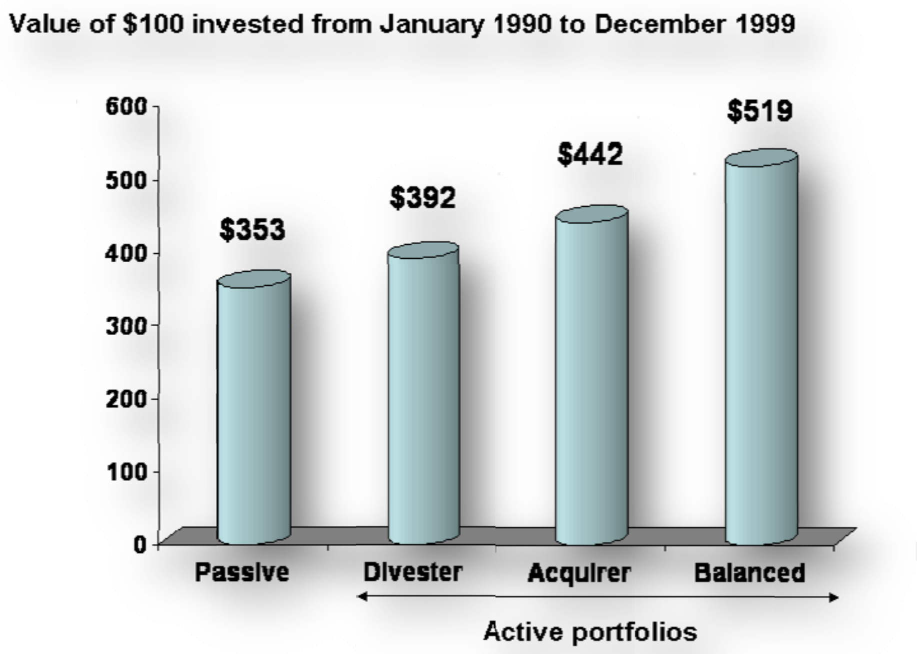

Figure 8: 10-yrs comparison of 200 US companies with different portfolio approach, Fallon W., McNish R. (Fall 2001): Trading the Corporate Portfolio, McKinsey on Finance, p. 1-5

Research has confirmed this view of parent companies holding on to underperforming businesses for too long.[33] Since this underperformance is transparent to the market, at the latest during a due diligence, companies selling underperforming or distressed businesses realize less money in the transaction.

Usually managers are more attracted by acquisitions rather divesting businesses. Divestitures mean derailing the top-line growth rate and the earnings of the business unit and corporation, and might be interpreted as “personal failure” of managers.

[33] Ravenscreaft D., Scherer F. (1987): Mergers, Sell-Offs, and Economic Efficiency, The Brookings Institution, p. 167 and Cho M. and Cohen M. (1997): The Economic Causes and Consequences of Corporate Divestiture, Managerial and Decision Economics, 18, p. 367 - 374

However, it is important to understand that the ultimate aim of a company to create value needs to include the review of a business portfolio in a periodically and systematically manner. Evidence indicates very clear that divestitures create value for companies in the short term, around the announcement, as well as in the long term. Companies employing a balanced portfolio approach of both acquisitions and divestitures have outperformed companies that rarely divested.[34]

The development of an active portfolio approach including divestitures requires establishing a respective corporate culture and a set of performance parameters and strategic benchmarks to avoid painful, and long-lasting internal discussions on divestitures. It is management's responsibility to establish this thinking, and to prepare the organization for this cultural shift towards an active and open approach.

It is important to communicate and make everybody in an organization clear, divestitures are a normal part of product and business life cycles and will happen, wisely and timely applied create value and should not be considered as a failure. Since divesting good businesses is hard for managers, the company needs to establish forcing mechanisms to keep the topic visible and on the management's agenda.

In summary, if another party is ready to pay more for the business because of better strategic fit and/or cost and revenue synergies, these transactions will create value, independent if the money is used for debt repayment, share buyback or re-invested in better performing businesses, and therefore should be pursued.

5.3 Selection of divestment candidates as part of an active portfolio management

As part of the Strategic Planning several strategic analysis- and planning instruments have been developed in the 1970ies, and several times adjusted and updated still representing the most popular and commonly used approaches.

The tool used later in the work to identify divestiture candidates is based on several theoretical models of portfolio management and –analysis.

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[34] Koller T., Goedhart M., Wessels D. (2005): Valuation: Measuring and Managing the value of companies, John Wiley & Sons, p. 454

In 1966 Ansoff developed the gap-analysis, a classical instrument of the Strategic Planning. The basic concept is the comparison of an extrapolation of the organic historical development with an ambition of the mission statement. Herewith you simply demonstrate the gap between “continuity of the current development” with a target ambition over several years. The diagnosed gap is the base for the search of strategic alternatives to close this gap.[35]

Beside the concept of product life-cycle, portfolio planning is one of the most used methods. The key principle is to balance the whole corporate portfolio holistically, and to position businesses or brands in a 2-dimensional scale matrix comparing external factors reflecting the attractiveness of a market (e.g. market growth, -size, etc.) and internal performance variables. Similar to the gap-analysis it is indicating the position in the matrix standard strategies, like divestment, skimming, selection or investment.

One of the first structured research in this area was developed by Ansoff with the product-market matrix (1966) which helps to define new business opportunities, so called “white spot”.

products \ markets	Current	New
Current	Market Penetration	Market Development
New	Product Development	Diversification

Figure 9: Product / Market matrix by Ansoff [36]

The model illustrates 4 basic marketing strategies. The market penetration strategy focuses on the realization of the existing market potential with existing products in

[35] Meffert H. (1994): Marketing-Management, Analyse – Strategies – Implementierung, Betriebswirtschaftlicher Verlag Dr. Th. Gabler GmbH, Wiesbaden, p. 109 - 111
[36] Meffert H. (1994): „Marketing Management: Analyse, Strategie, Implementierung“ Wiesbaden, Gabler, p. 110

existing markets. This can be achieved either through (a) a higher usage of existing consumers due to increased consumption frequency, weight increase of the respective product or line extension (new occasions, flavor extension etc.), (b) attracting new consumers buying currently competitive products due to improved offer (price reduction, promotions, improved product quality or better brand awareness) and increased or improved advertising efforts and finally (c) to gain new consumers for the product category due to improved distribution and product/benefits awareness.

Here comes the potential on revenue and cost synergies for an acquirer in play -to justify the premium which needs to be paid. The company needs to understand what synergies it can deliver on top of a strong position acquired.

The strategy of market development is to increase the availability of existing products in new markets (geographically or channels). The strategy of product development deals with real innovations beyond product extensions in existing markets.

The last strategy, the so called diversification strategy deals with new products for new markets and indicates the highest incremental impact but also the highest risk. We distinguish between horizontal diversification, vertical diversification and lateral diversification.

In the course of realizing diversification two alternatives are available: Organic growth or growth through acquisition. While organic growth is widely applied for horizontal diversification because of scale, product and technology advantages and similarities, M&A is applied commonly for lateral diversification, in particular for “conglomerate diversification concepts” because of lack of knowledge and technology in the new business field. [37] A conglomerate diversification concept means the company markets new products or services that have no technological or commercial synergies with current products, but which may appeal to new groups of customers. The conglomerate diversification has usually very limited correlation with the firm's current business.

[37] Becker J. (1998): Marketingkonyeption:Grundlagen des strategischen und operativen Marketing Managements, 6. Edition, Verlag Franz Vahlen, Muenchen, p. 172

Consequently, the key reasons for applying such a strategy are first to improve the profitability due to scale, second the increased flexibility of the company and the entry in new markets, third to get a better reception in capital markets as the company gets bigger or fourth it can provide the potential to transform the current business or portfolio due to technical competitive advantage.

A lateral diversification implies the highest risk but also provides the highest opportunity of incremental revenue and profit growth if executed successfully.

Ansoff's portfolio analysis has been developed further by Boston Consulting Group resulting in the BCG share/growth matrix as a portfolio planning model developed by Bruce Henderson in the early 1970's. It follows the observation of market growth and relative market share (share expressed as ratio to the share of the biggest competitor) and clusters the map in 4 categories mapping the key determinants of a company's profitability.

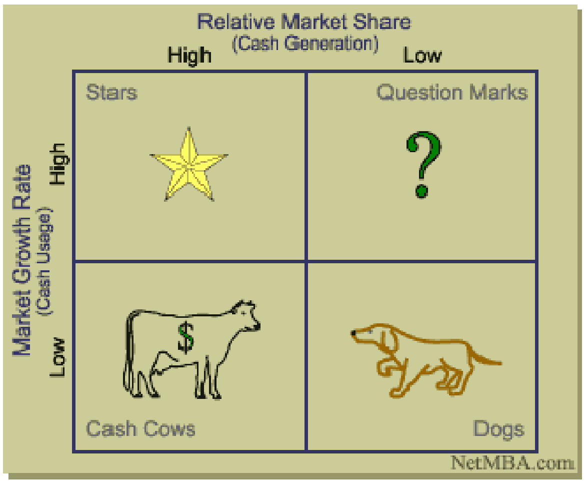

Figure 10: BCG Market/Growth Share[38]

The model is based on the thesis that an increase in relative market share results in an increase of cash generated due to competitive cost advantages (economies of scale, learning curve). On the other hand growing markets need cash for investments in assets (capacity increase) and marketing. Henderson reasoned in his model that the cash

[38] Netmba (2010): http://www.netmba.com/strategy/matrix/bcg/download: download: January 2nd, 2010

needed for so called “Stars” can be re-channeled from other propositions in the portfolio at a more mature stage and generating cash.

The simplicity of the model is one of the reasons why it is still used as a starting point in strategic discussions. The limitations of the BCG Market/Share Growth model, mainly (1) market growth rate is only one of the factors determining the industrial attractiveness, (2) the assumption in the model of independency of the business units, brands etc. is disregarding negative strategic or cost implications, and (3) the subjective definition of the breadth of the market (dominating a niche but being an overall small player in the category / industry) leads to very different results in the portfolio map.

However, over the time more comprehensive models have been developed. The McKinsey/GE matrix overcomes some of these disadvantages. It replaces market growth with market attractiveness. Secondly, competitive strength replaces relative market share. Considering a broader range as influencing factors the model becomes more balanced and comprehensive. The diagram below illustrates some of the possible elements that determine market attractiveness and competitive strength by applying the McKinsey/GE Matrix to the UK retail market.

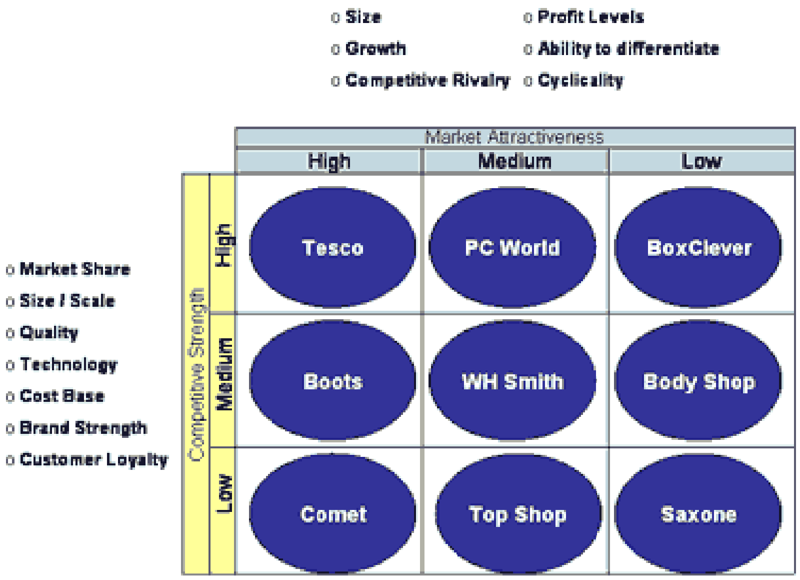

Figure 11: Market Attractiveness/Competitive Strength Matrix
http://www.tutor2u.net/business/strategy/ge_matrix.htm, download: 2.1.2010

The diagram shows several factors that can help to determine attractiveness to avoid subjective judgment. The factors affecting market attractiveness in this model are market size, -growth and -profitability, pricing trends, competitive intensity, overall risk of returns in the industry, segmentation, opportunity to differentiate products and services (maturity of the market segment) and distributor structure.

On the other axis the competitive strength is determined using the factors of strength of assets and competencies (addressing hard and soft facts, e.g. people or knowledge, which can serve as competitive advantage), relative brand strength, market share, customer loyalty, relative cost position, distribution strength, historic record of technological or other innovations, accessibility to financial funds or financing.

Two more models building a conceptual base when talking about portfolio analysis and –decision.

Kotler clustered in his work on strategies in 1988 four strategies where the targeted market position of the company is defined through the market share. In this systematic modeling he differentiates between market leader, market challenger, niche player and me-too strategy. [39]

The market leader strategy targets to maintain the market position while building further the market through initiatives to increase the

- Purchase frequency (consumer is buying more often)
- Consumption through bigger offers (e.g. 2L bottle instead of 1L)
- And qualitative upgrading of the offer (value per consumption goes up)

or the company decides building further the market position gaining market shares from competition.

[39] Meffert H. (1994): Marketing Management: Analyse, Strategie, Implementierung, Wiesbaden, Gabler, p. 112

The market challenger strategy obviously is targeting to gain market share and take the leading position or getting closer to the market leader. Common for this second strategy is to attack the market leader and other players in the business

- With lower prices and lower quality
- Or a better, more innovative and comprehensive product supported by intensive advertising at the same or slightly higher price

Me-too players accept the stronger position of other players and orient their business model on the common practice and the market leader. Successful me-too players select consciously their market segment and focus on scale-driven profitability due to cost advantage. Furthermore the strategy builds on low brand investments (advertising and promotion) and research (product development) to deliver against the target of cost leadership and put them in the position to offer a lower price. This translates in a low innovation rate and low brand awareness.

Applied as “fast follower” strategy, (meaning copying products of competitors fast and at lower cost) can result in successful share development, but the lack of innovation and low investment behind brand equity makes the position of me-too players vulnerable.

The niche player focus on less attractive segments for the bigger players (usually because of smaller market sometimes combined with high entry barriers in terms of investments or knowledge, complexity), but are offering good opportunities for smaller players with a strong customization of the product offer to customers, markets or technical solutions.

The strategies as such don’t reflect any specific behavior patterns and it can be interpreted that these strategies are more target and behavior alternatives.

The individual strategies also show different content-related links, e.g. strong competitor orientation in the market challenger and me-too strategy, while the niche player strategy is focusing on customer target groups.[40]

[40] Meffert H. (1994): Marketing Management: Analyse, Strategie, Implementierung,Wiesbaden, Gabler, p. 113

Porter's competitive strategy model helps the market participants to build a sustainable business model based on their strengths or strategic direction they have defined.

The second model I would like to describe closer is from Porter. Based on the central competitive factors he developed a strategic conceptual framework scoping the model on strategies focused on product benefits or cost advantage while applied either on the total market or a specific market segment.

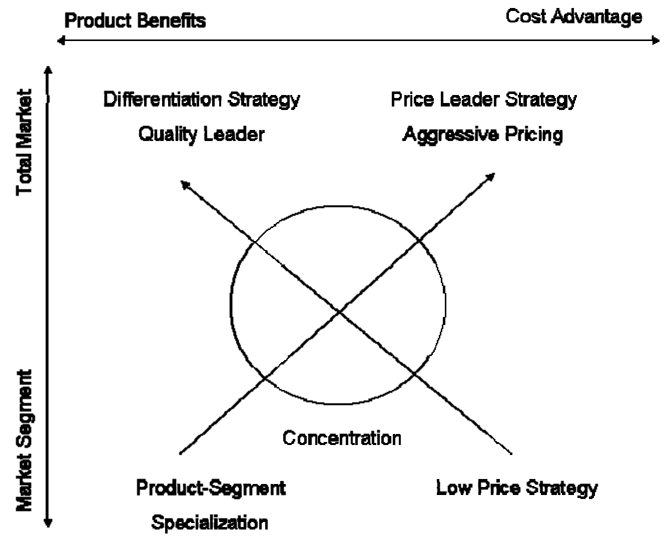

Figure 12: Competitive Strategy by Porter [41]

The Cost or Price Leadership strategy is focused on scale effects due to mass production and standardization to bring unit costs below competitor ones and realize competitive advantages to pass this cost advantage in price. The company usually needs a high relative market share (share lead versus the biggest competitor) to leverage cost through scale and learning experience.

The experience of "learning curves" was first observed by the 19th Century German psychologist Hermann Ebbinghaus according to the difficulty of memorizing varying numbers of verbal stimuli. As individuals as well as organizations get more experienced

[41] Meffert H. (1994): Marketing Management: Analyse, Strategie, Implementierung,Wiesbaden, Gabler, p. 113

at a certain task, they usually become more efficient at it, following a progression of the learning first getting easier and then harder as one approaches a limit.[42]

The rule used for representing the learning curve effect states that the more times a task has been performed, the less time will be required on each subsequent iteration.

This relationship was probably first quantified in 1936 at Wright-Patterson Air Force Base in the United States[43], where it was determined that every time total aircraft production doubled, the required labor time decreased by 10 to 15 percent.

Subsequent empirical studies from other industries have yielded different values ranging from only a couple of percent up to 30 percent, but in most cases it is a constant percentage: It did not vary at different scales of operation. Learning curve theory states that as the quantity of items produced doubles, costs decrease at a predictable rate.[44]

The price leader strategy supported by cost advantages can be either applied to the total market (aggressive pricing) or for a selected market segment (low price strategy). The low price strategy is often combined with reduced consumer benefits to establish an entry product for young consumers or first users to build a brand loyalty.

On the other side the differentiation strategy focus on the consumer benefit with a differentiated product offer and demonstrates flexibility, high customization and quality. Since the strategy builds on innovation and a strong brand image it is usually accompanied with high investments in research and development, and advertising. This quality leadership strategy is usually reflected in a higher pricing strategy and commonly applied for the market.

If the quality leadership strategy is only applied for a certain market segment or consumer target group Porter's model reflects this approach as specialization strategy.

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[42] Wikipedia (2010): http://en.wikipedia.org/wiki/Experience_curve_effects, download: May 1st, 2010

[43] Wright, T. (1936): Factors Affecting Cost of Airplanes, *Journal of Aeronautical Sciences*, p. 122-128.

[44] Wikipedia (2010): http://en.wikipedia.org/wiki/Experience_curve_effects, download: May 1st, 2010

Porter's generic competitive strategies are controversially discussed. The accelerated market dynamics and product development (life cycle), increased globalization and changed consumer purchase patterns since the 80ies are not reflected in the one-dimensional concept.

In summary of this chapter it is important to pin-point a holistic knowledge and understanding of company's strategies to do the right decisions and an appropriate evaluation and estimation of synergies (both cost and revenue) in the M&A process. A clear strategic and holistic understanding is vital for the success of any M&A transaction.

Following the general principles of Portfolio Management, the approach can be applied for M&A. In the following the thesis demonstrates a"5 steps guide" to (re)assess the attractiveness and future role of countries, categories and segments and the existing brand portfolio ("Brand Mapping") in order to identify potential divestiture candidates and attractive "white spots" for business expansion within existing business categories or segments, or an potential acquisition to enter a market or expand the portfolio.

The first 3 steps of this portfolio analysis approach identify the attractiveness of countries, categories and the existing brand portfolio. The next 2 steps are dealing with the more detailed evaluation of the divestiture candidates and the first preparatory steps for the effective divestment.

In particular for companies with complex brand portfolio due to long historical development of the portfolio, or continuous acquisitions, a regular portfolio review and brand decisions are a must for a continuous successful performance on the market.

This 5-step approach helps to optimize a portfolio reflecting the attractiveness of geographic markets, strength of brands as integrated part of a portfolio planning and decision process, including acquisitions and divestitures.

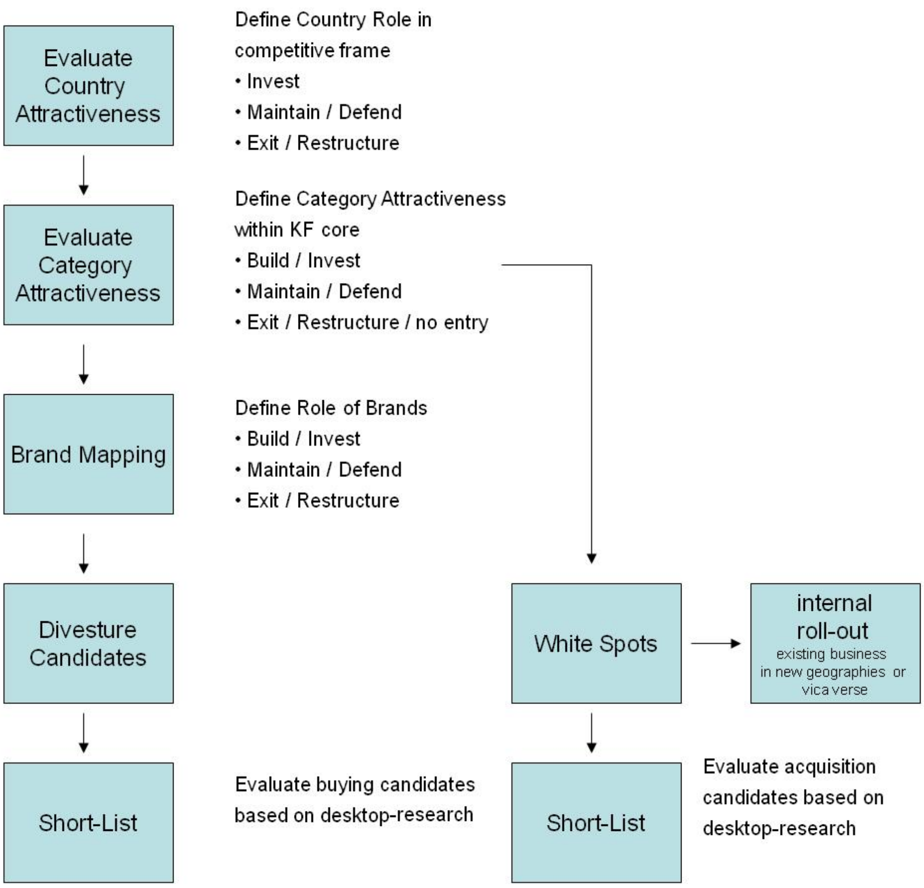

Figure 13: Process to identify divestiture candidates, own development

5.3.1 Country Attractiveness and Growth Potential – Step 1

In an international business environment the first step is evaluating the attractiveness of various countries within a pre-defined geographic region and/or world-wide. This step should help to define the strategic role of the countries within a company and how a country stands in terms of attractiveness in a broader, global context.

This country-portfolio analysis facilitates the decision to define which countries have an overall attractive potential to enter the market or to define the role of the country in a specific geographic portfolio, meaning should the company invest, maintain or exit the investment (level) in the respective country.

The analysis will plot the countries in a 2 axis / 9-field matrix with one axis reflecting the growth potential (dynamic indicator forecasting the future) and another axis reflecting the country's attractiveness (static indicator reflecting the status quo).

The parameters used for this analysis might depend on the business the company operates in. Obviously business to business, infra-structure projects or the consumer good product industry might require different indicators to identify the attractiveness and potential of a country. In some industries the political situation might play a more important role than in others.

In the following the thesis is focusing on the portfolio analysis from the view of a consumer goods manufacturing industry.

The consumer goods industry targets the end-consumer for business purposes and accordingly the wealth development and purchase behavior of the consumer is a major criterion for the future growth potential in a country.

1. Growth Potential

    a. Outlook of GDP Growth of the next 3 years (weight 30 %)
    b. Estimate of disposable income growth in the next 3 years (weight 35%)
    c. Future category (e.g. food) spending of the next 3 years (weight 35%)

The strong correlation of GDP growth and development of the income with private consumption makes these macro-economic indicators important for many industries which target the private consumer and represents therefore 65% weight to evaluate the growth potential.

In order to weight the growth potential indicator towards a more industry specific direction the third parameter is related to the expected consumer spending development in the respective category / industry; e.g. chocolate. In many industries you have numerous pre-indicators which hint the future development. For example if you have an increasing number of washing machines in a country, you have a strong indication that washing detergents will increase accordingly or even beyond.

2. Attractiveness of the Market

   a. Current GDP per capita (20 %)
   b. Current Disposable income (20 %)
   c. Current industry Spending (20 %)
   d. Financial Stability measured on Account Deficit (20 %)
   e. Political Stability measured on Euro-Monitor Index (20 %)

The attractiveness of the market evaluates the economic potential and the readiness of a country to enter.

Current GDP (Gross Domestic Product) per capita and the current disposable income indicates the wealth of the economy under analysis. The current spending in the respective industry shows the maturity of the respective market and the absolute size. This is in particular important if the respective market in focus of the company justifies an entry or remaining in the market, meaning is the market size big enough to represent a meaningful scale to invest in the market.

Financial and Political stability measures the macro-economics of the country and how safe it is to operate in the market place (e.g. legal, regulatory, environment, corruption, etc.).

In order to represent each of the factors in a fair amount, the weight of the parameters is allocated with 20% each.

For companies operating with an international scope it is important to have a balanced portfolio among countries in developed markets and developing markets.

Developed markets show a significant market size but also low growth rates due to mature market structures and consumers with already high, advanced spending levels and per capita consumptions. Due to more competitive and consolidated markets in developed countries, margins are more challenged.

Developing markets are usually still small but have great growth opportunities. One of the indicators is the size and development of the population in developing and emerging markets.

The estimate of 2015 world population is 7.2BN people. 6.1BN (= 85%) will live in low and middle income markets with an estimated annual population growth rate from 2005 – 2015 of 1.2% or three time higher than in high income countries (0.4% average annual growth) and more than 10 times compared to Europe EMU zone. The share of population below an age of 14 years is 30% in low and middle income countries (= developing and emerging markets) by 2005 compared to 18% in high income, developed countries.[45].

The country analysis helps to decide which the countries with the highest potential for expansion are and to review the execution of the overall corporate strategy. Overall the right mix between developed and developing markets gives the balance between scale and growth.

However, the decisions derived from the country analysis are highly depended on the mission statement of the company and the directional governance where the company aims to be in the future.

This confirms again, how important it is to have a clear vision and a corporate guidance and to follow the direction with disciplined steps without loosing the view on the whole, holistic picture.

In order to execute with success the principles and the direction need to be understood by the whole organization and communication within the organization is crucial and can't be a privilege for selected management team members. While the area of M&A might be a sensitive topic, it is important that everybody knows how he can contribute.

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[45] World Bank (2010) World Bank 2010 Population Dynamics Table, (http://econ.worldbank.org/WBSITE/EXTERNAL/DATASTATISTICS/0,,contentMDK:20394872~pagePK:64133150~piPK:641331), download: May 1st, 2010

5.3.2 Category Attractiveness and Growth Potential – Step 2

The second step is similar to the first one but evaluating the attractiveness and growth potential of specific categories in scope of the company. This step helps to prioritize among various choices.

The analysis is based on the following parameters and will place the categories in a 2axis/9-field matrix and like in the country analysis this step cascades the analysis down to the respective industry, in this example the consumer goods industry.

1. Growth Potential (dynamic indicators)

    a. Category Growth of the last 3 plus ongoing year (25 %)
    b. Per Capita Consumption Outlook (25 %)
    c. Change in Consumer Price per kilogram or unit of the last 3 years (50 %)

The first two parameters address the historical and future growth. The category growth of the last 3 years reflects the evolution of the previous years and together with the outlook of the future per capita consumption of the respective industry gives a good understanding of the development in the last years and how the trend looks like. Overall, these two factors cover the growth in the respective industry (= category, e.g. cars) or a segment (e.g. sport cars, SUV's etc.). These two parameters are weighted together with 50% and represent in the validation model the expectation in regards to revenue growth.

The third factor should address the historical dynamic of the profit development. For a divestiture or an acquisition of a brand or trademark the transaction structure will be done as asset deal. In such a case the profitability would be validated based on the so called Net Contribution (Gross Margin Profit minus investments in advertising, promotion and dedicated sales investments). This is different to a sale of a company which would be usually structured as a share deal with full succession. The sale of a company as share deal would include the full fletched company's infrastructure and therefore all overheads (including General Expenses and Administration) needs to be included in the profit number. This would be the so called operating income or EBIT (Earnings before Income Tax).

It might be difficult to get reliable profitability numbers of an industry and therefore the model is using the Consumer Price per kg (which can be easily gathered through market research agency) as profit indicator. The industrial experience shows that higher consumer price usually leads also to higher margins. This assumption holds only within a certain industry and can't be used to compare different industries.

For example the model qualifies to compare within the food industry, categories like chocolate, coffee, biscuits, meat, bread etc. and a higher Consumer Price per kg indicates a better margin structure. The comparison enables than to compare different categories within an industry. However, the comparison among different industries e.g. cars, food, detergents are not comparable based on the consumer price per kg or unit.

Since Growth Potential is a dynamic factor we are considering for the validation the change of the Consumer Price (per kg or unit) in the last 3 years. The governing thought here is that a positive change in Consumer Price reflects an improving margin structure due to upgrading of the consumer towards higher value products, or a decreasing Consumer Price indicates lowered margins e.g. due to increased competition or downgrading of consumers (private label etc.)

The Consumer Price Change is weighted in the model with 50% for the growth potential to balance as profit indicator the previous described revenue growth indicators.

2. Attractiveness of the Category (static indicators)

   a. Consumer Price of the Category as indicator of profitability (25 %)
   b. Concentration of Top 3 players (20 %)
   c. A&C intensity of the Category (20 %)
   d. Absolute size of the Category (35 %)

The attractiveness of the category is covered through 4 dimensions. First, the profitability of the category estimated based on Consumer Price per kg of the category as described before. For the evaluation of the category's attractiveness the model compares the Consumer Price per kilogram or unit of the benchmarked categories. The experience shows that categories with higher consumer prices achieve a higher profitability given the premium surplus of the respective category.

Consumer Price is used as indicator because of easy availability through market research agencies (e.g. Nielsen, MEMRB). The factor covers the financial attractiveness in terms of profit in the respective category.

Secondly, we look at the concentration of the industry. The experience shows that if the top 3 players consolidate more than 75% of the market we are facing a fierce competition among strong players which makes an entry in this market significantly more difficult, or an acquisition of one of these top 3 players more attractive. If the acquirer plays already in this industry regulatory topics needs to be addressed when a cumulated market share indicates a potential dominant position. While market share is only one of the indicators of a dominant position, the thesis will not further cover the pre-conditions for a dominant position triggering regulatory issues.

The third parameter looks at the activity in advertising and promotion. A high investment level of the current players in advertising and promotion indicates strong brand awareness of the existing players and requires high investment levels in this area for a new entry. In particular the combination of a consolidated market with few players with high advertising activity significantly reduces the likelihood of a successful entry for a new player, while on the other side it increases the attractiveness of an acquisition of one of the players. Detailed information is available through media buying agencies but for a first category assessment common industrial knowledge is sufficient.

Finally, and fourth the absolute size of the market gives an indication of how worthwhile it might be to invest in an entry in this market. For example, a big market with high profitability might be despite fierce competition and high advertising level attractive because even a small market share can deliver attractive absolute revenues and margins.

In summary, a market with attractive margins, low competition and advertising investment level attracts highly a “green field” entry, while a consolidated market with few strong players and high advertising levels indicates a high financial exposure for a

“green field” entry, but indicates an entry through acquisitions whereby higher premiums need to be expected.
The country and category analysis will help to identifying adjicient categories or areas not covered yet by the company, so called white spots. But the analysis can also help to assess the attractiveness of countries and categories identified in previous strategic marketing reviews and addressing new product-life cycle opportunities, new technologies or changes in consumer behavior.

5.3.3 Brand Mapping - Step 3

This analysis step follows the principals of the portfolio analysis. The best business portfolio is one that fits the company’s strengths and helps exploit the most attractive opportunities.

By doing so the company analyzes its current business and brand portfolio, and decides which businesses should receive more (invest) or less investments (maintain) or should be harvested or exit at all. While analyzing and understanding the results of the portfolio map, the company develops growth strategies identifying new business opportunities (“white spots”) or new products and at the same time deciding which businesses, brands or products should not be retained any longer. This can be executed through a harvest-strategy, a straight forward exit or a divestiture.

The brand mapping matrix helps to identify the divestiture candidates by analyzing the attractiveness for a potential buyer and the internal willingness to sell.

The “Brand Mapping” is based on 21 indicators to identify the role of the existing brands in the various countries. The tool facilitates the decision process and is building up the necessary transparency for portfolio decisions. Below table shows the basic 9-field matrix for the decision support.

The matrix can result in basically 5 directions: Invest, Selectively Invest, Harvest, Divest or Exit. With the following model based on Excel, the parameters and the 5 clusters are explained in more detail.

Internal willingness to sell

The internal willingness to sell includes three components: First, the competitive attractiveness following the principles of the common understanding of portfolio management but also including the benchmarking of the strategic fit and focus of the brand to the company.

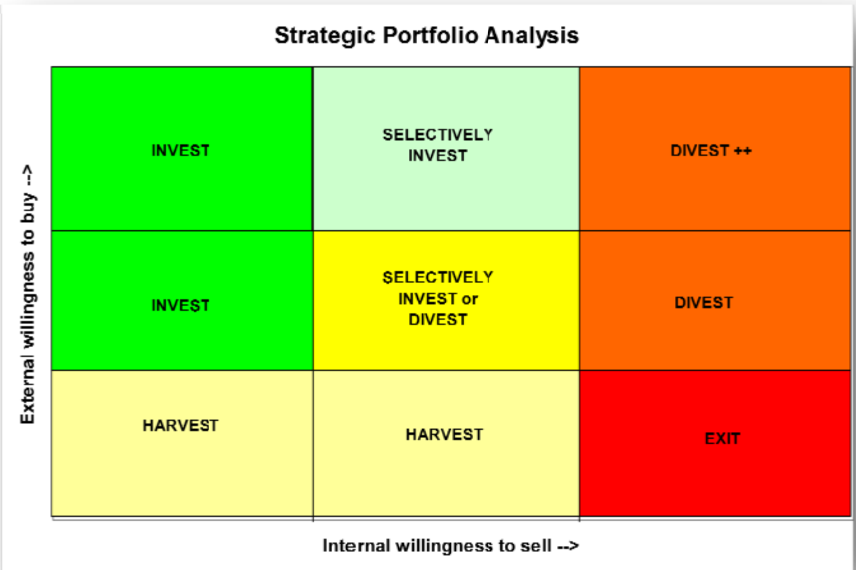

Figure 14: Brand Map, own development

<u>Strategic focus / internal attractiveness </u>(Competitive Attractiveness)

Priority Brand / Core / Non Core: Definition if the brand is a priority brand (e.g. a global brand in a multi-national company). A high score indicates it belongs to a core category/segment and/or brand.

"Growth relative to" and "profitability relative to" define the growth rate / profitability on a 3-years average compared to the growth rate / profitability of the total business defined as country organization or Strategic Business Unit.

Secondly, <u>Selling Propositions Competitiveness</u> defines the key parameters - how valuable and sustainable is the business under investigation for the Strategic Business

Unit reviewing the absolute market share, share dynamics over the last 3 years, profitability of the business compared to the market, the spontaneous brand awareness and the internal expertise which will go with the business (R&D, Marketing, technology etc.).

And finally the model investigates the implications <u>of the divestiture to the remaining business</u> in terms of size of the divestment for the Strategic Business Unit, and the process, the cost and efficiency implication on distribution and production.

External willingness to buy (Market Attractiveness)

First it is important to understand what would be the driving forces for a potential buyer to acquire the proposition for disposition. A company simply needs to define, what they themselves would focus on when acquiring a business.

Build significant scale in a high potential country where marginally or not presented

- Enter new categories / businesses where already established
- Entering new, high potential countries
- Tack-on acquisitions to consolidate scale where present

Following this ingoing position, the Market / industry attractiveness needs to measure the size, dynamic and future potential of a market. Category size and dynamics need to demonstrate reasonable scale and growth rates to attract someone to enter or build further in the market. The per capita consumption indicates the future growth potential or states if the market is already in a mature stage.

Category profitability is important for the potential buyer to estimate future cash flows but also for the benchmark with alternative investment opportunities. Finally the concentration of the competition and the advertising intensity/price aggressiveness in the market indicate how open a market is for successful new entries. Experience shows that a concentration of the top 3 players beyond 75% makes a new entry very difficult and acquisition is one of the opportunities to enter the market. The market entry becomes even more valid when few players in the market are also investing heavily through advertising and pricing resulting in strong brand equity of existing players.

Furthermore in the case of divestiture candidates the model has adapted the external attractiveness with performance indicators of the offered proposition to facilitate a final opinion on the attractiveness of the offer for a buyer in an alternative context. The model includes here the relative market share, profitability of the market, brand awareness and sourcing security (e.g. is a production facility or co-manufacturing included in the offer).

The below spreadsheet applies the theoretical steps described before and compares the attractiveness of various divestiture projects.

Divesture Base Analysis for Brand Mapping

	Measure	High (+1)	Ave (0)	Low (-1)	Weight	Project A	Project B	Project B1	Project B2	Project C	Project D	Project E	Project F	Project G	Project H
Net revenue						**80**	**90**	**60**	**30**	**5**	**10**	**5**	**10**	**10**	**20**
Internal willingness to sell - high / (low)						***-9%***	***51%***	***33%***	***89%***	***67%***	***76%***	***56%***	***33%***	***-7%***	***13%***
Strategic focus / internal attractiveness high / (low)					*33%*	*33%*	*-100%*	*-100%*	*-100%*	*-33%*	*-67%*	*-100%*	*-33%*	*-100%*	*-100%*
Priority brand / core / non core		core brand	core cat.	non core		-1	-1	-1	-1	-1	-1	-1	-1	-1	-1
Growth relative to	3yr cagr vs 3 yr core CAGR	> 5pp	-3pp to 5pp	< -3pp		1	-1	-1	-1	-1	-1	-1	-1	-1	-1
Profitability relative to	3ry average Net Contribution % vs core avera	> 5pp	-3pp to 5pp	< -3pp		1	-1	-1	-1	1	0	-1	1	-1	-1
Selling Proposition competitiveness (low) / high					*33%*	*-40%*	*-20%*	*0%*	*-100%*	*-100%*	*-60%*	*-100%*	*0%*	*20%*	*-40%*
Market share	current value share	> 30%	20% to 30%	< 20%		-1	0	1	-1	-1	0	-1	0	1	0
Share development	% change over 3 yrs	> 10%	-5% to 10%	< -5%		0	-1	-1	-1	-1	-1	-1	-1	0	-1
Profitability relative to market	OI% vs competition	higher	equal	lower		-1	0	0	-1	-1	0	-1	1	0	0
Change in brand awareness	3 yr change in spontaneous BA	higher	equal	lower		0	0	0	-1	-1	-1	-1	0	0	0
Internal expertise	i.e. dedicated R&D / marketing	high	med	low		0	0	0	-1	-1	-1	-1	0	0	-1
Disruptions to remaining business (low) / high					*33%*	*33%*	*-33%*	*0%*	*-67%*	*-67%*	*-100%*	*33%*	*-67%*	*100%*	*100%*
Relative size to country	NR / country NR	> 15%	5% to 15%	<5%		1	0	1	-1	-1	-1	0	-1	1	1
Distribution	Degree of integration	Integrated	Mix	Stand alone		1	0	0	0	0	-1	0	0	1	1
Manufacturing	Degree of integration	Integrated	Separable	Stand alone		-1	-1	-1	-1	-1	-1	1	-1	1	1
External willingness to buy - high / (low)						***-20%***	***0%***	***20%***	***-40%***	***-20%***	***0%***	***-50%***	***0%***	***10%***	***20%***
Market / industry attractiveness - high / (low)					*50%*	*20%*	*20%*	*20%*	*20%*	*20%*	*0%*	*-20%*	*0%*	*-40%*	*20%*
Category size	Retail country sales ($'bn)	> 0.35	0.1 to 0.35	< 0.1		1	1	1	1	-1	-1	-1	-1	-1	0
Category growth	3 yr cagr (historic)	>10%	5% to 10%	<5%		1	1	1	1	1	0	1	-1	0	0
Per cap consumption	long term forecast vs now	higher	same	lower		1	1	1	1	1	0	1	1	0	1
Category profitability	Segment GM%	>40%	30% to 40%	<30%		-1	-1	-1	-1	1	0	-1	1	0	0
Competition: mkt concentratio	# of players with 75% som	> 5	4 to 5	< 4		-1	-1	-1	-1	-1	1	-1	0	-1	0
External business attractiveness - high / (low)					*50%*	*-60%*	*-20%*	*20%*	*-100%*	*-60%*	*0%*	*-80%*	*0%*	*60%*	*20%*
Relative market share	% of #1 som	> 90%	60% to 90%	< 60%		-1	0	1	-1	-1	0	-1	0	1	0
Share development	% change over 3 yrs	> 10%	-5% to 10%	< -5%		0	-1	-1	-1	-1	-1	-1	-1	0	-1
Profitability relative to market	OI% vs competition	higher	equal	lower		-1	0	0	-1	-1	0	-1	1	0	0
Brand awareness	Spontaneous BA vs comp	high	med	low		-1	0	1	-1	0	1	-1	0	1	1
Sourcing security	risk of disruption	minimal	reasonable	high		0	0	0	-1	0	0	0	0	1	1

INPUT FIELD

Figure 15: Evaluation Worksheet, own development (Attachment 1)

The internal willingness to sell weights the decision dimensions “strategic focus and internal attractiveness”, “competitiveness of selling proposition” and “disruption to remaining business” equally, means with 1/3 each, while the indicators within each dimension are also considered equally.

Obviously the classification of the individual criteria what is high, medium and low depends from the industry and for example growth rates needs to be benchmarked with the industrial standard before making this classification.

However, some classifications might be applicable across the industry. For example market share we can clearly talk about a strong position beyond 30%, and a share gain of 10pp in the last 3 years might be seen very strong across many industries.

And a share of more than 15% of total business of a country organization or company might be seen as significant and together with the organizational integration (in particular for sales distribution and manufacturing) can be interpreted as significant disruption for the remaining business when this part of a business is sold.

The external willingness to buy validated with the decision dimensions “market attractiveness” and external business attractiveness” is also weighted equally, means ½ each. Also the parameters within these two dimensions are weighted equally. Each parameter is again valuated if it scores high, average or low according to industry benchmarks and economic standards.

Again most indicators might depend from the industry, but in particular for the market concentration a concentration of 3 players with an market share of more than 75% seems high, and therefore triggering a low interest to enter this industry, but might be over-compensated when he can buy one of this 3 players, which is reflected in the parameter relative market share and considered in the calculation. A relative market share of 1 means that player A has the same market share than the biggest competitor (e.g. both have 30% market share, cumulated 60%)

A high percentage on the one the x-axis calibrates the interest to sell, and a high score on the other axis reflects how attractive the initiative is from an external observer to buy.

4.3.4 Define divestiture candidates and potential buyers – Step 4, 5

The results of our example are plotted in below graph:

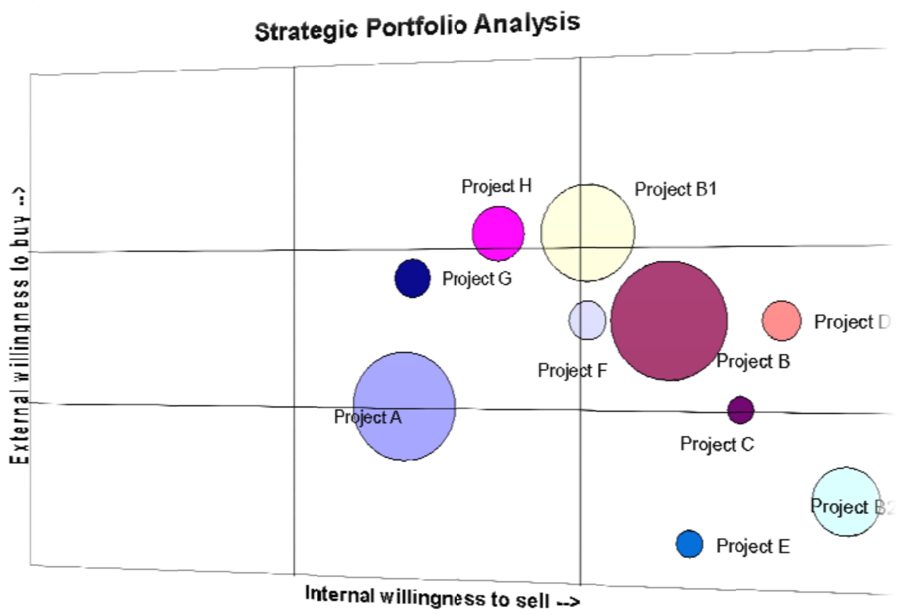

Figure 16: Validation Results of Example, own development

In the above graph the results of the previous analysis have been visualized and indicates that Project B, D and B1 seems to be strong divestiture candidates because they deliver greatly against the dimension "willingness to sell" and are representing also an attractive proposition reflected in a high score in the dimension "external willingness to buy. Project B2 and Project E seems to be exit candidates reflected in a low focus of the existing company, reflected in a high internal willingness to sell but seems less attractive and therefore also the external interest to buy is low. Project C and F probably needs a closer analysis but might qualify as divestiture candidate as well. Project G and H might qualify for further investments.

The size of the respective bubble indicates the size of the business expressed in net revenue (gross revenue minus discounts) and indicates where the company needs to set the priorities given the absolute size of the business and the potential financial implications of the decision.

So given the absolute size Project B is the key candidate for divestiture and should gain full management focus and requires fast decisions. For illustrative purposes project B is also reflected in an alternative scenario with Project B1 and B2 separating the business (e.g. one business/category unit) and selling as two independent candidates (e.g. two separate trademarks/brands). The analysis shows the higher attractiveness in the market of Project B1 and management might either decide to sell the combined business because of higher chance to be successfully placed in the market or to sell Project B1 and exit Project B2.

Project A seems sensitive given the absolute size but also the result between “harvesting” and “selectively invest” requires fast decisions. Project A is on the border between “selectively invest” and “harvest”, which means to keep the business and squeezing out as much cash flow as you can.

Important is to remember what was said before, that businesses often are sold too late and can’t be placed in the market attractively.

So management needs in such cases carefully evaluate if further investments are paying back and if a harvesting- or milking-strategy delivers better cash-flows (discounted) than an immediately sale. With the interpretation of the brand map Step 4 is finished, and while it might require more detailed analysis to test the results of the brand mapping, usually the work on Step 5 to build a database for potential buyer, the so called “short list” can start.

However, Step 4 “identifying divestiture candidates” is a major task to provide input to the M&A funnel in regards to a company’s “selling positions”.

The methodology of a funnel reflects the thinking to generate many ideas and to select in a disciplined and defined process the best choices to create sustainable value through growth, innovation, effectiveness and satisfaction, internally towards the employees and externally towards customers and consumers.

Again, divestitures are a major component to build a successful, profitable and sustainable portfolio.

5.4 The M&A Funnel

Making right portfolio decisions requires a disciplined approach in the analysis, decision making and bidding process to fully exploit the potential of a company's future.

Here comes the importance of a "M&A Funnel" in play which is fully aligned with the strength of the company and the overall vision of the company. Again if you don't know where to go and what your strengths are you cannot work with this information and your decision making process becomes a "maverick" strategy to make acquisitions.

A solid M&A funnel helps to illustrate your existing portfolio what to divest but also what the attractive white spots or incremental opportunities are.

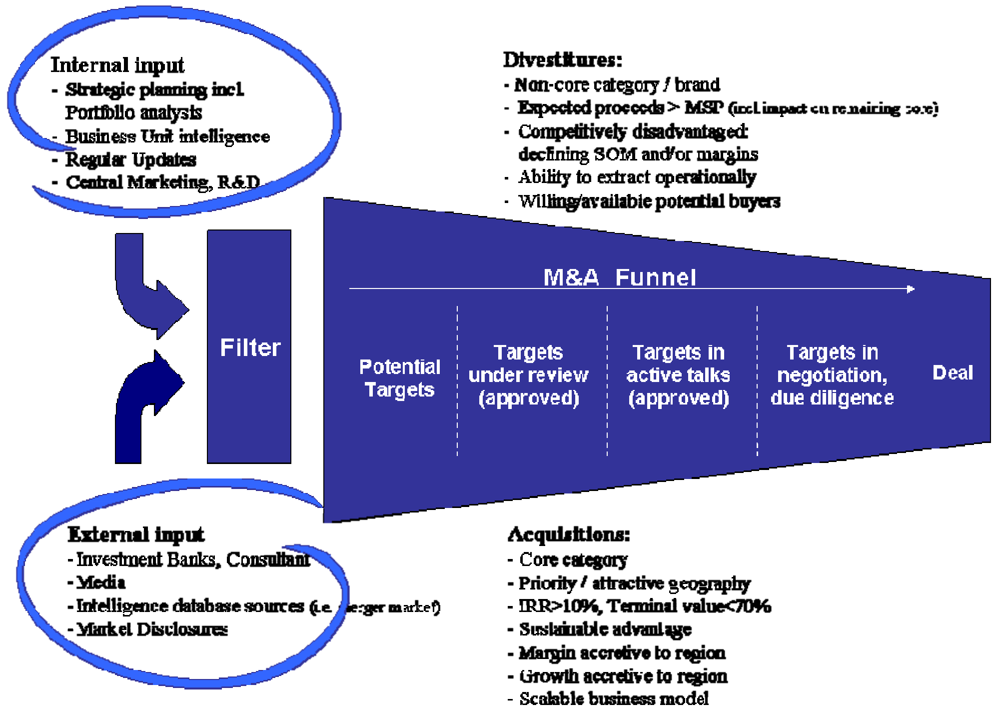

Figure 17: M&A Funnel, Kraft Foods

The M&A funnel is an ongoing process and reflects the results of external and internal business analysis and addresses the company's strategies. The key purpose of a funnel is to build a portfolio of M&A activities in different stages from Idea Generation until Signing and Closing of Deals in finalization. The process secures that there is a time consistency and the company is not lacking any opportunities in the market.

Embedded in the Strategic Planning Process a portfolio analysis is performed to define potential divestiture candidates and “white spots” for acquisitions. The input comes from internal sources like business unit management, marketing, R&D and considers internal strength and strategic fit, as well as technical and external development. Investment banks, consultants, media and various competitive intelligence and M&A database are further sources of information for this business analysis.

Important is an established set of values and performance criteria as a “filter” to decide in a structured and disciplined way which divestitures or acquisitions should be investigated further, and promise a reasonable payback.

The support of the top management of a company is important to establish these ground rules and a corporate culture towards a balanced, anticipative and open M&A approach built on values and principles. Once established the M&A framework facilitates the corporate discipline but requires also that management lives the agreed principles.

After these potential targets have been identified, further resources are invested to investigate the potential and the likelihood of an acquisition or divestiture, and step by step the process continues with first contacts, negotiations, due diligence, until the closing of the transaction.

The “funnel” is tracking numerous projects in various stages and facilitates the ongoing process.

5.5 Process Approach towards Divestiture

In principal there are 2 different approaches towards a divestiture. First, the so called 2-step Sales Process is appropriate when an attractive asset that is expected to receive strong interest is for sale.

Second, there is the so called accelerated sales process which is chosen for a poorly performing asset and when a narrow set of potential buyers, primarily strategic investors (from the industry vs. financial investors) are available.

Embedded in the strategic planning process the divestiture process might look as illustrated below.

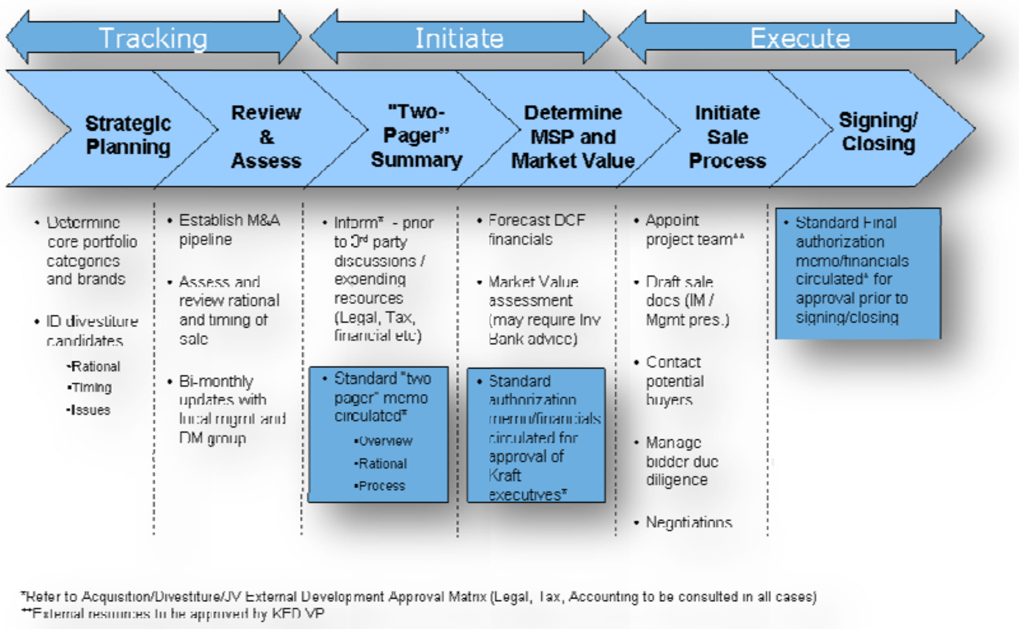

Figure 18: Divestiture - General Process, Kraft Foods

As mentioned for the 2-step Sales Process a wide range of potential buyers combined with a straight-forward selling story is the base for this method. The 2-step Sales process includes a detailed offering memorandum. Preliminary bids are required before management presentations are given to a reduced number of participants. Usually there is a limited or even no data-room access prior to the preliminary bid. The Sales Process is called “2-steps” because the seller is asking for a preliminary or also called indicative bid before asking for the binding bid.

In more detail a typical timetable for a divestiture process following the 2-Step Sales process might look as follows and will take between 9 – 12 months.

1. Strategic Assessment
   - Understand strategic fit / core for the corporation
   - Develop a strategic rationale for the transaction
   - Evaluate the business and finalize a SWOT analysis taking into account industry trends for growth and profitability

2. Feasibility Analysis
   - Define the business and assets available for sale (fixed assets, trademarks, IP, sales force, management etc.)
   - Prepare unaudited carve-out financials
   - Estimate minimum selling price and value to a potential buyer (incl. potential learning impact)
   - Develop a short list of potential buyers including financial investors
   - Conduct an internal due diligence and frame all carve-out issues and dependencies
   - Define the transaction and ideal process (share deal, asset deal)

3. Prepare the Transaction
   - Engage cross-functional internal divestiture teams and external advisors (incl. investment bank) if needed and negotiate fees
   - Prepare Teaser, Offering Memorandum / Information Memorandum and NDA (non-disclosure agreement)
   - Collect information and prepare data-room

4. Market the Business
   - Approach potential buyers, sign NDA, send OM (offering Memorandum) and bidding instructions
   - Solicit non-binding indication of interest (1st round bids)
   - Review bids and invite selected bidders into the 2nd round
   - Open data-room
   - Conduct Management Presentations and interviews and respond to due diligence inquiries
   - Plan factory / site visits
   - Send potential bidders draft of purchase and sales agreement and final bidding instructions

5. Negotiate and sign
   - Review 2nd round bids and select "finalists"
   - Solicit final bids including markups of PSA

- Negotiate definitive purchase and sales agreement (PSA) and definitive ancillary agreements like TSA (transition service agreements etc.)
- Finalize communication plans
- Sign and announce transaction

6. Signing to Closing
    - Help acquirer obtain necessary regulatory approvals
    - Seek and obtain any needed third party consents
    - Cooperate with acquirer to facilitate a smooth transition
    - Ensure business is operated with bounds of PSA covenants

From a timeframe the activities might be scheduled as follows:

Phase	Week	Objective and Action	Responsible
Strategic Assessment	1-10	♦ Internal Kick-Off Meeting ♦ Develop Strategic Rationale ♦ SWOT Analysis	♦ M&A Department, Legal, Management
Feasibility Analysis	6-10 10-14	♦ Define Assets to be sold ♦ Identify carve out issues ♦ Develop list of prospects ♦ Conduct internal DD ♦ Prepare Carve out financials ♦ Define Minimum Sales Price ♦ Determine Transaction Type ♦ Approval Process	♦ Investment Banker, M&A Department, Management, Legal
Transaction Preparation	14-18 18-22 18-26	♦ Engage Leadership Team ♦ Engage x-functional divestiture team ♦ Engage investment bank and other advisors ♦ External Kick-Off Meeting ♦ Develop Offering Memorandum and Teaser ♦ Define list of Potential Buyers ♦ Prepare NDA ♦ Prepare data-room	♦ M&A Department, Management, Legal, Manufacturing ♦ Investment Banker, Advisor,

Market the Business	18-22 22-26	♦ Contact Potential Buyers and Negotiate NDA ♦ Send Offer Memos and Bid Instruction ♦ Provide Access to preliminary data-room (virtual) ♦ Draft management presentations ♦ Solicit Non-Binding Indications of Interest ♦ Review Bids	♦ Investment Banker, Management, Outside Counsel, M&A Department, Operations, Legal ♦ Investment Banker, M&A Department
Final Bidding Round	26-30 30-34 34-38	♦ Invite Bidders into 2nd round ♦ Conduct Mgt Presentations ♦ Provice Access to Full data-room ♦ Respond to DD inquiries, plant visits ♦ Send draft PSA and final bid instructions ♦ Obtrain final bids and mark-up to PSA ♦ Initiate Communications Planning	♦ Investment Banker, M&A Department, Outside Counsel, Management ♦ Corp. Affairs
Negotiating and Signing	34-38	♦ Negotiate Transaction Documents ♦ Finalize Communication Plans ♦ Obtain Final Approval ♦ Signing and Announcement	♦ M&A Department, Legal, Management ♦ Corp. Affairs ♦ Management
Signing to Closing	34-40+	♦ Respond to confirmatory diligence requests ♦ Help buyer in obtaining regulatory approvals ♦ Seek and obtain required 3rd party consents ♦ Closing	♦ M&A Department, Management, Legal

Figure 19: Divestiture Detailed Process, own development based on course material

The Accelerated Sales Process is preferred when:

- A limited number of potential buyers (most likely strategic investors) is interested on a soft performing business or other issues
- The key selling themes are better expressed verbally rather than through a detailed Offering Memorandum and
- The Speed is critical due to a declining performance of the business to be sold

In this fast track or accelerated process only a 5-10 page description of the business is provided. Potential buyers will be contacted and invited to a Management Presentation and non-binding indications of interest are not pre-requisites for invitations. Management presentations are before receipt of preliminary bids. A limited data-room is made available to all potential buyers.

Potential buyers submit non-binding indications of interest and those potential buyers invited to continue to participate in the process are allowed additional due diligence on an accelerated basis. Final bids, including contract markups, are due within 3 weeks.

The advantage of the accelerated sales process is obviously the speed and reduced internal workload, therefore less disruptive to the business.

On the other hand a faster process may reduce the number of participants in the bidding process and limit the ability to maximize value and due to the more open access to the data-room sensitive data is provided potentially to a broader group. The accelerated process takes between 6 – 8 months.

If two or more bids are close on price and terms, or bidder’s ability to obtain financing is not secured – which is in particular in the current economic and financial situation of interest – parallel negotiations and response to due diligence inquiries are appropriate to maintain auction tension.

If a single bidder distinguishes itself by offering a pre-emptively high price and favorable terms, negotiations should be accelerated to get a deal quickly without granting exclusivity.

6 Valuation of Divestiture Candidates

The Merger and Acquisition waves in the 1980 and 90ies established new ratios due to a new and better understanding of the power and function of brands. Multiples, in particular in the consumer goods industry, doubled and tripled up to price earnings ratios of 20 and more.

While in the 50-70ies production capacities, technologies for mass production and sales and distribution capabilities have been an important driver of acquisitions, the globalization and vertical integrations to conglomerates have increased the perception of the value contribution of strong, powerful and well established brands. The focus shifted from acquisition of tangible assets to intangible assets which should help to create value in a company.

With increasing product offer due to improved production capability situation and a growing number of players in the market the strength of a brand enjoyed increasing importance. Among an increased offer to consumers a known and established brand stands for sustainable quality standards and facilitates consumers' decisions to make safe choices among many offers. If a brand provides this support, and the brand is known, appreciated and liked for its benefits and the offered bundle this will lead to continuous purchase, so called re-purchase. This leads to an increased brand loyalty which provides security in estimating future sales and cash-flow streams and provides credible financial outlook in regards to M&A business.

Through observation of acquisitions and mergers with purchase prices paid 3 – 4 times higher than the market value on the stock exchange, David A. Aaker derived as one of the pioneers in this area identifying 5 dominating factors:[46]

1. Brand awareness
2. Consumer's brand loyalty
3. Expected and perceived quality
4. Brand association
5. Other brand advantages (patents, distribution etc.)

[46] Simon H., von der Thathen A. (2002): Das grosse Handbuch der Strategie-Instrumente, Campus Verlag, p. 242

The work has been refined over the time including household penetration, sales channels, brand satisfaction or perceived purchase risk. The thesis is that a high brand index reflects a strong belief of the consumer to get the expected “benefit bundle” from the respective brand, resulting in consumer satisfaction after consumption or usage of the product. A high brand index results for the producer in a competitive advantage like higher re-purchase rates and brand loyalty, brand awareness and a better position in the trade.

Aaker developed between 1992 and 1996 a method for measuring the brand value through price premiums for the brand through observation of the market and consumer surveys.

Kapferer developed a Cash-Flow Model based on the classical investment valuation estimating future expected incomes related to the brand. Kapferer proposed also a multiplier-model based on net-income and a discount factor deriving from a scoring model considering similar transactions of brands in this segment and comparable market position. Basically our today’s valuation models are still based on Kapferer’s methodology to define the value of a brand in the M&A process.

To define the value added in the market of a brand compared to competitive brands and make marketing a relevant strategic decision, a different quantification is needed. Kamakura and Russel (1993) worked on the quantification of the intrinsic brand value based on panel data, and Park and Srinivasan (1994) approached the topic with results from consumer perceptions. A 2-step approach is commonly used in practice. [47]

In a first step the quantity- or price premium of products under the same technical pre-conditions are detected. The relation can be determined through an empiric price-sales function or in other words the price elasticity. The brand-price relation is demonstrated through a price-premium component, the ability of a brand to generate a higher price and the brand feedback since a higher price generates a certain consumer perception. Very often a high price takes over the role of a quality indicator.

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[47] Simon H., von der Tathen A. (2002): Das grosse Handbuch der Strategie-Instrumente, Campus Verlag, p. 242

In a second step the brand value drivers and the relative price premium to other brands is investigated. This is done through a so called Conjoint-Analysis, which is a multi-stage consumer research to figure out what are the brands considered from the consumer to buy. In order to do so a series of purchase decision attributes are analyzed and compared. This market simulation can be finally aggregated to forecast the future market share. The model is pretty robust and shows a correlation coefficient of 0.9. The result shows the brand price-premium, the percentage change in price where the same quantity of units is sold, or the quantity-premium, indicating the incremental units sold at the same price. In the M&A area this method gives a robust base to estimate the future market share and supports the financial outlook of an acquisition plan.

It is important to understand this strength of a brand in a divestiture process to incorporate this premium in the evaluation.

In practice our today's valuation models are still based on Kapferer's methodology applying the Discounted Cash Flow Method to define the value of a brand in the M&A process. The strength of the brand equity according to Aaker's five dominating factors[48] is reflected in the estimated share development, revenue flows and margins.

In a first step the so called "Keep Value" scenario is calculated. The "Keep Value" scenario reflects the valuation if the business continues as it is, or how the company would further manage this business and estimates the "intrinsic value" of the business.

In the course of a divestiture two distinct valuations need to be prepared. First the value of "what is the business worth" for the divesting company. This happens by calculating first the breakeven value. This valuation reflects the net present value of the cash flows on an after tax level and is based on a 10-year discounted cash flow (DCF method) with terminal value. In the used model the cash flow in year 10 is capitalized to compute the "terminal value".

[48] Simon H., von der Tathen A. (2002): Das grosse Handbuch der Strategie-Instrumente, Campus Verlag, p. 242

As said before the financial projection needs to reflect a realistic assessment of the industry's dynamics as well as the investments and resources needed to continue growing this business under evaluation.

Stranded overheads (= costs which are absorbed today by the potential divested business) need to be added to the operating profit of the potential divested business. Further negative effects to be considered by the seller include:

- Reduced fixed cost absorption of overheads or sales force impacting profits
- In direct distribution lower shop coverage due to increased costs per call
- Limited attractive portfolio resulting in lower sales
- Under-utilization of assets resulting in negative fixed cost absorption

The second valuation considers the "value of the business for a potential buyer". Obviously this value needs to be compared with the minimum selling price and defines how to proceed further with the divestiture candidate. The valuation estimate should be based on various methodologies and includes the analysis of multiples of comparable publicly traded companies and precedent transactions in the same sector.

The analysis should also include the estimate of synergies that may be available to potential acquirers. The methodology to benchmark with comparable companies estimates the stand-alone "extrinsic value" of the business; estimated value is equal to the ratio of the enterprise value – debt plus equity – to earnings (= EBITDA).

The benchmark with comparable deals estimates the "extrinsic value" of the business implicitly including value attributed to synergies (the portion of synergies the buyer shared with the seller). Here the estimated value is equal to the ratio of the purchase price (including assumed debt) to earnings (= EBITDA).

In the likelihood to achieve more than the minimum selling price the company usually valuates alternative scenarios.

Considering all consequences and synergy opportunities for a potential buyer the seller sharpens the valuation model and helps to identify the "best solution" for the divestiture to optimize the sales price and maximize value for the seller.

This said, it is important that the valuation might be done for each prospective with the respective synergy potential for this buyer, when the seller progress in the sales process.

In the following valuation model the Keep Value Scenario (=Break-Even Scenario) results in a DCF of $ 2.5 MM and reflects the minimum selling price.

In the evaluation of the minimum sales price, also called "Keep value" meaning the seller continues business as usual, the following assumptions have been applied in terms of market and share evolution:

- A brand is identified as non-core business and a "milking-strategy" is defined
- Reduced focus and advertising investments lead to continuous share loss
- Discounts are increased to reflect higher share of promotions to offset partly lower advertising
- Inflation is reflected in pricing and costs, overall gross margin is declining

VOLUME, MARKET AND SHARE

(tons)	Actuals			Projections										CAGR		
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	07 - 09	10 - 14	10 - 19
Market Volume in Austria (in tons)																
Total Market (tons)	**10,000**	**9,800**	**9,500**	**9,595**	**9,787**	**10,081**	**10,232**	**10,385**	**10,541**	**10,699**	**10,860**	**11,022**	**11,188**	**-2.5%**	**2.0%**	**1.7%**
% vs year ago		*-2.0%*	*-3.1%*	*1.0%*	*2.0%*	*3.0%*	*1.5%*	*1.5%*	*1.5%*	*1.5%*	*1.5%*	*1.5%*	*1.5%*			
Volume Prod. A, B																
Total	**1,579**	**1,164**	**1,025**	**1,125.0**	**1,010.5**	**889.6**	**800.6**	**708.8**	**614.0**	**569.7**	**551.1**	**531.8**	**511.8**	**-19.4%**	**-10.9%**	**-8.4%**
% vs year ago		*-26.3%*	*-11.9%*	*9.8%*	*-10.2%*	*-12.0%*	*-10.0%*	*-11.5%*	*-23.3%*	*-19.6%*	*-10.2%*	*-6.7%*	*-7.1%*			
Volume Share																
Total Business	**15.8%**	**11.9%**	**10.8%**	**11.7%**	**10.3%**	**8.8%**	**7.8%**	**6.8%**	**5.8%**	**5.3%**	**5.1%**	**4.8%**	**4.6%**	**-5.0 pp**	**-4.9 pp**	**-7.2 pp**
pp vs year ago		*-3.9%*	*-1.1%*	*0.9%*	*-1.4%*	*-1.5%*	*-1.0%*	*-1.0%*	*-1.0%*	*-0.5%*	*-0.3%*	*-0.3%*	*-0.3%*			
Competitor 1	15.9%	18.4%	17.3%	17.0%	17.5%	18.0%	18.3%	18.6%	19.0%	19.1%	19.2%	19.3%	19.4%	1.4 pp	1.6 pp	2.4 pp
Competitor 2	7.0%	8.6%	7.7%	7.4%	7.9%	8.4%	8.7%	9.0%	9.4%	9.5%	9.6%	9.7%	9.8%	0.7 pp	1.6 pp	2.4 pp
Other	61.3%	61.1%	64.2%	63.9%	64.4%	64.9%	65.2%	65.5%	65.9%	65.9%	65.9%	65.9%	65.9%	2.9 pp	1.6 pp	2.0 pp

(A) Market growth projections should be based on serious data source
(B) Calcuated based on projected volumes and Nielsen market size

Keep Value Computation														
MM LC	2010 projected	2010 (H2) projected	2011	2012	2013	2014	2015	2016	2017	2018	2019	2013 2010	2016 2013	2019 2010
Market growth	1.0%	-11.9%	2.0%	3.0%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%			
Share	11.7%	10.9%	10.3%	8.8%	7.8%	6.8%	5.8%	5.3%	5.1%	4.8%	4.6%			
Volume (tons)	**1,125.0**	**525.0**	**1,010.5**	**889.6**	**800.6**	**708.8**	**614.0**	**569.7**	**551.1**	**531.8**	**511.8**	-10.7%	-10.7%	-8.4%
List price per kg	*10.0*	*10.0*	*10.2*	*10.5*	*10.8*	*11.1*	*11.4*	*11.8*	*12.1*	*12.5*	*12.9*	*2.6%*	*3.0%*	*2.9%*
inflation	*0.0%*	*0.0%*	*2.2%*	*2.5%*	*3.0%*	*3.0%*	*3.0%*	*3.0%*	*3.0%*	*3.0%*	*3.0%*			
Net revenue	**7.1**	**3.3**	**6.4**	**5.8**	**5.4**	**4.9**	**4.4**	**4.2**	**4.2**	**4.1**	**4.1**	-8.7%	-8.0%	-5.9%
NR per kg	*6.3*	*6.2*	*6.4*	*6.5*	*6.7*	*6.9*	*7.1*	*7.3*	*7.6*	*7.8*	*8.0*	*2.3%*	*3.0%*	*2.8%*
inflation	*-0.7%*	*-1.6%*	*1.3%*	*2.5%*	*3.0%*	*3.0%*	*3.0%*	*3.0%*	*3.0%*	*3.0%*	*3.0%*			
Total COGS	4.6	2.2	4.3	4.0	3.9	3.7	3.4	3.3	3.4	3.4	3.4	-5.7%	-4.6%	-3.3%
% NR	*65.2%*	*67.1%*	*67.5%*	*69.8%*	*71.8%*	*74.5%*	*78.1%*	*80.1%*	*81.1%*	*82.1%*	*83.3%*			
LC/KG	*4.1*	*4.2*	*4.3*	*4.5*	*4.8*	*5.2*	*5.6*	*5.9*	*6.1*	*6.4*	*6.7*	*5.6%*	*6.8%*	*5.6%*
Gross margin	**2.5**	**1.1**	**2.1**	**1.8**	**1.5**	**1.3**	**1.0**	**0.8**	**0.8**	**0.7**	**0.7**	-14.9%	-18.1%	-13.2%
% NR	*34.8%*	*32.9%*	*32.5%*	*30.2%*	*28.2%*	*25.5%*	*21.9%*	*19.9%*	*18.9%*	*17.9%*	*16.7%*			
LC/KG	*2.2*	*2.1*	*2.1*	*2.0*	*1.9*	*1.8*	*1.6*	*1.5*	*1.4*	*1.4*	*1.3*	*-4.7%*	*-8.3%*	*-5.3%*
A&C	1.8	0.9	0.6	0.6	0.5	0.5	0.4	0.4	0.4	0.4	0.4	-33.5%	-8.0%	-15.3%
%NR	*25.9%*	*28.0%*	*10.0%*	*10.0%*	*10.0%*	*10.0%*	*10.0%*	*10.0%*	*10.0%*	*10.0%*	*10.0%*			
Net Contribution	**0.6**	**0.2**	**1.4**	**1.2**	**1.0**	**0.8**	**0.5**	**0.4**	**0.4**	**0.3**	**0.3**	16.0%	-25.0%	-8.8%
% NR	*8.9%*	*4.9%*	*22.5%*	*20.2%*	*18.2%*	*15.5%*	*11.9%*	*9.9%*	*8.9%*	*7.9%*	*6.7%*			
LC/KG	*0.6*	*0.31*	*1.4*	*1.3*	*1.2*	*1.1*	*0.9*	*0.7*	*0.7*	*0.6*	*0.5*	*29.9%*	*-16.0%*	*-0.4%*
Overhead	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.3	0.3	29.9%	2.7%	11.1%
Allocated	-	-	-	-	-	-	-	0.0	0.0	0.0	0.0			
Direct	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.3	0.3			
inflation	*4.7%*		*3.6%*	*3.0%*	*2.7%*	*2.7%*	*2.7%*	*2.7%*	*2.7%*	*2.7%*	*2.7%*			
OI	**0.5**	**0.1**	**1.2**	**1.0**	**0.8**	**0.5**	**0.3**	**0.2**	**0.1**	**0.1**	**0.0**	13.0%	-38.6%	-31.8%
% NR	*7.5%*	*1.9%*	*19.2%*	*16.6%*	*14.1%*	*10.9%*	*6.7%*	*4.2%*	*3.1%*	*1.8%*	*0.4%*			
LC/KG	*0.5*	*0.1*	*1.2*	*1.1*	*0.9*	*0.8*	*0.5*	*0.3*	*0.2*	*0.1*	*0.0*	*26.5%*	*-31.2%*	*-25.5%*
Incremental OI	**0.5**	**0.1**	**1.2**	**1.0**	**0.8**	**0.5**	**0.3**	**0.2**	**0.1**	**0.1**	**0.0**	13.0%	-38.6%	-31.8%
% NR	*7.5%*	*1.9%*	*19.2%*	*16.6%*	*14.1%*	*10.9%*	*6.7%*	*4.2%*	*3.1%*	*1.8%*	*0.4%*			
LC/KG	*0.5*	*0.1*	*1.2*	*1.1*	*0.9*	*0.8*	*0.5*	*0.3*	*0.2*	*0.1*	*0.0*	*26.5%*	*-31.2%*	*-25.5%*
Tax	0.1	0.0	0.3	0.2	0.2	0.1	0.1	0.0	0.0	0.0	0.0			
Working capital (dec) / incr	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0			
Capex	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1			
Depn	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1			
Cashflow	**0.4**	**0.1**	**1.0**	**0.8**	**0.6**	**0.4**	**0.3**	**0.1**	**0.1**	**0.1**	**0.0**			
Terminal value											0.2			
Total	**0.4**	**0.1**	**1.0**	**0.8**	**0.6**	**0.4**	**0.3**	**0.1**	**0.1**	**0.1**	**0.2**			
DCF			**2.5**											
NR multiple (2011)	0.4 x		2.4 Ongoing											
EBITDA multiple (2011)	1.9 x		0.1 terminal											

Figure 20: Validation Example, own development (Attachment 2)

The share losses are driven by limited focus and declining brand investments, and result together with insufficient pricing in a year on year reduced Operating Income. In 2019 the bottom line result is zero. Therefore the discontinued cash flow of the business is $ 2.5 MM from ongoing operations, while the terminal value is zero given the break-even situation in the last year of the operations. This reflects a multiple of 0.4 of Net Revenue and an EBITDA multiple (= Operating Income) of 1.9 based on 2011 P&L.

Overall this example reflects good the declining interest and investment for a non-core business, resulting in a “milking strategy” with unfavorable share and financial evolution in the long run. Recognizing the situation at the right time leads to the right internal discussion process if the business should be divested.

As said before it is important to make a sensitivity analysis in a second step with industrial standards in terms of multiples to understand where we stand.

Sale price sensitivity analysis

Scenario / Sensitivity	Value *LC'MM*	NR x	Rept. EBITDA x	Incr EBITDA x	Cash impact* *LC'MM*	P&L impact *LC'MM*
Minimum selling price	2.5	0.4 x	1.9 x	1.9 x	2.0	1.5
1x NR	6.4	1.0 x	4.9 x	4.9 x	5.9	5.5
5x Reported EBITDA	6.6	1.0 x	5.0 x	5.0 x	6.1	5.6
5x Incremental EBITDA	6.6	1.0 x	5.0 x	5.0 x	6.1	5.6
Average	6.5	1.0 x	5.0 x	5.0 x	6.0	5.6

Memo	*LC'MM*
2011 NR	6.4
2011 Reported EBITDA	1.3
2011 Incremental EBITDA	1.3

* Exclude from discresionary cash flow

Figure 21: Sale price sensitivity analysis, own development

Figure 21 gives some standard sensitivities for the consumer good industry. When a short list of potential buyers becomes visible and first negotiations are starting it is worthwhile that the seller is putting himself in the shoes of the buyer and calibrates the minimum sales price calculation with potential synergies, both revenue and cost synergies, of the buyer.

This calibration indicates the negotiation space and a good preparation opens the opportunity to participate on the synergies of the buyer.

However, while the calibration indicates an opportunity to benefit from potential synergies of the buyer with a higher sales-premium, the calculated minimum sales price is the decision benchmark to make the right strategic choice if the negotiations indicate that the seller can't succeed generating a higher premium while trying to participate on buyer's synergies when negotiating the sales price.

7 Implications of the economic downturn

Divestitures have a better probability of success in a down-turn and create substantial value for both buyers and sellers.

The retreat from big ticket transaction together with the bleaker economic outlook is likely to lead to an increase in small “tuck-in” acquisitions and divestitures, in particular asset sales on tail and non-core brands, non-strategic business units and divisions.

A 2009 study of Boston Consulting Group summarized [49] that divestitures in a downturn have a higher probability of success for acquirers and create higher value for both buyers and sellers.

- On average, 57.5% of buyers of divested assets generate positive returns, compared with just 41.7 percent of buyers of entire companies (called public-to-public deals)
- Divestitures create value under all economic conditions for buyers, including downturns when acquirers achieve an average return of 1.9 percent
- The average divestiture creates more value for the buyer - a cumulative abnormal return (CAR) of 2.2 percent - than the average public-to-public transaction (CAR of -1.2 percent)
- Downturn deals are twice as likely to produce long-term returns in excess of 50 percent and, on average, create 14.5 percent more value for shareholders of the buyer than upturn deals
- Divestitures produce positive returns also for the seller and while overall returns are 1.5 percent on average, returns are rising to 1.7 percent during downturns

In particular in the so called FMCG (fast moving consumer good) industry, like the food industry, the brand or trademark represents beside the distribution power and customer base usually the biggest intangible asset. The brand strength secures the success of a consumer good company and brand awareness is a major driver of the valuation. A high brand awareness and brand affinity means that the brand is in the so called “relevant

[49] Kell J., Kengelbach J., Roos A. - Boston Consulting Group (May 2008): The return of the Strategist, Creating Value with M&A in Downturns, p. 8

set” of the consumer, which means this is one of the first brands consumer has in mind when he makes a purchase decision in the respective category.

Maybe not only applicable for deals in weak economies, but even more important in these times is to select acquisition targets with lower profitability but sound financials, good historical brand heritage and consequently good synergy potential in order to create superior future value.

It’s widely known in the industry that more than half of mergers destroy value for acquirer’s shareholders. BCG released in their 2003 report Winning Through Mergers in Lean Times: “The Hidden Power of Mergers and Acquisitions in Periods of Below-Average Economic Growth” that the average downturn merger created value (8.3 percent) 2 years after the transaction, whereas the average upturn merger destroyed value (-6.2 percent) over the same period – a 14.5pp difference”, as illustrated in the graph below.

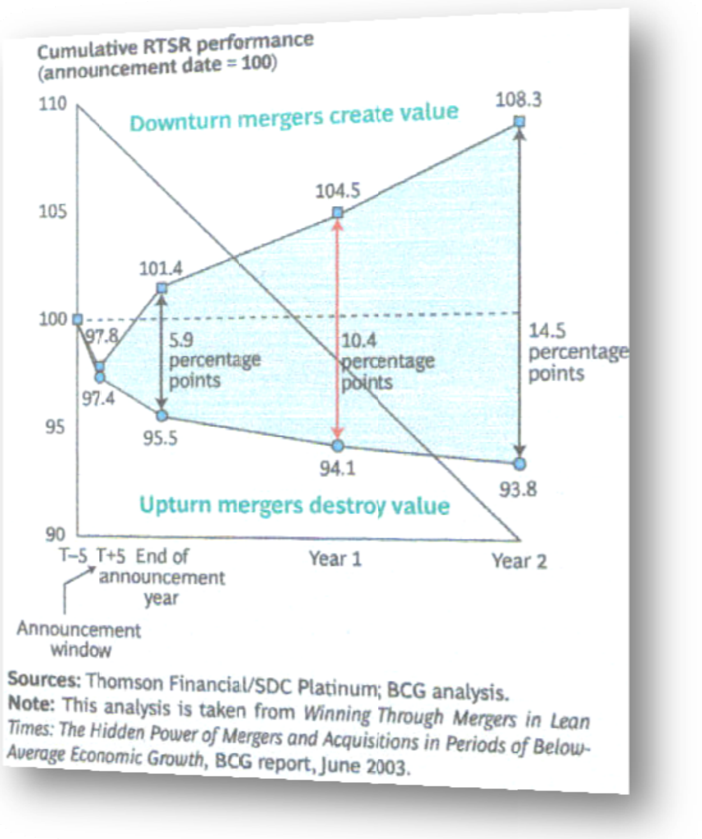

Figure 22: Presentation “The Impact of the Financial Crisis on Central and Eastern Europe, BCG (10/2009)

Downturn mergers outperform upturn ones in terms of relative total shareholder return in the long term.

The next graph shows that in successful downturn mergers, the difference in profitability between the acquirer and the target, measured by cash flow return on investment (CFROI), is five times higher than the difference in profitability between acquirer and target in successful upturn mergers.

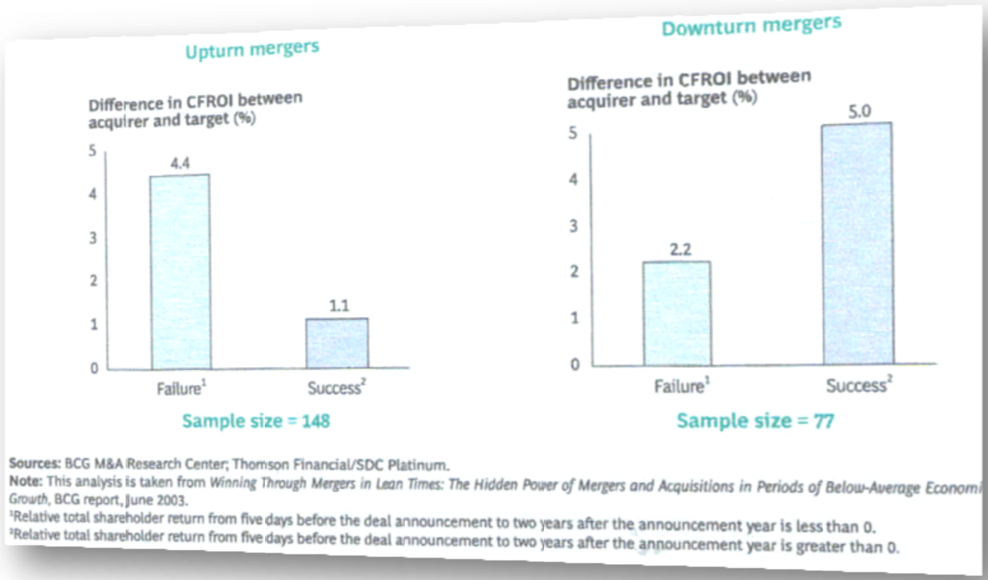

Figure 23: Presentation "The Impact of the Financial Crisis on Central and Eastern Europe", BCG (10/2009)

In summary, successful downturn mergers have a large CFROI spread between acquirer and target.

In the introduction a retrospect on how the economic crisis started was given. For the real economy and the M&A market in particular the crisis has 3 major implications:

1. Dented consumer confidence
2. Significant slow-down in consumer demand
3. Shortage of Credit

7.1 Dented consumer confidence

Consumer behavior and spending is the crucial backbone of modern economy. In the US consumer spending accounts for 70% and given the size of this market 16% of world's GDP is driven by US consumers. Consumer confidence is falling worldwide and all measures show the picture of an increasing uncertainty. This reflects the fear of the consumers of job and financial losses.

Anxiety about the economy has spread to every market in the world, also in market places where the economic indicators are looking more positive like in Asia. BCG asked consumers in March 2009 whether they thought the economic would get even worse in the next 12 months, and 56% of respondents in US agreed (+24 pp vs. October 2008), in Europe 60% of respondents (+11 pp). Emerging markets showed a more diverse picture with Russia 59%, Mexico 50% and China with only 23%. [50]

Confidence is plummeting worldwide, at historic lows in Japan, Spain and US. Similar is the trend when consumers are asked about fear on job loss.

Consumers are adapting to the new situation and developing new behaviors to cope with the economic crisis and the uncertainty about the future and potential job loss.

The consequence of a more negative thinking about the future leads to profound impact on consumer spending behavior. Consumers are the key of country's economy, and a serious cutback in consumption results in slower growing economies or recession driving confidence of consumer even further down.

7.2 Significant slow-down in consumer demand

The most markets were increasingly declining in the course of 2009 and following unemployment accelerated the negative trend continued in many industries in the first quarter of 2010.

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[50] Roche C., Silverstein M. J., Ducasse P., Charpilo N. (April 2009): Winning Consumers Through the Downturn, 2009 BCG Global Report on Consumer Sentiment, p. 8

Before slowing down or cutting spending, consumers are starting trading down and this was so far about treasure hunting for promotions and bargains and is now shifting towards making compromises out of necessity, obviously different industries are differently impacted by that. Over 2009 consumers started increasingly cutting back on spending by deferring nonessential purchases and reducing purchase frequency.

“Consumers in Italy, France, and Germany – where household savings rates were already relatively high before the downturn – said that they will save even more because of the impending hard economic times. At least 60 percent of a BCG survey participants said they will defer major purchases and eliminate nonessential spending over the next year. When asked in which categories they will most likely cut back, consumers rated leisure, consumer durables, and apparel at the top of their do-without list. Manufacturers are deferrable big-ticket items – such as cars, furniture, home appliances, and consumer electronics – are clearly feeling the pinch, with double-digit declines in sales end of 2008.” [51]

Besides cutting down spending and trading down, consumers adapted their life style and established new ways of coping with the situation.

Cocooning experiences a renaissance and consumers are turning more inward, stay more at home and spend less out-of-home. There are two related trends. First is in-sourcing. Instead of buying or paying others for providing a service consumer are making it themselves. The second is “staycations”, which describes the behavior that vacations are spent home or taking day trips to nearby attractions.

Frugality is the new chic for now. Most consumers don’t feel that spending more is the right thing to do now. Emotional rewards like spending time with the family and friends, the rediscovery of lost tradition and the living for a higher purpose are reflected in this behavior. Consumer lost trust in big corporations and financial markets and this is feeding the changed consumer attitude as well.

[51] Rhodes D., Stelter D. - Boston Consulting Group (December 17th, 2008): Collateral Damage, Part 4: Preparing for a Tough Year Ahead: The Outlook, the Crisis in Perspective, and Lessons from Early Movers, p. 4

These consumer trends have a clear impact on consumer spending, future revenue development of companies and influence the valuations.

7.3 Shortage of Credit

Most financial institutions had to unwind their debts and revise their credit practices. This had a negative effect on the real economy as both companies and consumers struggled to get loans. As the real economy worsened during 2009 the financial institutions continued to be affected by the economic crisis and losses in the real economy, while companies had to reduce costs, lay-off employees and reduce investments in order to protect cash funds.

The credit situation tightened and the difficulty for companies in getting loans increased. In consequence two things happened; firstly the interest rates increased due to limited availability of money and secondly the debt/equity ratio has been impacted meaning for the M&A market more equity was needed to fund acquisitions.

The debt/equity ratio is a measure of a company's financial leverage simply calculated by dividing the total liabilities by the stockholder's equity and the result shows which proportion of equity and debt the corporation is using to finance its assets. In principal a high debt/equity ratio means that a company appliers an aggressive policy to fund growth with debt. In consequence the operating income gets more vulnerable impacted by the additional interest expenses and dependency on interest rates and availability of funds. On the other hand the increased level of debt also called leverage effect can potentially create more earnings due to faster growth and the additional business delivers a higher net yield than the interest rate is. The debt/equity ratio depends obviously on the industry, so tend capital-intensive industries (e.g. car manufacturers) to a high debt/equity ratio above 2 while trading companies might have a ratio of below 0.5. In other words a debt/equity ratio of 0.5 means that the company is using $ 0.5 of liabilities in addition to each Dollar of shareholder's equity in the business.

Debt ratios offer a valuable method for assessing a company's fundamental health and indicate deepening debt problems. An example of this was seen during the financial crisis which started in 2008, whereby many financial institutions over-leveraged themselves with debt and as asset valuations went down, the debt ratio became significantly too high to be sustainable.

In a recession or economic downturn cycle, balance sheet strength becomes more important. It determines whether a company has a strong financial position to dive through a challenging period or might get whipped out during the crisis. Obviously financial markets tend to punish over-leveraged companies at the start of a recession because high debt-leveraged companies have the difficult task of paying their interest obligations out of a flat or even declining business and sustain their credit worthiness and might face financing challenges down the road.

As a consequence of the shortage in the credit market and the recent crisis interest rates are impacted. Should the declining offer of credits in the market in a normal situation lead to higher interest rates following the offer and demand principle, the situation is different in a financial driven economic crisis. When we look at the development of the EURIBOR (Euro Interbank offered Rate) which is the rate at which banks offer to lend unsecured funds to other banks in the EURO wholesale money market, also called interbank market, we can see that the EURIBOR rates went significantly down in the recent environment.

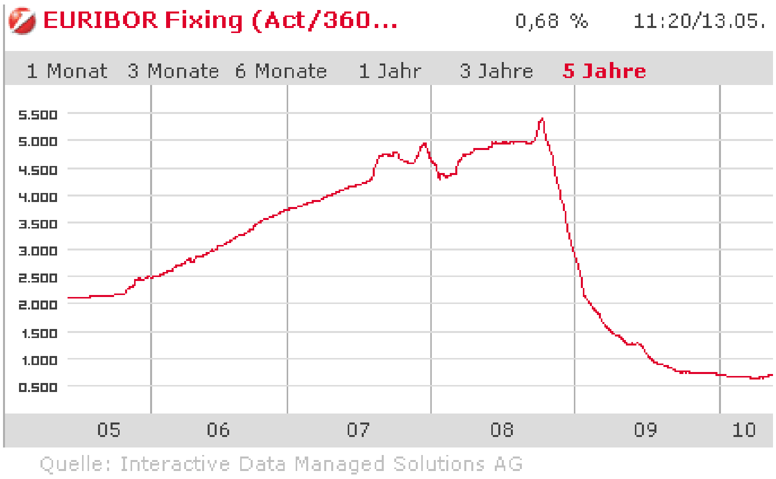

Figure 24: EURIBOR Fixing 5-year
http://www.bankaustria.at/de/open.html?openlf=http://kursinfo.bankaustria.at/gatekeeper.html?sPage=100&lang=de

On the other hand interest rates for financing went up due to the limited availability of cash and the increased risk premium charged from banks given the overall economic situation.

Even more important the tightness of available financing funds combined with the increased conservatism of banks during the crisis enforces a different composition of acquisition financing. Under normal circumstances the equity should represent min. 30% of the acquisition price, for smaller transactions even 40 -45% are expected to be funded on equity base. The recent economic downturn was driving the required equity base up to 60-80%.

What does this all mean for the financing of an acquisition? The impacts of the credit shortage in a crisis can be best summarized in the WACC (weighted average capital cost) and demonstrated comparing a "normal" pre-crisis situation and a "crisis situation" as we are currently facing.

WACC	Scenario	
	Normal	"Crisis"
Equity	40.0%	75.0%
Debt	60.0%	25.0%
Risk free interest rate	3.48%	4.34%
Market risk premium	4.50%	4.50%
ß	0.50	0.50
r(Equity)	**5.73%**	**6.59%**
r(Debt)	3.25%	7.15%
Marginal Tax Rate	20%	20%
Cost of debt after TAX	**2.60%**	**5.72%**
WACC	**3.9%**	**6.4%**

Figure 25: WACC Calculation (based on EURO and risk assessment of Austria), own development

1. The composition between equity and debt is shifting towards equity reflecting the uncertainty of the environment and the limited availability of funds and therefore demand for higher equity is increasing and currently of experience and experts opinion between 60 – 80%.
2. The risk free Euro interest rates used for equity are secondary market yields of Austrian government bonds with a remaining maturity close to ten years. Considering the beginning recovery in the financial markets we use April 2010 as "normal" scenario with an interest rate of 3.48% while for the crisis scenario a rate from April 2008 with a rate of 4.34% is used. [52] The indicative interest rates for debt was changing from 7.15 % in summer 2008 (coming from 6.65 % in summer 2007) to 3.25 – 3.75 % in 2010. [53]
3. The market risk premium is assumed to be unchanged for a market like Austria. *"The starting point to estimate the long-term country risk premium is the country rating from Moody's (www.moodys.com) and the estimated default spread for that rating over a default free government bond rate. This becomes a measure of the added country risk premium for that country. This default spread is added to the historical risk premium for a mature equity market (estimated from US historical data) to estimate the total risk premium. The historical premium for mature markets is about 4.5%, and the default spread of Austria of 0% gives us the total risk premium of 4.5%."*[54] The estimate could be adjusted for a risk premium of the respective industry addressing the vulnerability due to the uncertainty of the economic environment and sustainability of the business performance. In principle the risk-free rate and risk premium are common to all companies within a national industry and only the beta factor varies across companies.

Beta represents a stock's incremental risk to a diversified investor. Risk is defined by the covariance of the stock with the aggregate stock market.[55] In other words, investors are willing to pay a different premium for stocks of companies that are expected to perform better than the average market.

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[52] http://www.ecb.int/stats/money/long/html/index.en.html; download :June, 2010 (last update 12/05/2010)
[53] Raiffeisenlandesbank Vienna, e-mail, June 2010
[54] http://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/ctryprem.html; download: June 3rd, 2010
[55] Dangl T., Randl O. (May 2009): Advanced Corporate Finance / Valuation, MBA Mergers & Acquisition hand-out from May 2009

The assumption in the example is that the Beta factor to the market is unchanged given the hypothesis that the company continues the historical trend to the industry.

7.4 From Seller Market to Buyer Market

Nevertheless the M&A market usually turns into a buyer market in an economic downturn. The uncertainty of the economy and business outlook with dented consumer confidence and slow down of consumer spending forecasts, and the limited availability of cash makes the M&A market more favorable for the buyer.

"Overall divestitures deliver 11.8 percentage points lower returns than public-to-public deals. The institutional differences between public-to-public and divestitures might explain part of this gap in returns. But the persistence of this difference in returns through the deals in BCG's sample indicates that companies that divest tend to undersell their assets."[56]

So, the fact that companies tend to undersell their assets might get even accelerated in the situation of an economic downturn with

- Dented consumer confidence
- Significant slow-down of consumer demand
- Shortage of credit.

The lack of capability to sell a business at the right value combined with a challenged forecasts and an increasingly difficult situation to receive funds in economic weak times clearly favors buyers in such a situation. We move from a seller positive market in strong economic times to a buyer market in soft economic environment.

Sellers need to follow a disciplined approach and a consistent methodology to calculate the minimum sales price they want to achieve. In difficult economic times with pressure on multiples and to find a buyer, the seller needs to sharpen his sales proposition even more.

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[56] Kell J., Kengelbach J., Roos A. - Boston Consulting Group, (May 2008): The return of the Strategist, Creating Value with M&A in Downturns, p. 8

In order to maximize the value of the divestiture the seller needs to be careful in selecting and targeting acquirers who will gain the utmost shareholder returns and have the greatest space to pay a higher acquisition premium. And of course it's always about price. An acquisition is an auction, a competitive bidding that should be awarded to the highest offer. But in reality deals rarely come down purely to price unless bad preparation and discipline in deal-making. Deloitte summaries the basics on good deal preparation[57]:

- "Build good relationships with important decision-makers and influencers and you have a right to ask tough questions, but trying to come across as a hard-nosed negotiator often backfires"
- Understand each party's real needs instead of assuming that money is all that matters. Sellers may be more interested in closing a deal quickly. Create a compelling offer instead of just throwing money at the problem
- Think carefully about your own needs too, and structure the deal accordingly
- Creative deal-making can help, but have in mind this creativity can complicate matters after the deal closes
- Nothing wrong to pay a premium on a specific opportunity as long as you know exactly what your strategy is about, how the acquisition delivers against it and you have realistic financial plans to realize the needed synergies, both revenue and cost-wise.

A research of the Boston Consulting Group[58] confirms that divestitures are systematically higher when the relative size of the asset is substantially higher for the buyer than for the seller.

In transactions where the divested business represents more than 50% of the value of the buyer, and less than 10 percent of the value of the seller, acquirer returns of 6.5 percent on average are almost three times higher than in deals where the relative size of acquirer and seller are similar (returns of 2.2 percent). If the acquired proposition

[57] Deloitte (2008): Straight Talk Book No. 9 "M&A Lies", 2008 Deloitte Development LLC, p. 17
[58] Kell J., Kengelbach J. , Roos A., Boston Consulting Group (May 2008):The return of the Strategist, Creating Value with M&A in Downturns, p. 8-9

represents a core business for the acquirer the returns are 23 percent higher than for non-core assets.

Overall, we can conclude that despite the economic downturn all facts confirm that the M&A market is alive.

7.5 Impact on Valuation

The economic crisis discussed in the previous chapter is impacting the valuation as follows:

- The Dented consumer confidence and the slow-down in consumer demand results in a lower growth perspective in the short- and mid-term and increased uncertainty of the business outlook. The lower revenue forecast will result in a lower valuation, and for a buyer, revenue synergies might be more difficult or slower to realize.
- The shortage of credit results for the buyer in a higher requirement on equity to finance a deal and the finance costs reflect a higher premium
- The economic and financial situation constrains the M&A market and less buyers might be available. In other words the market is translating into a "buyer market". This means the lower competitiveness in the market makes it more difficult to sell and more challenging to gain the premiums as in a strong economic environment. However, as mentioned before empiric studies confirm that downturn mergers outperform upturn ones because buyers are paying less premium and are more selective and cautious in their acquisitions.

The impact of the economic crisis has already been reflected in the valuation model as follows:

- Lower Market Growth Forecast reflecting the slower economic development and lower consumer spending
- Margins have been reduced due to higher promotion share and higher discounts to stimulate sales

While the WACC might change due to the economic situation the seller defines the discount rate based on his own assumptions what the business needs to deliver. And while the growth rates might be impacted by the economic environment, the expectations on the bottom line delivery might be unchanged. This means that increased pressure on sales prices and discounts needs to be offset by cost saving initiatives.

The limited competitive bidding given the overall economic situation and lower participation of private equity funds should reduce the opportunity to participate on buyer's synergies resulting in a lower premium, but should not compromise the minimum selling price, which is already reflecting lower growth rates of a changed economic environment.

The minimum sales price or the so called "Keep Value" is the one and only value to consider if the seller wants to create value through divestiture. In other words, if an offer is below the minimum sales price it is better for the seller to keep and continue the business and the seller will create value. If the seller achieves a higher price than the minimum selling price than the value creation is even higher.

The only key question which remains is now, after you have decided to divest parts of a business or a business as such for strategic reasons, if it is worth-while to sell now.

8 Selling "Now" or "Later"

Most companies pull away from acquisitions during economic downturns. But research confirms that it might be ideal to acquire a company in a soft economic environment provided the strategic fit is right and financial possibilities are not over-stretched. Downturn deals have a better chance of creating higher shareholder value and returns.

A 2003 report of Boston Consulting Group "Winning through Mergers in Lean Times:

"The Hidden Power of Mergers and Acquisitions in Periods of Below Average Economic Growth, states that the average downturn merger created value (8.3 percent) two years after the acquisition, whereas the average transaction in an upturn merger destroyed value (-6.2 percent) over the same periods, resulting in an 14.5 percentage point difference." [59]

Mergers and acquisitions remain a risky pursuit. Only 41.7 percent of public-to-public transactions produced positive shareholder returns (versus the market) for the acquirer on announcement of the deal according to a study of Boston Consulting Group. [60]

Divestitures have a higher probability of success now in a downturn for acquirers, and they can create substantial value for both buyers and sellers.

Weak economic conditions force companies to think better through the opportunity. It is essential to combine the acquisition with a sound and ready-to-install business plan for turning the target into an economic success and delivering the planned synergies.

When dealing with divestitures and aiming to make them a success we need to understand the fundamental principles of acquirers of picking winners.

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[59] Kell J. , Kengelbach J., Roos A. - Boston Consulting Group, (May 2008): The return of the Strategist, Creating Value with M&A in Downturns, p. 16
[60] Kell J., Kengelbach J., Roos A. - Boston Consulting Group, (May 2008):The return of the Strategist, Creating Value with M&A in Downturns, p. 16

- ✓ Choose relatively small targets
- ✓ Pay a premium for low valuation multiples
- ✓ Cash is king
- ✓ Practice makes perfect
- ✓ Profitable growth

So it is about preparing the deal in a professional and disciplined way, putting your-self in the shoe of the buyer. But at the end of the day there is only one overarching argument for the seller in the decision process to sell now, later or harvest the business:

When the achievable Minimum Sales Price is higher than the so called Keep Value; means is the sales price higher than the discounted cash flow of a continued business or a later realized sales price, than sell now.

Is the Minimum Sales Prices lower than the discounted cash flow of a continued business the company would probably harvest the existing business, except a selling today would open the opportunity to invest in a new business opportunity with a better payback and compensating the lower sales price.

Such decisions will always deal with the uncertainty of the future, in particular in more difficult times. A clear strategic framework developed on a sound and disciplined strategic planning process supported with a professional portfolio management can help to make better decisions in the M&A process.

9 Conclusions

The work of the master thesis can be concluded in 6 key take away:

1. Strategic Planning Process facilitates the right strategic choices
2. Active portfolio management with an pro-active, disciplined approach towards divestitures creates value for the company

   Acquisitions are the glamorous, sexy side of M&A where everybody wants to be involved and work on. But divestitures are strategically as important as acquisitions. Very often managers are reluctant to sell businesses or tail brands.

   Divestitures mean derailing the top-line growth rate and the earnings of the business unit and corporation, and might be interpreted as “personal failure” of managers.

   On the other hand many business leaders want to sell as quickly as possible so they can focus on their core business, looking for low-performers fast. It is crucial to understand how the remaining business will operate the day after the divestitures took place and to select the divestiture candidates at the right time to create holistically value for the corporation.

   A disciplined portfolio approach helps to define the right strategic fit of your portfolio and the appropriate timing for divestitures.

   In the thesis a 5-step approach was developed which helps to optimize a portfolio reflecting the attractiveness of geographic markets, strength of brands as integrated part of portfolio planning and decision process including acquisitions and divestitures.

3. Put yourself in the shoes of the buyer

   But it is evenly important to develop a top-to-bottom view of how the business will operate the day the deal closes. The seller needs to think about business opportunities and continuity of the selling proposition. This signals that the seller is looking for the best interest of the buyer, and trying to understand why these investments create value added for the buyer. The buyer needs to know exactly what he is buying, and this includes trademarks, manufacturing, research and development including an appropriate innovation funnel, sales and marketing capabilities and all over people. It's all about to demonstrate the buyer that he can create value added with this acquisition and that the price is a good deal for him.

However, the seller should not forget about the opportunities and synergy potential a buyer has with the acquired proposition. While it is a great result to achieve a sales price beyond the so called "keep value" minimum sales price, the minimum sales price should be evaluated from a buyer's point of view when a short list is defined and concrete negotiations have started.

The calculated minimum sales price is as the name says a minimum to achieve but depending on the buyers in the game an active calibration of the sales price during the negotiations gives a true and fair view of the value for the buyer and needs to be considered in the final sales discussions.

Being prepared to answer tough questions and offer options is increasing the number of potential buyers and will help to get a premium price. The so called offer memorandum or information memorandum should address these advantages and possibilities in a true and fair view.

4. Downturn pressures sales price but can still make sense strategically

Good deals are usually a function of strategy and execution. That does not mean that companies can ignore the overall economic situation, simply because of the implications on the real economy with lower revenue growth projection in the first years, pressured margins and higher financing costs. The mistake is very often, that the typical deal analysis examine a wide range of details about operations and finances, but often take a fairly static view of the overall business environment.

A tight credit market will significantly increase the cost of a highly leveraged deal, making it hard to achieve the expected return on investment. An economic turmoil will impact consumer confidence and slow down customer demand and will make it harder to sustain revenues while being focused on the integration challenges and realizing the planned cost synergies.

It is important to develop various scenarios with a range of economic assumptions to stress-test the expected financial hurdle rates.

5. Downturn mergers outperform upturn ones

   Research indicates that the returns from M&A activities executed during economic downturns have the potential to create much greater value than it is the case in upturns for both, buyers and sellers.

6. The M&A market is Alive in an Economic Crisis

   In general, research underlines the strategic value of M&A, provided the deals are identified and executed properly.

In a global downturn the M&A market will always slow down since values and volumes of transactions are closely correlated to GDP. However, divestitures create value for both, buyer and seller, and are likely to deliver better results in an economic downturn. Difficult times force management to a better strategic thinking and evaluation of different scenarios before making a final decision.

These learning are crucial to identify the right divestiture candidates and perform well in a divestiture process. But to create value in absolute terms it is key that the minimum sales prices (over)achieves the discontinued cash flow of the so called “keep value”, meaning, the value when the seller continues the business, and more important if the realized sales price finally can be re-invested in a business with a better payback, a mixture of profitability and growth, than the divested business. Only then a manager can feel well having done a good job. Yes, a difficult economic environment might impact the validation and the achievable premium, but the key for success is to follow a defined strategic framework and to realize a better price than the keep value option.

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12 Appendix

Attachment 1

Divesture Base Analysis for Brand Mapping (Attachment 1)

	Measure	High (+1)	Ave (0)	Low (-1)	Weight	Project A	Project B	Project B1	Project B2	Project C	Project D	Project E	Project F	Project G	Project H
Net revenue						80	90	60	30	5	10	5	10	10	20
Internal willingness to sell - high / (low)						**-9%**	**51%**	**33%**	**89%**	**67%**	**76%**	**56%**	**33%**	**-7%**	**13%**
Strategic focus / internal attractiveness high / (low)					33%	33%	-100%	-100%	-100%	-33%	-67%	-100%	-33%	-100%	-100%
Priority brand / core / non core		core brand	core cat	non core		-1	-1	-1	-1	-1	-1	-1	-1	-1	-1
Growth relative to	3yr cagr vs 3 yr core CAGR	> 5pp	-5pp to 5pp	< -5pp		1	-1	-1	-1	-1	-1	-1	-1	-1	-1
Profitability relative to	3ry average Net Contribution % vs core avera	> 5pp	-5pp to 5pp	< -5pp		1	-1	-1	-1	1	0	-1	1	-1	-1
Selling Proposition competitiveness (low) / high					33%	-40%	-20%	0%	-100%	-100%	-60%	-100%	0%	20%	-40%
Market share	current value share	> 30%	20% to 30%	< 20%		-1	0	1	-1	-1	0	-1	0	1	0
Share development	% change over 3 yrs	> 10%	-5% to 10%	< -5%		0	-1	-1	-1	-1	-1	-1	-1	0	-1
Profitability relative to market	OI% vs competition	higher	equal	lower		-1	0	0	-1	-1	0	-1	1	0	0
Change in brand awareness	3 yr change in spontaneous BA	higher	equal	lower		0	0	0	-1	-1	-1	-1	0	0	0
Internal expertise	i.e. dedicated R&D / marketing	high	med	low		0	0	0	-1	-1	-1	-1	0	0	-1
Disruptions to remaining business (low) / high					33%	33%	-33%	0%	-67%	-67%	-100%	33%	-67%	100%	100%
Relative size to country	NR / country NR	> 15%	5% to 15%	<5%		1	0	1	-1	-1	-1	0	-1	1	1
Distribution	Degree of integration	Integrated	Mix	Stand alone		1	0	0	0	0	-1	0	0	1	1
Manufacturing	Degree of integration	Integrated	Separable	Stand alone		-1	-1	-1	-1	-1	-1	1	-1	1	1
External willingness to buy - high / (low)						**-20%**	**0%**	**20%**	**-40%**	**-20%**	**0%**	**-50%**	**0%**	**10%**	**20%**
Market / industry attractiveness - high / (low)					50%	20%	20%	20%	20%	20%	0%	-20%	0%	-40%	20%
Category size	Retail country sales ($bn)	> 0.35	0.1 to 0.35	< 0.1		1	1	1	1	-1	-1	-1	-1	-1	0
Category growth	3 yr cagr (historic)	>10%	5% to 10%	<5%		1	1	1	1	1	0	1	-1	0	0
Per cap consumption	long term forecast vs now	higher	same	lower		1	1	1	1	1	0	1	1	0	1
Category profitability	Segment GM%	>40%	30% to 40%	<30%		-1	-1	-1	-1	1	0	-1	1	0	0
Competition: mkt concentratio	# of players with 75% som	> 5	4 to 5	< 4		-1	-1	-1	-1	-1	1	-1	0	-1	0
External business attractiveness - high / (low)					50%	-60%	-20%	20%	-100%	-60%	0%	-80%	0%	60%	20%
Relative market share	% of #1 som	> 90%	60% to 90%	< 60%		-1	0	1	-1	-1	0	-1	0	1	0
Share development	% change over 3 yrs	> 10%	-5% to 10%	< -5%		0	-1	-1	-1	-1	-1	-1	-1	0	-1
Profitability relative to market	OI% vs competition	higher	equal	lower		-1	0	0	-1	-1	0	-1	1	0	0
Brand awareness	Spontaneous BA vs comp	high	med	low		-1	0	1	-1	0	1	-1	0	1	1
Sourcing security	risk of disruption	minimal	reasonable	high		0	0	0	-1	0	0	0	0	1	1

INPUT FIELD

Attachment 2a

Business Assumptions
Attachment 2 a

Assumptions overview

- a non-core brand is selected as divestiture candidate

- Distribution continues with existing sales force
- Manufacturing and sourcing continues
- Moderate share loss planned year on year due to low innovation and focus
- no changes in overheads / cross-charges for shared services

Market volume growth:			1.0%	2010 Forecast
			2.0%	2011 Forecast
			3.0%	2012 Forecast
			1.5%	Estimate 2012+
Vol share:	Detailed in spreadsheet: Vol, Mkt, Share			
	Assumption is moderate losses per year due to low innovation and lwo focus in export model			
Volume:	Impact of lower focus on distribution:		-12.5%	
	- Reduced net weighted distribution		-5.0%	Vol share impact ('10vs'11) = -1.6 pp
	- SKU rationalisation		-5.0%	
	- reduced Advertising		-2.5%	
Discounts				
	Promotional Discounts		1.0%	Increase of promotional activities to compensate lower A&C
	Trade incentives - carry fwd existing % of NR			
Pricing:	Product A	Inflation multiple	100%	
	Product B	Inflation multiple	100%	
Sourcing	Sourcing and costs stay unchanged			
Direct COS	FMC as a % of Direct COGS		20%	
	Rawpack & DVL		80%	
	COGS inflation		100%	
Transport:	Allocated vs direct		50%	
	Inflation multiple		100%	
Advertising & Promotion	Product A		5%	of NR
Overhead			200	
	Marketing		100	1 Brand Mgr., 1 Ass. Brand Mgr.
	G&A		100	allocated cost
	Salary inflation multiple		110%	
Tax	Tax on operating profits		25.0%	Austrian Statutory Income Tax
	Tax on divestiture profits		25.0%	No tax loss carry-forward applicable
Capex	Capex = Depreciation; no expansionary capex required			
Depn	Depreciation Rate (applied on gross book value)		10	yrs
Working cap	Days:			
	Accounts Receivable		30	
	Inventory on Hand		25	
	Accounts Payable		35	
One off Cost			0	
Transaction costs			0%	divestiture managed internally
Discount rate			10.0%	
Terminal growth			0%	not growth business
Euro			1.00	

	2009	2010	2011	2012	2013	2014	2015
Inflation *Estimate*	0.4%	1.2%	2.2%	2.5%	3.0%	3.0%	3.0%

Attachment 2 b

Volume, Market and Share
Attachment 2 b

VOLUME, MARKET AND SHARE

(tons)	Actuals			Projections										CAGR		
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	07 - 09	10 - 14	10 - 19
Market Volume in Austria (in tons)																
Total Market (tons)	10,000	9,800	9,500	**9,595**	**9,787**	**10,081**	**10,232**	**10,385**	**10,541**	**10,699**	**10,860**	**11,022**	**11,188**	**-2.5%**	**2.0%**	**1.7%**
% vs year ago		*-2.0%*	*-3.1%*	*1.0%*	*2.0%*	*3.0%*	*1.5%*	*1.5%*	*1.5%*	*1.5%*	*1.5%*	*1.5%*	*1.5%*			
Volume Prod. A, B																
Total	**1,579**	**1,164**	**1,025**	**1,125.0**	**1,010.5**	**889.6**	**800.6**	**708.8**	**614.0**	**569.7**	**551.1**	**531.8**	**511.8**	**-19.4%**	**-10.9%**	**-8.4%**
% vs year ago		*-26.3%*	*-11.9%*	*9.8%*	*-10.2%*	*-12.0%*	*-10.0%*	*-11.5%*	*-23.3%*	*-19.6%*	*-10.2%*	*-6.7%*	*-7.1%*			
Volume Share																
Total Business	**15.8%**	**11.9%**	**10.8%**	**11.7%**	**10.3%**	**8.8%**	**7.8%**	**6.8%**	**5.8%**	**5.3%**	**5.1%**	**4.8%**	**4.6%**	**-5.0 pp**	**-4.9 pp**	**-7.2 pp**
pp vs year ago		*-3.9%*	*-1.1%*	*0.9%*	*-1.4%*	*-1.5%*	*-1.0%*	*-1.0%*	*-1.0%*	*-0.5%*	*-0.3%*	*-0.3%*	*-0.3%*			
Competitor 1	15.9%	18.4%	17.3%	17.0%	17.5%	18.0%	18.3%	18.6%	19.0%	19.1%	19.2%	19.3%	19.4%	1.4 pp	1.6 pp	2.4 pp
Competitor 2	7.0%	8.6%	7.7%	7.4%	7.9%	8.4%	8.7%	9.0%	9.4%	9.5%	9.6%	9.7%	9.8%	0.7 pp	1.6 pp	2.4 pp
Other	61.3%	61.1%	64.2%	63.9%	64.4%	64.9%	65.2%	65.5%	65.9%	65.9%	65.9%	65.9%	65.9%	2.9 pp	1.6 pp	2.0 pp

(A) Market growth projections should be based on serious data source
(B) Calcuated based on projected volumes and Nielsen market size

Attachment 2c

Keep Value Computation
Attachment 2 c

MM LC	2010 projected	2011	2012	2013	2014	2015	2016	2017	2018	2019	2013 2010	2016 2013	2019 2010
Market growth	1.0%	2.0%	3.0%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%			
Share	11.7%	10.3%	8.8%	7.8%	6.8%	5.8%	5.3%	5.1%	4.8%	4.6%			
Volume (tons)	**1,125.0**	**1,010.5**	**889.6**	**800.6**	**708.8**	**614.0**	**569.7**	**551.1**	**531.8**	**511.8**	-10.7%	-10.7%	-8.4%
List price per kg	*10.0*	*10.2*	*10.5*	*10.8*	*11.1*	*11.4*	*11.8*	*12.1*	*12.5*	*12.9*	*2.6%*	*3.0%*	*2.9%*
inflation	*0.0%*	*2.2%*	*2.5%*	*3.0%*	*3.0%*	*3.0%*	*3.0%*	*3.0%*	*3.0%*	*3.0%*			
Net revenue	**7.1**	**6.4**	**5.8**	**5.4**	**4.9**	**4.4**	**4.2**	**4.2**	**4.1**	**4.1**	-8.7%	-8.0%	-5.9%
NR per kg	*6.3*	*6.4*	*6.5*	*6.7*	*6.9*	*7.1*	*7.3*	*7.6*	*7.8*	*8.0*	*2.3%*	*3.0%*	*2.8%*
inflation	*-0.7%*	*1.3%*	*2.5%*	*3.0%*	*3.0%*	*3.0%*	*3.0%*	*3.0%*	*3.0%*	*3.0%*			
Total COGS	4.6	4.3	4.0	3.9	3.7	3.4	3.3	3.4	3.4	3.4	-5.7%	-4.6%	-3.3%
% NR	*65.2%*	*67.5%*	*69.8%*	*71.8%*	*74.5%*	*78.1%*	*80.1%*	*81.1%*	*82.1%*	*83.3%*			
LC/KG	*4.1*	*4.3*	*4.5*	*4.8*	*5.2*	*5.6*	*5.9*	*6.1*	*6.4*	*6.7*	*5.6%*	*6.8%*	*5.6%*
Gross margin	**2.5**	**2.1**	**1.8**	**1.5**	**1.3**	**1.0**	**0.8**	**0.8**	**0.7**	**0.7**	-14.9%	-18.1%	-13.2%
% NR	*34.8%*	*32.5%*	*30.2%*	*28.2%*	*25.5%*	*21.9%*	*19.9%*	*18.9%*	*17.9%*	*16.7%*			
LC/KG	*2.2*	*2.1*	*2.0*	*1.9*	*1.8*	*1.6*	*1.5*	*1.4*	*1.4*	*1.3*	*-4.7%*	*-8.3%*	*-5.3%*
A&C	1.8	0.6	0.6	0.5	0.5	0.4	0.4	0.4	0.4	0.4	-33.5%	-8.0%	-15.3%
%NR	*25.9%*	*10.0%*	*10.0%*	*10.0%*	*10.0%*	*10.0%*	*10.0%*	*10.0%*	*10.0%*	*10.0%*			
Net Contribution	**0.6**	**1.4**	**1.2**	**1.0**	**0.8**	**0.5**	**0.4**	**0.4**	**0.3**	**0.3**	16.0%	-25.0%	-8.8%
% NR	*8.9%*	*22.5%*	*20.2%*	*18.2%*	*15.5%*	*11.9%*	*9.9%*	*8.9%*	*7.9%*	*6.7%*			
LC/KG	*0.6*	*1.4*	*1.3*	*1.2*	*1.1*	*0.9*	*0.7*	*0.7*	*0.6*	*0.5*	*29.9%*	*-16.0%*	*-0.4%*
Overhead	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.3	0.3	29.9%	2.7%	11.1%
Allocated	-	-	-	-	-	-	0.0	0.0	0.0	0.0			
Direct	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.3	0.3			
inflation	*4.7%*	*3.6%*	*3.0%*	*2.7%*	*2.7%*	*2.7%*	*2.7%*	*2.7%*	*2.7%*	*2.7%*			
OI	**0.5**	**1.2**	**1.0**	**0.8**	**0.5**	**0.3**	**0.2**	**0.1**	**0.1**	**0.0**	13.0%	-38.6%	-31.8%
% NR	*7.5%*	*19.2%*	*16.6%*	*14.1%*	*10.9%*	*6.7%*	*4.2%*	*3.1%*	*1.8%*	*0.4%*			
LC/KG	*0.5*	*1.2*	*1.1*	*0.9*	*0.8*	*0.5*	*0.3*	*0.2*	*0.1*	*0.0*	*26.5%*	*-31.2%*	*-25.5%*
Incremental OI	**0.5**	**1.2**	**1.0**	**0.8**	**0.5**	**0.3**	**0.2**	**0.1**	**0.1**	**0.0**	13.0%	-38.6%	-31.8%
% NR	*7.5%*	*19.2%*	*16.6%*	*14.1%*	*10.9%*	*6.7%*	*4.2%*	*3.1%*	*1.8%*	*0.4%*			
LC/KG	*0.5*	*1.2*	*1.1*	*0.9*	*0.8*	*0.5*	*0.3*	*0.2*	*0.1*	*0.0*	*26.5%*	*-31.2%*	*-25.5%*
Tax	0.1	0.3	0.2	0.2	0.1	0.1	0.0	0.0	0.0	0.0			
Working capital (dec) / incr	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0			
Capex	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1			
Depn	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1			
Cashflow	**0.4**	**1.0**	**0.8**	**0.6**	**0.4**	**0.3**	**0.1**	**0.1**	**0.1**	**0.0**			
Terminal value										0.2			
Total	**0.4**	**1.0**	**0.8**	**0.6**	**0.4**	**0.3**	**0.1**	**0.1**	**0.1**	**0.2**			
DCF		**2.5**											
NR multiple (2011)	0.4 x	2.4	Ongoing										
EBITDA multiple (2011)	1.9 x	0.1	terminal										