M&A as an agent for change: How communications are impacted by transactions

07 June 2011

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Agenda

I. M&A – a possible game changer

II. A typical M&A situation

III. M&A as opportunity for IR

IV. What to do if the deal fails

V. Summary

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M&A – a possible game changer

How M&A affects a company

- There is an abrupt share price movement of the company being targeted
- Significant increase in daily traded volumes
- Investor base changes: Opportunistic investors such as hedge funds invest heavily in the targeted company; roughly 20% of investors after the leak of a transaction are typically event-driven investors
- Significant media attention and speculation
- Employee concern and uncertainty

M&A effects on IR

- Investor relations work suddenly gets more intense: More calls from investors, analysts and more requests from internal audiences
- Management focus on IR increases: Engagement with financial markets becomes a key tactical tool and listening post
- Workload increases exponentially from one moment to the next; M&A on top of the “day job”
- Questions arise about strategy and future direction of the company with a successful deal and if it fails

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A typical M&A situation – announcement of bid

- **Share price and volume** increase immediately
- **Investor bases** changes
  - 20% moves into arb hands within days of announcement
- Significant **media attention** surrounding
  - Valuation
  - Role of management
  - Impact on employees
  - Strategic rationale of the deal
  - Impact on sector

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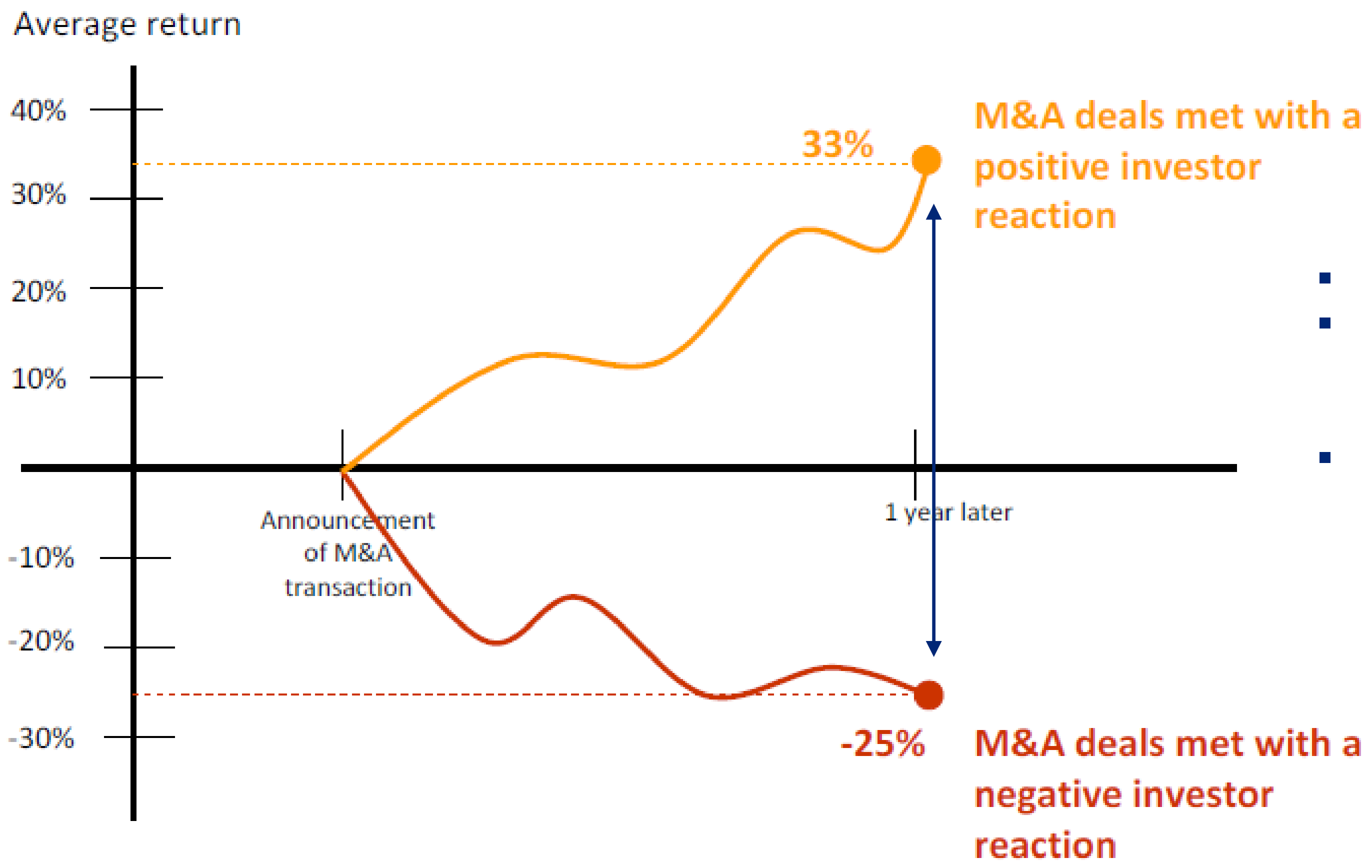
Obtain positive investor reaction



- Intangible value of stocks
- Significant upside potential to be achieved through effective communications
- There is significant down side to valuation if you get IR wrong

Source **Boston Consulting Group**

M&A as opportunity for IR

1 Management attention for IR

- M&A focuses significant attention on IR and the role it plays in engagement with the capital markets
- Management is more focused, and therefore more receptive, to impulses from the IR department
- The IR department should use M&A to position the IR practice as a strategic function

2 Broaden investor base

- M&A can often change the size, geographic position or sector of a company, increasing the pool of potential investors
  - Transactions can significantly raise the profile of companies in both the media and capital markets
  - Depending on the structure of the transaction, there is potential to attract former investors in the target company to the new entity

3 Position IR internally better

- Transactions generally raise interest among employees in the performance of the company's share price and in IR in general
- IR team needs to adjust size and potential locations to adapt to new company structure and relevance
- One should use this attention to educate staff about the role of IR (i.e. through internal road shows)

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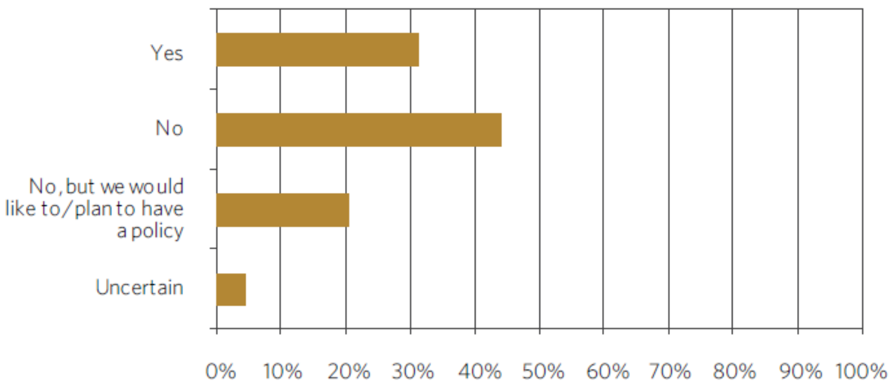
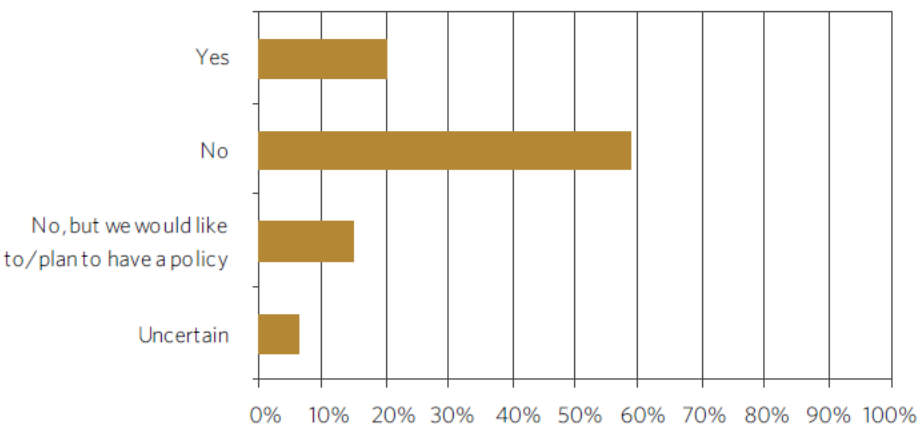
Management attention for IR – use to prepare

Companies with crisis communications policy



Companies with M&A communications policy



- While written disclosure policies have become standard within many IR departments, a written crisis communications policy has not yet, according to a survey of Bank of NY Mellon
- Only 31% of firms are formally drafting what actions to take during a corporate emergency and only 20% have a written transaction or M&A communications policy
- IR teams should utilize the focus of management surrounding an M&A process to ensure internal structures and procedures are developed and kept up to date

Source **Global Trends in Investor Relations, Bank of NY Mellon 2010**

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Management attention for IR – use strategically

Status Quo		Transaction increases awareness
Goals tend to focus on incremental change	**Goals**	Use attention to set new, aspirational goals
Budget and resources designed to minimize overall expenditure	**Resources / Budget**	Leverage management attention on communications post M&A to reset expectations and resource dedicated to IR function
Significant effort by IR team to gain input and support from operational management in IR activities	**Involvement / Support**	Coming out of intensive discussions with investors and analysts, management better understands what value its personal involvement can add

Since management is now focused on communications, use their attention to enhance IR function

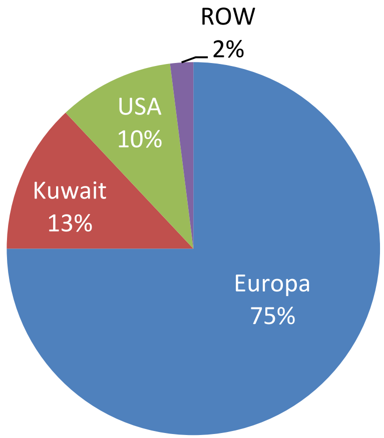
Broaden investor base – the new equity story

New story	Challenge	Actions
▪ IR has to sell the new story to investors and analysts ▪ Maintain momentum of market interest in the company ▪ Underlying performance of acquisition post closing, beyond synergies	▪ There is empirical evidence that mergers and acquisitions in the short run tend to create significant value for the target shareholder ▪ The long-term affects on the acquirer are more challenging because of the difficulty of estimating long-term performance	▪ In an M&A situation establish early a process for gathering and evaluating underlying performance of the transaction ▪ Focus on aspects beyond cost synergies ▪ Build the company's acquisition track record

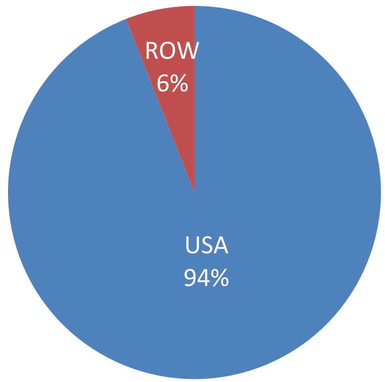
At the start of a deal you should think how you want to present the success of the deal later

Broaden investor base – targeting new investors

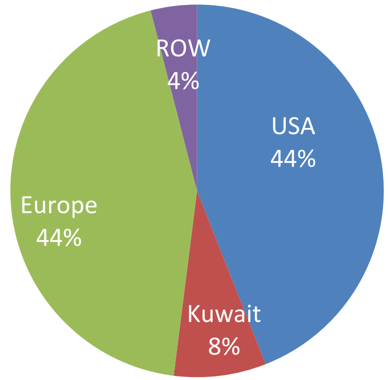
Target



Buyer



Combined entity



- As a consequence of a transaction, the size of companies and the investor base change
- Very often relevance in certain sectors increases
- Transactions also broaden geographic relevance of combined entity
- With new business areas, new investors can be targeted
- If all cash deal, target former shareholders of target company to recover them as new investors
- If cash and shares, focus on retaining target company investors post closing and minimizing flowback

Internal positioning – find supporters in-house

- Build out IR team
- Educate the work base about IR
- Go on internal road show with CEO/CFO
- Discuss best practice of IR
- Get feedback from employees
- Stay in regular contact with staff

- The IR team needs to adjust size and potential locations to adapt to new company structure and relevance
- Utilize increased employee attention on capital markets activities to educate staff and role and importance of Investor Relations
- Help to establish or cultivate an "equity culture" among the broader team utilizing the transaction as the catalyst
- Post-merger integration and operational management changes accompanying M&A provide an opportunity and need to expose a broader range of executives to the new equity story

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What to do if the deal fails: VNU / IMS Health

- Dutch company VNU proposed a $6.3bn merger with IMG Health Inc., a US-based health-care data firm in July 2005
- Two large shareholders holding a combined 25 % of the stock publicly opposed this merger even before the proxy was filed with the SEC
- They argued that VNU should focus on improving performance of its current business and questioned management's ability to execute a difficult integration
- By the end of November 2005, the deal was off and VNU's chairman and CEO, Rob van den Bergh, resigned
- Company was later broken apart and sold

VNU's action post deal

"Initiating, in the near future, a program to return approximately EUR 1 billion to shareholders, on top of the regular dividend now in place."

"Pursuing a listing on the New York Stock Exchange, to raise the company's public profile and expand its shareholder base."

General advice

Management should focus more on the "why" of a transaction than only on the "how".

Foremost management needs backing from investors on any strategic steps before they are announced; i.e. build up a broader shareholder support base.

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What to do if the deal fails

Impact

- Shareholder base has significantly shifted
  - Arbitrage investors have sold their stakes
  - Target company prone to other offers
- Share price of target will drop dramatically
- Potential for investors to question management motivations and ask for change
  - Management change (CEO/CFO) likely
- Questions about stand alone strategy arise
  - How do you secure financing?
  - How do you plan to grow?
  - Do you plan to acquire yourself?

Actions

- Step up IR activities to enhance existing relationships and build demand for stock to take up liquidity
  - Arbs have pushed out strategic investors
  - Put effort into winning them back
- Utilize public attention to position management and tell your story
  - Spotlight is still on: talk about your stand alone strategy and opportunities for growth
- Review and update internal process
  - Check if you have preparation documents in place for the special situation (M&A, crisis)
  - Review what went wrong and update process accordingly

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M&A as an Agent of Change: How Communications are Impacted by Transactions

2011 DIRK Conference

Joshua Young – Head of Investor Relations, Merck KGaA

Frankfurt, June 7, 2011

Key Messages

- Large acquisitions require clear, concise and consistent messaging about the strategic rationale of the transaction
- Transactions that fundamentally change the company facilitate the need for an updated or changed approach to communications
- Investor relations must take the lead in communicating changes and tracking progress beyond just integration targets and cost synergies
- Leverage opportunities to make the changes “real” for the capital markets

About Millipore

- Life Science Tools company based outside Boston, USA
- $1.7 billion in revenue
- $3.5 billion market capitalization
- 6,100 employees worldwide
- 70% of revenues outside of U.S.
- 95% institutional ownership

Millipore’s $1.5 billion all cash acquisition of Serologicals

- Strategic transaction that established Millipore as a leader in the life science industry
- Transaction was expensive
    - 35% stock price premium
    - 5x Trailing Sales; 20x Trailing EBITDA
- Millipore added substantial debt: Debt to EBITDA of 5.0x
- Stock traded up 10% on initial day of announcement

Strategic rationale of transaction

- Transformed Millipore from a niche filtration provider with moderate growth prospects into a high-growth life science company
  - Transaction was about growth and new capabilities, not cost savings
- Company entered several fast growing markets that were highly competitive, but very attractive
- Opportunities for substantial product and geographic sales synergies
- Serologicals was one of the last mid-size ($300M sales) life science tools assets on the market

Communications issues created by Serologicals transaction

- High premium would make it difficult to drive incrementally higher returns on invested capital
- Integration would be challenging due to cultural differences and global scale of business
  - Employee compensation system adjusted on company-wide basis
- Management's philosophy in running the business changed from risk averse to openly willing to take calculated risks that supported strategy
- Consolidated company faced tougher competitive landscape with a very risky balance sheet
- Acquisition had a more substantial impact on the division that was less liked by analysts and required an increased education process

Changes made after the Serologicals transaction

- Shareholder base migrated toward more growth oriented investors that were less valuation sensitive, targeting strategy changed
- Company launched a new brand
  - IR asked to help lead new branding effort
- Investor relations materials were overhauled to reflect new portfolio and educate investors about the changing drivers of our business
- CEO had higher involvement in IR activities to answer questions about strategy and execution of our operational and integration plans
- Held analyst day 3 months after transaction closed to provide more details on strategy and execution plan

What happened?

- Strategic rationale and integration plan were positively received by capital markets
- IR materials were used for internal communications to make the case for change with employees
- Integration effort was difficult and resulted in some operational disruptions
- Transaction was successful in driving cultural change within Millipore; 50% of employees were new to the company three years post the transaction
- Stock traded at a consistently high premium post transaction (P/E 20x)
- Serologicals acquisition set off a wave of consolidation in Life Science Tools Sector

Merck's 5.2 billion EUR acquisition of Millipore

- Millipore received an unsolicited bid, which began an auction process that Merck ultimately won
- Transaction was expensive
  - 50% stock price premium
  - Enterprise Value/EBITDA 14x
- Few analysts or investors suspected that Merck would be interested in Millipore
- Transaction closed in July 2010

Merck's Acquisition of Millipore Business Transforming, Culture Strengthening

Acquisition Criteria	Millipore's Contribution
Focus on high-margin specialty products in growth markets	Strong competitive position; one of the fastest growing companies in Life Science Tools industry with >20% operating margin
Concentrate on innovative businesses	Innovation-driven culture with strong track record of success
Expand geographical reach and enhance presence in US	Adds well-recognized global brand and almost triples Merck Chemicals' revenues in the United States
Build on Merck's in-depth sector knowledge	Capitalizes on Merck's strong expertise in pharma and biopharma sectors
Balance Merck's business portfolio	Higher percentage of Merck Group's sales and profit now derived from Merck Chemicals

Communications issues created by Millipore transaction

- High premium would make it difficult to drive incrementally higher returns on invested capital
- Life Science business poorly understood by analysts and shareholders
- Significant criticism of Merck's last large transaction: Serono
- Auction process created impression that transaction was opportunistic rather than strategic
- Pharma oriented sell-side investors interpreted acquisition as a risk diversification move rather than offering strategic and synergistic value
- Millipore business is classified in Merck's chemicals business even though its business is almost entirely life science

Changes made after the Millipore transaction . . . in progress

- Held analyst day 3 months after transaction closed to provide more details on strategy and execution plan
- We are in the process of changing our shareholder base toward more cash flow and chemically oriented investors
- Developing updated equity story and overhauling IR materials
- Leveraging roadshows and teach-ins to articulate changing drivers of the business and attractiveness of Merck Millipore division
- Simplifying business descriptions and creating more balance between discussion of pharmaceutical and chemicals businesses
  - Chemicals grows from 24% to 45% of Core EBIT in only two years

Differences between Serologicals and Millipore transactions

- Less investor focus on integration activities and risk than experienced with Serologicals
- Challenge of educating investors from different backgrounds: chemicals, pharma, life science, about the Millipore business
- Higher burden on Investor Relations to carry the message: Merck is in the midst of significant changes in the executive management team
- Higher challenge of retaining key employees
- Lack of clarity around current strategic objectives of new management team and how transaction will fit within those goals

Lessons learned

- Repeat the strategic rationale of the deal again and again; strong alignment of strategic fit reduces skepticism around the deal
- Provide a through review of the acquired business, including introduction of acquired management and products within 3 months of closing deal
- For expensive, strategic transactions avoid getting into detailed return on capital discussions, simply point out upside opportunities where the company can drive higher revenue growth or profits
- Recognize that no matter how good of a job you do in communicating certain investors do not like acquisitions and will simply sell out of stock
- Leverage anecdotes in investor communications to describe how company culture has changed, customer relationships improved or incremental sales or profits are generated