Increasing Expectations
It should come as no surprise after the last two years of economic turmoil and recovery that those charged with corporate oversight would scrutinize deals more thoroughly. Today we observe boards are much more participative throughout the deal process and are demanding deeper levels of detail into the business case supporting the transaction and the valuation of targets.

We also find a marked increase in board advisory assignments where, in a given buy- or sell-side transaction, the board, or a special committee, engages its own advisors independent of those used by management. Sometimes this involves working alongside management and their advisory team and other times it might be vis-à-vis providing a fairness opinion or other similar independent analysis. Either way, boards are inserting themselves as active and independent players in the transaction oversight process.

As boards insert themselves into the process, they are demanding more from management and the finance team. It has become common practice for acquirers to conduct commercial, operational and financial diligence prior to the transaction. However, in the past, this analysis rarely extended to the evaluation of post-transaction operations vital to unlocking the potential value from a deal. Indeed, a few years ago there was often a clear delineation between deal teams and integration teams. In contrast, today we find the lines between pre- and post-transaction are blurring. Often, valuation is now diving deeper into what drives value and risk and how these factors behave under changing conditions. Increasingly, the insights gleaned through the valuation process pre-closing are being used to inform and focus Day 1 operating plans to increase the probability of realizing the expected value of the deal post-closing.
In order to increase the likelihood of achieving the expected transaction results, boards are putting pressure on CFOs and other C-suite executives to provide them with two things: 1) a clear financial vision and roadmap on how to drive value from the deal, and 2) greater depth of detail in their valuation analysis and plans to manage uncertainties and contingencies. These changes are shifting valuation from a static quantification and estimate of expected value to a form with greater inherent consideration of flexibility and the management of risk that can undermine value. These considerations require finance to undertake a deeper and more detailed level of analysis than what perhaps was previously common practice.

**Clear Vision and Roadmap for Driving Value from the Deal**

Prior to closing, Boards are asking company management for more detailed plans and explanations of how value will be realized and over what timeframe. For starters, CFOs increasingly need to deliver a perspective on value and a financial plan that is actionable and aligned with company strategy.

The CFO should be prepared to explain how the transaction is accretive to the company with some degree of granularity. Instead of keying in strictly on financial returns, CFOs now need to consider the mechanics of the operations post-transaction. Beyond a projection of value, they have to clearly articulate what key assumptions and metrics they are measuring and tracking and the likelihood of achieving stated goals. As part of their holistic big-picture approach, the CFO should be thinking about the ability to manage the acquired business for value, and then examining the choices, options and decisions that go into that. If these factors are contemplated during the deal making process, it can create more strategic flexibility and options for the CFO and company downstream as business conditions change and the management team adapts.

Companies are dedicating more resources to pre-transaction analysis — not just for the board, but to gain greater insights into alternatives on how management can actually deliver on the value promises of the transaction while minimizing risk. The emerging valuation process is keenly focused on gleaning insights into the decisions that the acquired company must make, and utilizing these insights to create flexibility through the deal making process and in post-merger operations. This flexibility is fundamental to navigating future uncertainties and managing risk.

As the line between pre- and post-transaction blurs, more is being demanded of the CFO and the finance organization in the valuation process. In many companies CFOs will need to build, buy or borrow capabilities for deeper and more insightful analysis. They may also have to consider non-conventional sources of information as inputs into their deal models when, for example, evaluating targets in emerging markets where market or comparable performance data may not be readily available. Furthermore, the finance organization will have to team more effectively with business units and functional leaders involved in a transaction - as well as deal teams - to effectively model out different scenarios for value creation and risk from the deal.

**Deeper Analysis focused on Insight: The Devil is in the Details**

Previously, an acquiring company’s focus in developing a valuation was to determine a point of view on the expected value of the transaction. Now boards not only want to know the expected value, but they want to know the shape of the distribution around that expected value. In other words, what is the likelihood of realizing the expected value of the deal and what can be done to increase the probability of realizing the expected value? The change in valuation practices is not just about increasing the level of detail for measuring value; it is an evolution of the tools, techniques, approaches and theory that we have to do so. Leading valuation practice is no longer just calculating the NPV or expected return on a deal, but applying probabilistic modeling, decision analysis and other advanced techniques to analyze value. This includes finding ways to measure and accelerate capture of deal synergies under different scenarios and could include the design and evaluation of different “real options” to hedge against alternate risk scenarios.

Boards are increasingly interested in the sustainability of the target’s business model and competitive advantage and post-merger requirements to make the deal a success. Astute boards increasingly want a clear delineation of key risk considerations and avenues for hedging that risk or de-risking a transaction as completely as possible. A comprehensive valuation analysis should provide insight to help the board navigate these considerations during their deliberations of a transaction.
Act Now, Don’t React
As companies turn toward M&A to accelerate growth, boards and management have the same ultimate goal: value creation. Both want to realize financial and other outcomes from the deals they pursue and want to have high confidence in realizing the outcomes without undue risk. This is creating a “new normal” for deal valuation and pre-transaction planning and modeling. Recognizing the change in practices and establishing capabilities for providing clearer perspectives and detailed analysis of prospective transactions can position CFOs to advance future transactions more effectively and with greater confidence.

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