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working world

Does your integration playbook tackle tomorrow's M&A challenges?

Technology, media and entertainment,
and telecommunications

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Soaring valuations mean even less room for error in capturing synergies

Deal values have rebounded in the technology, media and entertainment and telecommunications (TMT) sector, with 2018 on pace to meet or surpass the record levels seen in 2015-16. Cash-rich corporates and hyperactive financial buyers are competing for targets – driving valuations to all-time highs.

Megadeals, including Broadcom's foray into software with its US\$18.9b acquisition of CA Technologies, the US\$26.5b proposed horizontal merger of Sprint and T-Mobile, and the battle between Disney and Comcast for Twenty-First Century Fox's assets, have dominated the headlines. In technology alone, there have been a record number of transactions valued at more than US\$1b in the first half of 2018.¹

We expect this highly active M&A market to continue in the second half of the year. Some transactions will be driven by traditional TMT M&A factors, such as the need for scale and competition for best-in-class technology, talent and content. Many, however, will be driven by TMT companies' increasing need to vertically integrate in order to "own" their ultimate customers' demand. In media and telecom, we expect to see more transactions that marry content with distribution, as new digital platforms result in the ability to leverage fixed investment costs over a large user base. In technology, the move toward customer ownership will drive deals that blend traditional technology subsectors for the sake of building platforms around Internet of Things (IoT), artificial intelligence (AI) and other emerging technologies. Software companies will also continue to seek acquisitions that will allow them to sell suite solutions across multiple functional verticals, thus owning more and more of each customer's software stack.

Meanwhile, sky-high valuations mean that TMT companies need to find a reliable path to capture synergies to avoid the multifaceted pitfalls of bad deals. Our advice is to move away from the legacy playbooks and reinvent a nimble, value-focused integration strategy based on the goals and objectives of each deal. Innovation is the lifeblood of TMT companies, so M&A should accelerate innovation for both buyer and target, and carefully avoid stifling it through burdensome processes wherever possible.

About this report

This report is part of the EY *Buy & Integrate* series of sector-specific reports that encourage CFOs, CDOs and transaction leaders to take a fresh look at how they identify and capture synergies during M&A. In the reports we suggest leading strategies to improve your M&A and integration playbook.

For more EY *Buy & Integrate* perspectives, see the reports at ey.com/synergies:

- ▶ Advanced manufacturing
- ▶ Consumer products and retail
- ▶ Health care
- ▶ Life sciences

¹ EY analysis of 451 Research M&A KnowledgeBase

Setting synergy strategy

No two deals are exactly alike, thus neither are two integrations. We recommend that TMT dealmakers start the strategic planning process by asking themselves the following questions:

What should be integrated and what should be left alone?

A purposeful, deal-specific integration strategy allows you to integrate only where it creates value. The strategy should be designed to achieve the deal's rationale, and provide guidance on the intended balance between integration speed and long-term value creation.

For example, HR executives could rapidly standardize compensation and benefits across the board, but choose to retain a specific sales performance incentive fund (SPIF) or sales bonus schemes for an extended period in order to meet revenue growth targets.

We recommend using an integration strategy matrix (see below), which drives companies to think through why they plan to integrate each component and function. For example:

- ▶ Is it required by law?
- ▶ Is it needed to manage risk to the firm?
- ▶ Does it enable the deal's value drivers?
- ▶ Is it just nice to have?

Dealmakers should avoid integration for the sake of integration (yes, it still happens) and develop a plan that focuses on maximizing synergies.

Take, for example, a serial technology acquirer's US\$5b+ acquisition of a leading software company. This buyer had deployed an integration playbook for years that called for full integration of its acquisitions. Executives were quick to realize, however, that this deal would require a more flexible approach to attain the value drivers – first and foremost, product augmentation. We worked with this client to identify what was necessary to achieve the desired product and people outcomes, and what should be left independent so as not to stifle growth. As it turned out, maintaining a separate headquarters (including maintaining the existing HQ look and feel) was important to target leadership, but not important to the buyer. Leaving this and other employee-experience items separate fostered goodwill among the target employee base, which supported integration efforts where they were undertaken (largely in the back office).

How can the combined product slate and IP be optimized to achieve a superior portfolio?

Integration of R&D, product development and related functions requires buyers to strike a chord between allowing independence, so as not to stifle innovation, and performing enough integration to realize value from the combined product slate. Dealmakers and business leaders should initiate this process by evaluating the combined portfolio and intellectual property (IP) and aligning product road maps from the beginning:

- ▶ Should the product pipeline be streamlined to avoid redundancy?
- ▶ How can each company's IP be leveraged across the new enterprise?
- ▶ What products are no longer part of the combined company's core business and should be divested?

Charting your integration journey (sample integration strategy matrix)

The integration strategy matrix (ISM) enables companies to think through potential areas for integration, and outline a strategy for the appropriate degree and speed of integration for each based on the deal's rationale.

Function/process/policy	Required per regulations and laws	Required for buyer risk management	Required to attain value drivers	Open to discussion
SEC reporting, SOX plan	▲			
Internal audit, contingent staff policy		▲		
Product road map, salesforce cross-training			▲	
Product hosting site, real estate				▲
▼ +50-100 additional integration considerations				

Consider again our example above. Part of the acquisition rationale was speed to market around a particular software capability at the target. The buyer, with EY's help, set up a product clean room pre-close to work through product development integration issues and set up a joint development program that could mobilize immediately upon close. As a result, technical capabilities were built up and ready to support planned priority programs from Day One.



See our article [The elephant in the room: R&D integration](#) for more considerations when integrating these key functions.

What matters to talent that matters to the deal?

Engineering talent can represent a significant portion of the value from a technology acquisition. The same can be said of creatives in M&E. Alienating this talent is a sure and fast way to destroy value. Companies should perform robust human capital diligence before inking the deal to understand what motivates key talent (e.g., quirky employee perks, creative license, stock vs. cash compensation), and then develop robust retention programs to maintain or even magnify that motivation. This is easier said than done, as companies often struggle with reconciling entrepreneurial and creative mindsets with desired scale and controls. The answer is often a precise definition of what behaviors need – and need not – change in order to enable value capture and carefully managing to that vision.

Human capital and cultural considerations were a key driver behind a technology client's decision to largely not integrate a recent US\$25b+ acquisition. In this case, both buyer and seller spent months visiting each other's campuses and collaborating to understand cultural fit before proceeding with the deal. This slow courting helped the buyer to realize the value of fueling the target's growth engine and set retention as the most critical deal objective. To accomplish this, the buyer allowed the target to design the integration plan, which left the target largely operationally independent, despite limited back-office integration and some policy alignment to achieve legal and risk management compliance. The outcome? The target's brand and culture were preserved and its most high-profile leaders remained with the company. This integration strategy cost the buyer in terms of increased near-term SG&A expense, but fueled long-term synergy opportunities from the complementary suite of products and services.

How can the deal catalyze the transformation your company needs?

Media and entertainment companies are facing profit pressure as high-margin revenue streams fade and the cost of content development skyrockets. Telecom providers seek further scale and control over content that brings them closer to

their customers. Technology firms are causing or experiencing seismic shifts across the board with each new wave of emerging technology.

In this era of structural change across TMT, the merger integration process can become an agent for more comprehensive transformation of key operating elements at both the acquirer and target, allowing the combined company to effectively position for the current and future competitive landscape – this is particularly true in transformative deals. Think of the recent megadeals that are translating historically vertical businesses into horizontal businesses (and vice versa). Those companies must rethink their entire operating models, from org design to systems to employee incentives, in order to compete in a different type of business environment. Further, companies should take into account technological advances like automation and robotics, machine learning, and data analytics that can give NewCo a competitive edge.



Engineering organizations can also leverage deals to transform R&D processes. See our article [Purposeful disruption](#) for more insights.

Watch your step

There are several common pitfalls that steer TMT buyers away from synergy realization. Dealmakers should be careful to avoid the following:

Shiny-object syndrome

Executive attention is a currency, and there is never enough of it to go around. We have seen too many examples of well-intended deal leaders moving on to the next interesting project (or deal) once a transaction closes. That creates a dangerous combination when you consider the increased likelihood that TMT acquisitions will include revenue growth and product innovation synergies in addition to traditional cost take-out. Revenue synergies are harder to achieve than cost synergies and take longer to realize, requiring significant executive focus over a longer period of time.

Companies should maintain focus on these synergies by setting KPIs aligned to the deal's intention and monitoring them for at least two years post-close. Metrics should be diverse – including leading and lagging indicators around talent, business performance, technical milestones, operations, customer satisfaction and compliance. Most important, executives (via an Executive Steering Committee or other body) should continue to monitor progress and engage with the integration for as long as it takes to secure the transaction's synergies. Leading companies hold deal executives and segment leaders accountable for delivering the synergies they agreed on back at signing.

Counting on ill-conceived cost synergies

Vertical mergers have become common in the headlines, and can be a strategic way for TMT companies to own customer relationships by controlling an entire stack. These transactions can go awry, however, when deal models assume significant cost synergies where they may not exist. Unlike large horizontal mergers, buyers in vertical deals lack operational experience in the market they are entering and are likely to find that back-office redundancies seem less redundant once they dig into the operational details. This is not to say that significant value can't be achieved from vertical mergers in TMT – only that synergy estimates, cost synergies in particular, should be rooted in operational realities; and realistic costs to capture such synergies should be factored into the deal model.

Segregating or delaying the product innovation, R&D or creative integration work from the core integration

We often see that back-office and sales integrations are rigorously managed from the start, but companies shy away from integrating product, R&D and creative functions for fear of disturbing a successful status quo. This may or may not be the right answer (see "What should be integrated and what should be left alone?" section above), but it should be one that is arrived at strategically and carefully managed regardless of the ultimate decision. Because TMT transactions typically involve some product or IP synergies, there will need to be some degree of integration of these functions – integration that deserves at least the same level of thoughtful planning and execution as other functions.

Conclusion

TMT transactions often fail to live up to planned value, especially in larger deals. EY research showed that from 2010-15, deals with a value of more than US\$50b were likely to have missed the cost synergy target. Revenue and growth synergies are less frequently announced, and thus harder to track, but are even more difficult to realize.

In this era of high valuations, dealmakers have even more to lose from shallow integration and synergy realization planning. They must develop fit-for-purpose, tailored integration strategies with laser focus on capturing deal value.

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