MERGER EVALUATION

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FIVE P'S TO REMEMBER

Products	Relation to existing business
People	Style/culture, stakeholders
Price	Value, acquisition premiums
Payment	Cash, securities, earn out
Problems	Time to solve

Diversification and Return I

(Canada's 200 Largest Companies 1960 - 1975)

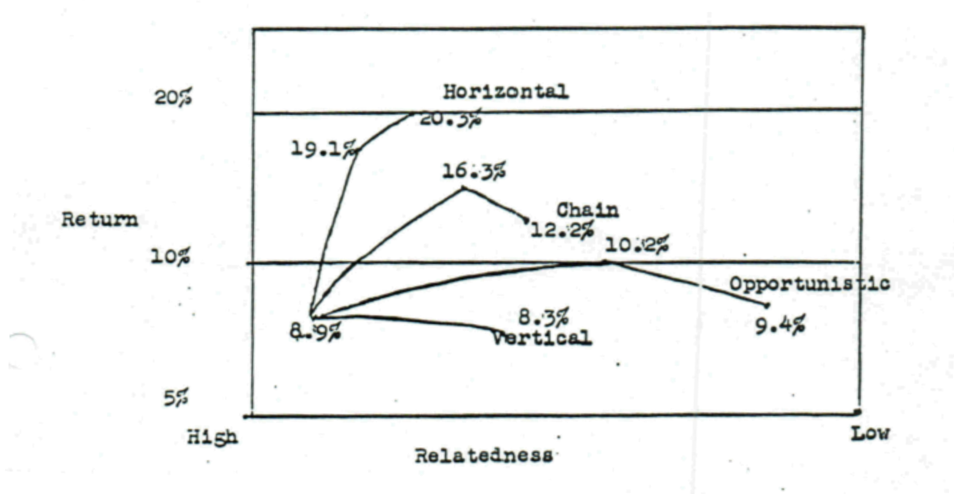
Fit Category		**Merger Strategy**	**Compounded Annual Return**	**CVS Risk Rating**
Focused	Single business		8.90%	5
Dominant	New businesses based on particular strength, skills or resources	Horizontal	19.10%	4
Related	New businesses related to most of others	Horizontal	20.30%	3
Linked	New businesses linked to aspect of original business	Chain	16.30%	3
Disparate	New businesses based on existing strength or skills but not always the same	Chain	12.20%	2
Integrated	Operating at many levels of same industry	Vertical	8.30%	5
Unrelated	New business unrelated to dominant activities	Opportunistic	10.20%	1
Conglomerate	No operating relation-ships between different business none of which predominates	Opportunistic	9.40%	1

Source: Royal Commission on Corporate Concentration

Risk Rating: 1 (low) to 5 (high)

Diversification and Return II

Returns and Acquisition Strategies



Conglomerate versus Portfolio

Compounded Average Annual Returns (1960 - 1975) for ten Canadian Conglomerates and ten “Mirror" portfolios with the same industry mixes.

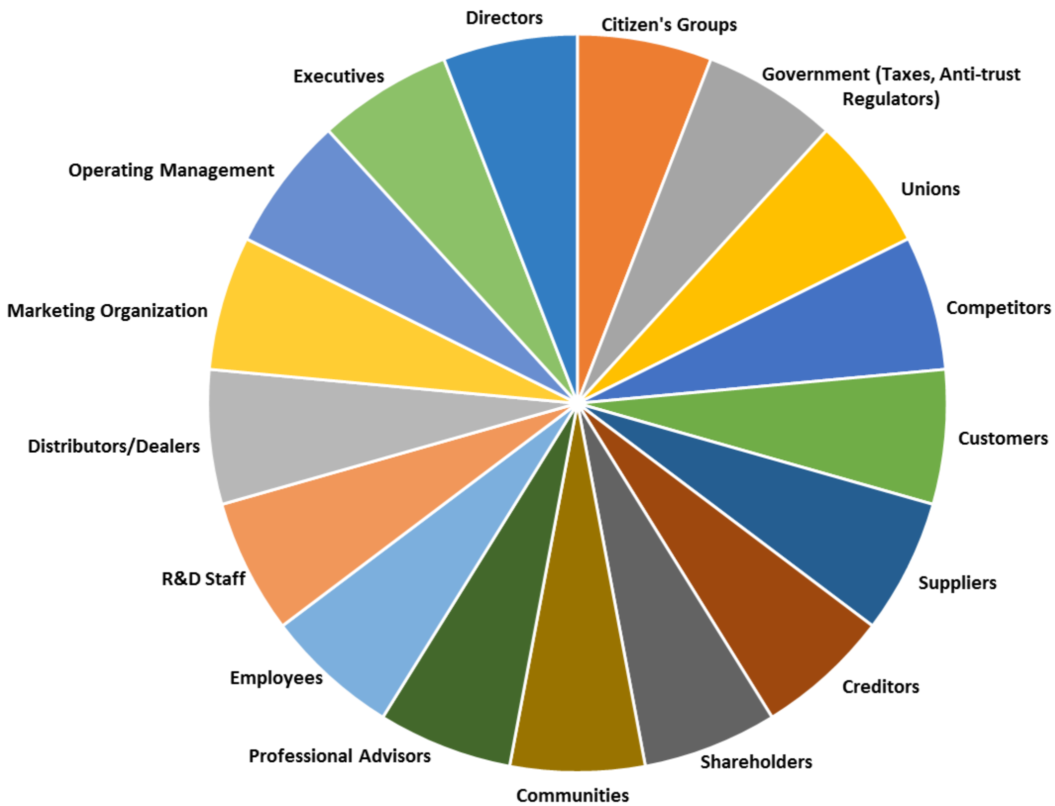
Mirror Portfolios 12.7%

Reduction due to average acquisition premium of 27.3%

Reduction due to operational costs 0.6%

Conglomerates 9.4%

Stakeholders in a Business – each has a different objective



Factors Affecting Price

Merger Evaluation

Stand Alone Values

Earnings

Growth	Sales / Margins / Fixed Costs / Earnings
Stability	Variation about Trends / Volatility
Multiple	Risks / Size / Development / Capital Requirements

Assets

Physical	Replacement / Liquidation / Conditions
Intangible	Brands / Licences / Technology
Goodwill	Going concern component of assembled workforce

Cash Flow

Generation	Profits / Assets / Sales
Usage	Debt Repayment / Capital Expenditures
Discount Rate	Growth / Risks

Five Things to Think About

1. Financial Position – pre & post merger
2. Product Lines – pre & post merger
3. Competitors – potential action
4. Sales – delivery means & trends
5. Personnel & Systems – integration problems & terminations

Risks

Business

- Product Life Change
- New Competitors
- Improved Technology
- Government Restrictions

Financial

- Gearing (fixed versus variable costs)
- Leverage (proportion of debt in capitalization)
- Interest Sensitivity (floating vs. fixed interest obligations)
- Working Capital Requirements
- Maintenance capital expendables
- Expansion projects
- Commitments

Complimentary Criteria

Industry Trends

1. Offsetting seasonal swings
2. Counter cyclical sales
3. Different stage in cash flow life cycle
4. Insurance against random factors
5. High entry resistance
6. Low exit costs

Investor Appeal

7. Increased price/earnings ratio
8. Higher credit rating
9. Margin improvement
10. Smoothing earnings
11. Increasing growth in earnings per share
12. Obtaining a share listing

Market Position

13. Reaching minimum market share
14. Higher share of existing markets
15. Obtaining price independence
16. Broader customer mix
17. Access to larger market
18. Improved shelf clout with retailers
19. Additional marketing methods
20. Diversified distribution channels
21. Add-related product range
22. Full-lining
23. Product to bundle with existing item
24. Obtain fighting brand
25. Functional product in complimentary market
26. Improving anti-social image
27. Increased number of customers

Operations

28. Union relationship
29. Improve labour relations
30. Progress down experience curve
31. Improved purchasing power
32. Service efficiencies
33. Stabilization of inventories
34. Related production facilities
35. Reduced operating costs
36. Spreading of overheads
37. Rationalize transportation
38. Experienced operating management

Supplementary Criteria

Human Resources

1. Directors and officers
2. Executive line management
3. Staff functions
4. Operating line management
5. Sophistication of management tacks
6. Production worker skills

Facilities

7. Compatibility with existing equipment
8. Utilization of spare capacity
9. Production of related items
10. Integration of administrative facilities
11. Combination of storage and distribution

Technology

12. Unexploited R & D
13. Improved production process
14. Product design
15. Product engineering
16. Automation potential
17. Quality control
18. Bidding and pricing
19. Customer service

Marketing Resources

20. Sales force
21. Dealers and distributors
22. Customer needs
23. Advertising efficiencies
24. Public relations

Operations

25. Supplies
26. Customers
27. Unit pricing
28. Order size
29. Industrial relations
30. Government regulation

Finance

31. Unused credit
32. Cash flow pattern
33. Information systems
34. Planning abilities
35. Data processing capacity

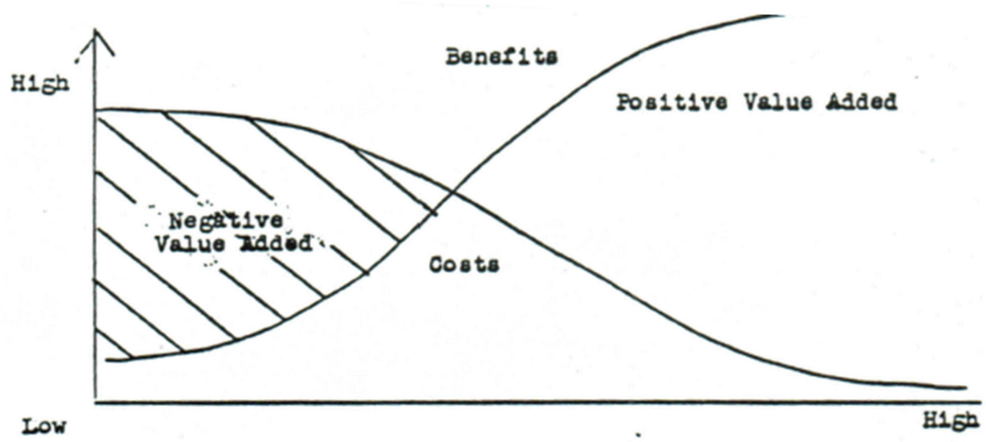
Value Added Merger Decision Rules

For Buyer

- Buy if transaction price is less than value added plus stand-alone value of target
- Pass if transaction price exceeds 150% of value added plus stand-alone value

For Target

- Usually reject first offer; it is often a sighting bid
- White knights can be found (customers, competitors)
- Look for sugar daddies (foreigners, hungry brokers, empire builders, the cash risk, shrinkers, star worshippers)
- Sell if premium over stand-alone value is substantially part of value added (say over 90%)



Components of Value Added

Operational Benefits

- Sales and Marketing
- Costs and Production
- Research and Technology
- Resource Utilisation
- Management and Systems

Financial Factors

- Credit Rating
- Taxes
- Risk
- Ownership
- Investor Standing

Costs

- Transaction
- Conformity
- Managerial
- Learning
- Opportunities ForeGone

Merger Evaluation Example

Dupont Acquires Conoco - Value of Merged Companies

Final Offer (July 1981)

- $98 cash for 45% (39M CONOCO Shares) and
- 1.7 Share Dupont for each of remaining 55% (48M COMA. Shares)

	$M	**$M**
Value of Dupont - pre merger 156M shares at $46.50 (pre offer price)		7,254
Stand alone value of Conoco – 87M shares at $50 (pre approach)	4,350	
Gain on sale of Hudson's Bay Oil & Gas	245	4,595
Amount added by Merger		
Operational Benefits		
Sales & Marketing	-	
Costs &-Production - Secure feedstodk supply 15% increase in DuPont earnings	1,085	
Research & Technology - 20% increase ($200M) in.Conoco profits in 5 years x PE(6) x 20% risk factor	240	
Resource Utilization	-	
Management & Systems - 10% increase ($100M) in Conoco profits in 3 years x PE(6) x 50% risk factor	300	
Financial Factors		
Credit rating decline- AAA to AA	-	
Taxes - increased depletion ($100M/yr) x 50% x PE (6) x 90% risk factor	240	
Integration risk	-	
Ownership changes	-	
Investor standing - PE decline: (9.3 to 8.0) due to chain diversification (1.3 x 156M x $5.00)	(1,014)	
Costs		
Transaction	(15)	
Systems uniformity	-	
Managerial changes	-	
Employee learning - 2.5% of Conoco value	(115)	721
Value of merged companies		12,570

Dupont Shareholders Position		**$M**
Value of merged companies		12,570
Cash portion - 39m Conoco shares @ $98		(3,822)
Post-merger value Dupont shares		8,748
Common shares outstanding		**M**
Pre merger		156
For Conoco - 48 M x 1.7 (exchange ratio)		82
Post merger		238
Value per Dupont share		
Pre-merger		$ 46.50
Post-merger		$ 36.82
Change		-20.8%
		$M
Post-merger value		8,748
Value at 1981 low ($35.75 in December)		8,508
Decrease		240
Decrease from post merger value		-2.7%
Value added by merger		721
As % of Dupont pre-merger value	**Impact**	9.9%
Allocated to Dupont shareholders	-21.0%	(1,525)
Conoco shareholders	48.9%	2,246
		721

Conoco Shareholders Position	**$M**
Offer - cash	3,822
- shares - 82m Ddupont shares at $36.82	3,019
Purchase price	6,841
Stand alone value	4,595
Premium	2,246
Value added	721
Multiple of value added	3.12

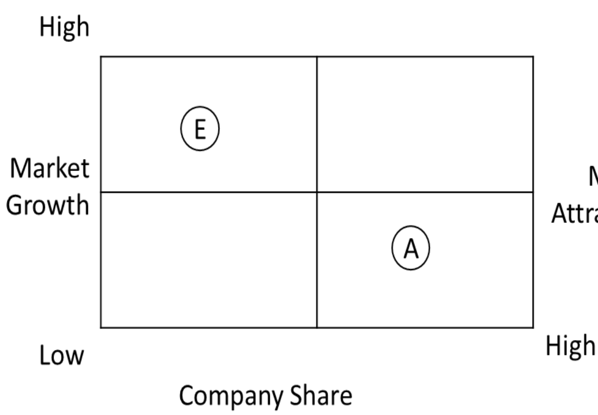
Divestiture Evaluation – Industrial Products Inc.

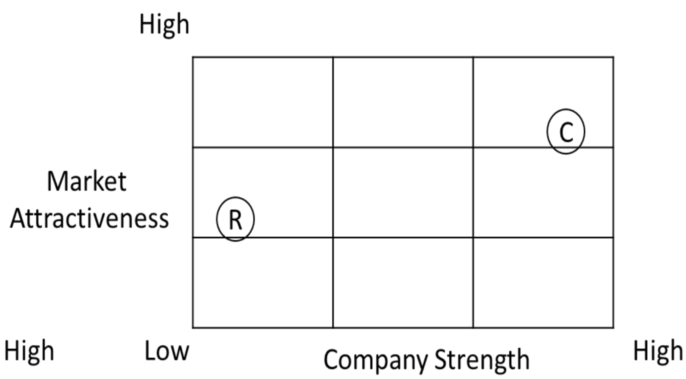
Four divisions:

- Abrasive
- Chemicals
- Rubber
- Electronics

Each has sales of about $100 M but different strategic and financial outlooks.

Product Portfolio Analysis





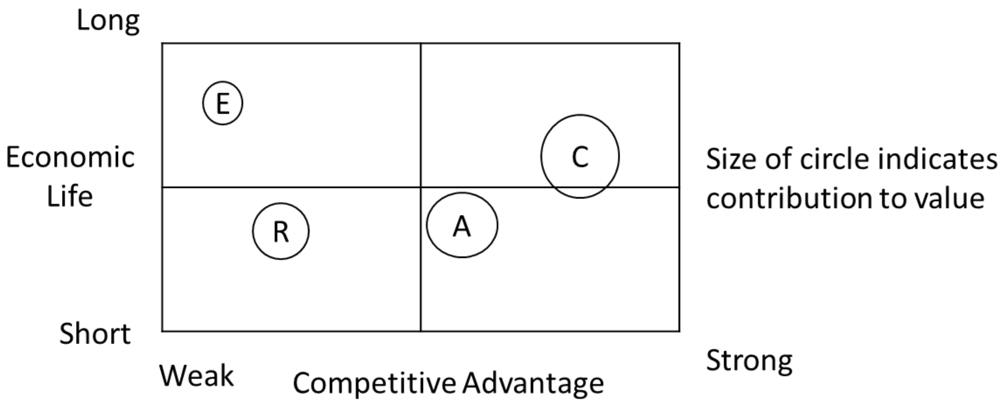
Division	Margin	Economic Life	Risk	Capital Requirements	Status	15% ** NPV ($M)
Abrasive	20%	Short	Low	Low	Cash Cow	71.4
Chemicals	20%	Long	Medium	High	Star	191.3
Rubber	5%	Short	Low	Low	Dog	17.9
Electronics	-2%	Long	High	High	Wildcat	7.3
						287.9

* *After R&D increasing to 8% of sales in year 6*

** *Company Hurdle Rate*

		High	Low	Last
Shares Outstanding	10,127,256			
Stock Market Prices	last 12 months	$ 34.125	$ 23.625	$ 27.500
Market Capitalization	$M	345.6	239.3	278.5
Net Present Value	$M	287.9	287.9	287.9
Apparent Value of Synergies	$M	57.7	(48.6)	(9.4)

Value Contribution Analysis



Alternatives for Electronic Division	**Net Present Value (NPV) $M**	**Risk**
Expand - increase investment (margins 14% from year 6)	53.5	High
Expand - acquisition for $? (double sales - 2% margin	56.1 less acquisition	Medium
Form Joint Venture	?	Low
Rundown - low investment	36.8	Low
Divest for $4.4 M (60% NPV and reinvest in other divisions at 15%)	32	Nil
Close down	17.7	Nil

Rule of Two & One Half

Developed by Tony O'Reilly, President & COO of H J Heinz Company.

In reviewing any project assume:

1. It takes twice as long as expected.
2. It costs twice as much as expected.
3. Half the return is half that projected.

If the resulting benefit is better than leaving the funds in the bank or government bonds, put the deal on the acceptable list.

Successful Acquisition Decision Making

1. Formulate acquisition criteria consistent with overall strategy.
2. Rigorously apply them. Don’t let acquisitions become plaything of CEU.
3. Do not react to what is available go out and find what you want.
4. An experienced specialist can usually improve the quality interest of the merger decision process and reduce management learning time.
5. Reduce risk by involving operating management as well as staff in the merger analysis and discussion.
6. Apply rule of 2 1/2 to estimates of future funds acquired and management time demanded.
7. Give responsibility for running acquisition to managers involved in the sale.
8. "Practice makes Perfect" – the more prior deals the higher the chances of success.
9. Unrelated acquisitions increase the risk (one survey says two out of three not totally satisfactory) and do not add to returns.

