MITSloan CFO SUMMIT
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9TH ANNUAL
MIT SLOAN CFO SUMMIT
November 17th, 2011

EXECUTIVE SUMMARY

CFO AS A DEALMAKER

Executive Summary sponsored by:

THOMSON REUTERS

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CFO As a Dealmaker

- Moderator: **Andy West**, Principal, McKinsey & Company
- Speakers: **Tim Collier**, Senior Vice President, Finance, Thomson Reuters
  Bill Kurtz, CFO & CCO, Bloom Energy
  Michael Levitz, CFO, Analogic Corporation
  Moni Miyashita, Vice President, M&A Strategy, IBM

Overview

The CFO's role has expanded beyond traditional control, finance, and compliance. Increasingly it now includes using M&A to shape the makeup of the corporate portfolio. Expectations for CFOs are high that M&A will create value and help transform an enterprise. CFOs must understand an organization's vision and strategy and engage in deal making to bring this strategy to fruition.

This increased emphasis on M&A requires that CFOs be able to balance financial analysis, corporate aspirations, and cultural issues. Also, CFOs are increasingly involved in the execution and integration of acquisitions. This requires developing capabilities to effectively manage acquisitions to deliver the value creation that has been promised.

Context

A panel of senior finance professionals discussed how CFOs shape company strategy and performance through M&A.

Key Takeaways

- **The Dealmaker CFO requires strategic vision, business knowledge and persuasive leadership.**
  CFOs must understand more than the numbers. They must play a key role in setting strategy by being intimately familiar with the company's products, services, technology, competitive landscape, customers, and suppliers.

> *"I believe it is important for the Finance team to be key business partners rather than just accountants rolling up numbers.*
> — Michael Levitz, Analogic

  Techniques used to become respected strategists:

  1. *Set strategy and take responsibility for the execution*. It is one thing to do a deal and another to own it and to make it work.
  2. *Establish attainable goals*. One of the most powerful things a CFO can do is to set appropriate goals and hold employees accountable for achieving them.
  3. *Enable good business decision making*. Instead of simply collecting data for SEC reporting, a team at Analogic analyzed the needs of business leaders for financial information. After changing the chart of accounts, business leaders saw Finance as a source for valuable data.

- **Consistent risk metrics are key to building complex M&A portfolios.**
  Thomson Reuters uses M&A as a key strategic tool. So far in 2011, it has made 30 acquisitions totaling $2 billion and has divested businesses worth around $2 billion. The company drives this strategy by using consistent metrics established by the CFO for evaluating M&A risks.

> *"The CFO has to ensure that the right conversations are happening. You must try to frame the risk that will be taken in an acquisition."*
> — Tim Collier, Thomson Reuters

  The CFO's job is to frame the risks that will be assumed during an acquisition. Thomson Reuters uses seven metrics to quantify risk. They are:

  — *Three standard financial metrics.*

  1. Internal rate of return (IRR)
  2. Earnings before interest and taxes (EBIT)
  3. Return on invested capital (ROIC)

  — *Four non-standard metrics.*

  4. How quickly the transaction will increase cash flow
  5. The payback period
  6. How long it will take to finish the integration
  7. The split between present and future value, which identifies where risks are

  To classify deal risk, Thomson Reuters uses a traffic light system where red is high risk, orange is medium, and green is low. Although many people believe only low-risk projects will be approved, that isn't true. The goal is simply to frame the risk, so the team can ask the right questions.

  Mr. Collier emphasized the power of standard metrics. Thomson Reuters holds people accountable to these metrics, using an 18-month period and quarterly acquisition reviews. Bloom Energy has a similar practice, holding annual portfolio reviews for the first three years post-acquisition. When people know what they are accountable for, the execution of an acquisition stays focused.

- **When organizations have a clear strategy, CFOs can use M&A to drive portfolio management.**
  IBM relies heavily on portfolio management to achieve its financial goals. This approach has helped reshape IBM.

Twenty years ago, half of IBM's revenue came from hardware. Company leaders recognized the need to evolve into a software, services, and solutions provider. In the last 10 years, IBM has had a major divestiture almost every year and has purchased 116 software and services companies.

> *"A very important element of portfolio management is using M&A on both the divestiture and acquisition sides."*
> — Moni Miyashita, IBM

Ms. Miyashita maintains an M&A roadmap which shows the company vision over the next five years. Each acquisition is based on this roadmap. This creates clarity for employees about the company direction and their role in it.

This shift has profoundly affected the company's finances:

— *Business composition.* Today, 80% of IBM's business comes from software and services. Software used to account for 25% of IBM's profitability and is now 44%.

— *Margins.* In 2000, revenue was $84 billion and pretax profit was $9 billion (10.7% margin). Last year, with revenue of $100 billion pretax profits were $21 billion (21% margin).

In May 2007, IBM made a bold move. Earnings were $6 per share and the CFO announced that in 2011, IBM would deliver $10 to $11 per share. This would be accomplished through: 1) revenue management, focused heavily on portfolio management and M&A; 2) share buy-backs; and 3) cost and expense reductions. In January 2011, IBM announced earnings of $11.60 per share.

Since M&A has been so central to portfolio management, IBM has set a target for 2015 that 90¢ of EPS growth will come from M&A. This will be monitored on every deal. If the 17 deals closed in 2010 make their numbers, they will deliver about 60% of that target in 2015.

- **Both financial and organizational factors make or break a deal.**

Due diligence on a deal's financial aspects is essential. However, CFOs must also recognize the importance of organizational factors such as culture and processes. When evaluating deals the panelists recommended:

1. *Understand the numbers*. During due diligence, the top-line numbers often look very appealing. Further analysis may reveal, however, that revenue growth is not sustainable or it isn't from the product that the acquirer wanted to buy.
2. *Trust your instincts*. During due diligence sessions, the team may not trust what they have been told and their instincts are usually right. Those are the deals companies should walk away from, but it is hard to do.
3. *Recognize the importance of cultural fit*. When buying smaller companies, a major challenge is maintaining an entrepreneurial environment while working within a big company. It can be a struggle to overcome the "us versus them" mentality. The more open that acquirers can be, the better. Although many cultural differences can be overcome, some cannot.
4. *Consider process differences*. At large companies, processes are important. When IBM acquires a company, it compares the process differences across key functions. After buying a small hosting company, IBM did not impose its highly structured capital process. Instead, it pre-approved the company's five-year capital plan, with quarterly milestones.

- **Successful deals depend on efficient execution and integration.**

Execution and integration are key to successful deals. CFOs must identify potential obstacles to integration and strive to minimize them. The panelists emphasized:

— *Integration planning must occur before a binding bid*. As a serial acquirer, IBM creates an integration roadmap for each deal. For the recent purchase of an Indian firm a five-year plan was created. The company's back-end systems were integrated quickly with IBM's, but hiring was left with the acquired company. At Thomson Reuters, functional areas like HR and IT must sign off on the integration plan before a deal is done. This prevents surprises from occurring after the purchase.

> *"What's important is what happens after the deal closes, on the execution side. CFOs need the ability to flag issues so the company can reduce mistakes."*
> — Bill Kurtz, Bloom Energy

— *Productivity tools can't be underestimated*. CFOs should not ignore how time consuming it can be for staff to manage deal-related tasks. Easy-to-use productivity tools can help greatly. After Ms. Miyashita was asked to manage 15–17 acquisitions per year, she implemented a SAS-based project management tool. Today, about 5,000 people use that tool for deal integration.

— *A shared services model can improve integration efficiency*. When integrating a deal, it can be useful to analyze which functions should move to a shared services model and which should remain in business units. IBM, for example, identifies functions that belong at the corporate level, like analyzing real estate leases. After a deal is closed, such functions are handled by experts in a shared services center. On the other hand, some functions like sales stay with the business.

— *Organic opportunities may be easier to execute than inorganic ones*. Some companies have many internal investment opportunities. At Analogic, organic opportunities are often less risky than outside deals because the CFO knows who will execute the project. The

company has spent considerable time enhancing its team in different functional areas so it can take advantage of internal opportunities.

- **Talented M&A teams have outstanding people skills and business knowledge.**

A McKinsey survey of nearly 900 executives found that building skills, capabilities, and organizational capacity are key issues for CFOs. This "Organizing for M&A" survey is at www.mckinseyquarterly.com/Organizing_for_MA_McKinsey_Global_Survey_results_2891.

The panelists agreed with the overall findings from this survey and shared their thoughts about talent acquisition and development.

Thomson Reuters' corporate finance group has a deal-execution team of M&A specialists. Mr. Collier emphasized that talented M&A employees have strong people skills, rather than extensive experience with complex spread-sheet models. The best M&A teams understand who in-house will run newly acquired businesses, as well as the employees who are being acquired.

> *"M&A is not about creating clever spread-sheets with 17 models. It's about understanding people."*
> — Tim Collier, Thomson Reuters

Although IBM has in the past recruited investment bankers into its finance function, retention of these employees has been low because the pay is not comparable to what is available externally. The company has had more success bringing people in for M&A who know IBM's business.

To develop employees with high potential, Mr. Kurtz assigns people to projects outside their usual duties. For example, when the CEO asked him to source a rare material, Kurtz worked with a talented subordinate on an acquisition. That employee is now learning how to execute and develop a business, as the CFO of this new business.

Other Important Points

- **Early alerts.** Thomson Reuters embeds M&A into its strategic vision through a pipeline of acquisition targets that is reviewed each quarter. An early alert system identifies opportunities as they get warmer and the business units describe each deal's potential financial outcomes.

Biographies

Andy West (Moderator)
Principal, McKinsey & Company

Andy West is a leader of both McKinsey's Merger Management group and the High Tech Practice. He serves clients across a range of industries including software, consumer electronics, telecommunications, and life sciences.

Andy has helped drive effective post-merger integration as well as worked with clients on restructuring and performance transformation, salesforce integration, and building go-to-market strategies. He has worked with several of his clients to deliver rapid growth through serial acquisitions that include developing their overall integration approach; managing back-office consolidation; and helping build merger-management capabilities to support future acquisitions.

In his work on major global mergers and joint ventures, Andy has helped identify synergies and transformational revenue-growth opportunities. In such deals, Andy's role has included leading the management office; profiling the organizational health of the merging companies; creating change-management programs; and helping establish new corporate centers and governance models. He has also helped clients capture immediate sales opportunities arising from mergers.

Tim Collier
Senior Vice President, Finance, Thomson Reuters

Tim Collier is Senior Vice President, Finance and Business Development for Thomson Reuters, the world's leading source of intelligent information for businesses and professionals. As a member of the Investment Committee and a key player in the company's global growth strategy, he is responsible for managing the largest and most complex acquisitions and strategic dispositions in the Thomson Reuters vast global portfolio.

In this role Collier drives the analysis underlying the company's largest capital investments that generate cash flow and fuel Thomson Reuters growth. As well as advising Thomson Reuters on its purchase and sale candidates, he heads the Financial Planning & Analysis function (FP&A), as well as Internal Audit, and is charged with making informed decisions about the direction of Thomson Reuters businesses and the organization as a whole. He is also responsible for helping design the company's compensation plans, and advising senior management on linking pay with motivation and shareholder interest both on an annual and long-term basis.

His strategic vision and meticulous execution are complementary abilities that have been developed over an international career spanning industries and functions including banking, corporate, Treasury, insurance, audit, chief accounting officer and M&A. This nontraditional trajectory has prepared him for financial leadership in today's business community requiring diverse skill sets to operate globally and locally.

Collier's tenure at Thomson Reuters is distinguished by his record of converting tough financial challenges into long-term achievements, helping integrate the Reuters transaction and transforming Finance at Thomson Reuters into a modern era strategic engine, and laying the groundwork for the overall company's growth and expansion. Joining Reuters in 2002, Collier was tapped to reorganize the Treasury department, then to remake Internal Audit. Then he ran both the mergers and acquisitions team and the central finance operation where he became a key executive in the Thomson acquisition of Reuters.

Bill Kurtz
CFO & CCO, Bloom Energy

Bill has just over 30 years experience serving as either Chief Financial Officer for Fortune 500 companies and/or COO & CFO for fast growth Mid–Cap companies in both the East Coast and Silicon Valley. Bill joined Bloom in March 2008 as its Chief Financial Officer and Chief Commercial Officer and is responsible for leading Bloom's commercial contracts, finance, accounting, legal, facilities, HR and admin functions. Kurtz started his career on the East Coast as a Certified Public Accountant with PriceWaterhouse (now PriceWaterhouseCoopers, LLC) and then joined AT&T where he rose up the ranks during his 15-year career. He became a Corporate Officer at age 39 and held several high profile positions. Two of significance were AT&T Cost Czar, where he was responsible for AT&T's world–wide cost reduction program, and VP and Financial Officer of AT&T's $25B Business Markets Division. Bill also led the financial negotiations for the $15B acquisition of McCaw Cellular. Kurtz left AT&T and moved to the Silicon Valley in 1998 and operated as either COO & CFO or CFO of several fast growth start–ups, including Scient Corporation and 3PARdata that successfully made the transition from private to successful public, profitable companies. Prior to joining Bloom, Kurtz operated as CFO at Novellus Systems, Inc., a $2B global semiconductor equipment company, where he led the company's focus on improving its profitability and cash flow. Bill currently also serves on the Board of Directors for PMC–Sierra Inc and is Chair of their Audit Committees. He holds a bachelor's degree in Commerce (major in

Accounting) from Rider University and a Master's degree in Management Sciences from Stanford University.

Michael Levitz
CFO, Analogic Corporation

Mike Levitz is senior vice president, CFO, and treasurer of Analogic Corporation. Mike leads the Company's finance organization and its IT, strategic planning, and investor relations groups. Before joining Analogic in 2009, Mike was vice president and controller of the Cytyc business unit of Hologic Inc. and, prior to that, vice president and corporate controller of Cytyc Corporation. Mike also served as controller of NEON Communications, Inc. and was audit manager in the high-technology practice at Arthur Andersen LLP.

A certified public accountant, Mike graduated from the University of California at Santa Barbara with a bachelor of arts degree in business economics, with an emphasis in accounting. In 2011 Mike was a finalist for Boston Business Journal's CFO of the Year.

Moni Miyashita
Vice President, M&A Strategy, IBM

Moni Miyashita is Vice President, M&A Strategy, Investments and Relationships at IBM, where she is responsible for proactive M&A initiatives supporting relevant and timely acquisitions. She leads a bi–monthly M&A strategy forum with the top senior IBM executives to execute on the strategic and financial objectives of the 2015 roadmap and ensure M&A decisions are made from an enterprise–wide perspective. She makes strategic investments and manages IBM's Venture Capital portfolio of 85 funds in 15 countries to help gain early access to emerging technologies and companies. Moni manages IBM's relationships with all investment banks to gain insights and execute M&A. In her two years in this role, IBM invested more than $8.5 billion on 27 acquisitions.

Prior to this role, from August 2003 to July 2009 Moni was IBM managing director, M&A Integration. In this role she built and led IBM's first corporate practice to support integrating and tracking newly acquired companies. During the six years she held this position, IBM built its integration capability and spent more than $16 billion acquiring and integrating 75 companies.

After several finance management positions at IBM, in January 1999 Moni was appointed the Director of IBM Corporate Development Asia, headquartered in Tokyo. She was responsible for IBM's M&A activity in Japan, China, India, Australia, Korea and Southeast Asia. She worked with Business Unit and Country General Managers to support unique business requirements and execute M&A, divestitures and joint ventures across the region. In Japan, she served as an elected Governor on the American Chamber of Commerce in Japan's Board.

Moni speaks on M&A best practices at conferences, CEO Forums, Conference Boards, academia and with IBM and McKinsey clients. She serves in leadership positions for several organizations, including McKinsey's Merger Management Advisory Council, US–Japan Council's Board of Directors, Ridgefield Young Life Board, The Navigators International Executive Advisory Council and IBM's Strategy Executive Council.