

# Do Your Homework or Flunk the Acquisition

By George M. Taber

Last week Pittsburgh-based PNC Financial's announced takeover of Riggs Bank in Washington, D.C., collapsed in mutual recriminations and threatened lawsuits but then came back to life. It was a classic case of failed due diligence, the art of examining potential merger partners before the deal is finally closed. The deal was saved after Riggs agreed to accept a price 16% lower than the original offer. Nonetheless, PNC hadn't done proper due diligence on Riggs.

With corporate mergers on the upswing, as seen in giant deals like SBC Communications taking over ATT and Proctor & Gamble gobbling up Gillette, the timing for last week's due-diligence symposium could not have been better. The event was presented by the New Jersey chapter of the Association for Corporate Growth, a networking and education group that specializes in mergers and acquisitions.

The morning session of the day-long event was devoted to a series of in-depth presentations on the various aspects of due diligence, including financial, legal, tax and operational. State Treasurer John McCormac was the luncheon speaker. The afternoon sessions were break-out meetings on more technical issues and case studies of acquisitions.

Steven Pinsky of the accounting and consulting firm J.H. Cohn gave the day's best definition of due diligence when he said it was the "search for risk." The acquiring company should be going over all the financial records looking for what's not there. Pinsky said that revenues are likely to be down 5% to 10% in the year after a merger, while expenses could well be higher. Those developments result from the changes that take place after a merger, especially in the acquired company.

H. Glenn Tucker, a partner in the Newark law firm of Greenberg Dauber Epstein & Tucker, discussed the legal aspects. He urged the audience not to "rush a closing." Said he: "You may catch the rabbit but rue the day that you got into an agreement that's going to be nothing but trouble going forward."

Tucker urged acquiring companies to check all the contracts of companies being bought, especially verbal contracts that may not leave a paper trail.

Jill Harris, the senior tax manager for J.H. Cohn, took the audience through the tax issues involved in a merger. The driving factor for tax implications is how the deal is structured. There are basically three types of transactions: stock deals, asset deals and a hybrid of the two that's known by the section of the tax code (338(h)(10)) that allows it. There are a variety of advantages for the buyer and the seller in each type of transaction, and the final price could be affected by the type of deal structured. The bottom line for Harris: "Don't forget taxes and consider them early."

**Robert J. Iommazzo**, the managing director of NachmanHays-Brownstein, a Pennsylvania-based turnaround consultancy, discussed the operational issues involved in a merger. He said the acquiring company should carefully evaluate the business model of the company being acquired and evaluate the management. "You have to understand what makes the company work," says Iommazzo. That means interviewing people up and down the organization and not just top management.

After due diligence comes integration of the two companies. The vast majority of mergers fail to achieve the financial objectives because of poor integration. But that's a good topic for another symposium.