

M&A Integration: Looking beyond the here and now

PwC's 2014 M&A Integration Survey Report

March 2014

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PwC's Deals M&A
Integration practice*

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The heart of the matter

Early integration planning, accelerating the transition, and a sustained commitment to integration completion over the long term improve deal success.

Today's deals are more complex, broader in geographic scope, and far likelier to go off course than ever before.

The current business landscape requires a sharp focus and strong commitment to overcoming the key challenges inherent in the integration process, along with an open-minded approach to learning from fellow dealmakers who have reported areas of both success and difficulty.

At PwC, our experience shows three primary factors are creating a more complicated integration process in today's deals.

- **Doing bigger deals.** Companies cannot necessarily apply what they have done before on smaller deals to their new, larger-scale integration projects.
- **Doing different types of deals.** Venturing beyond a company's core competencies and acquiring outside of current or past experience, such as into new markets, channels, and products, can provide new sources of revenue, but can also be a double-edged sword, creating new pitfalls that impact long-term profitability.
- **Feeling stronger stakeholder pressures.** Stakeholders are stepping up their pressure on companies to deliver quantifiable deal value. This has increased emphasis on expediting the integration process and quickly communicating what has been achieved.

In 2008 and 2011, our tri-annual M&A Integration Survey Reports underscored the need for early planning and an accelerated transition as critical factors for successful integration.

This 2014 Survey Report confirms these factors remain in today's deals, and offers additional insights—showing that while early planning and rapid transition remain important, the commitment to integration completion over the long term can be the deciding factor for deal success.

To give you a distinct advantage in the M&A arena, this report shares the knowledge gained from your peers in the deal-making community, including integration survey findings and insights with charts and graphics.

An in-depth discussion

Deal success remains a challenge by any measure, but, in particular, a rise in transformational deals has increased the complexity of integration.

Finding #1:

Strategic and financial goals are easier to reach than operational targets.

Though it may be tempting to bask in the glow of a short-term deal well done, the heady flush of celebration can fade quickly once reality sets in after the first few months of deal close.

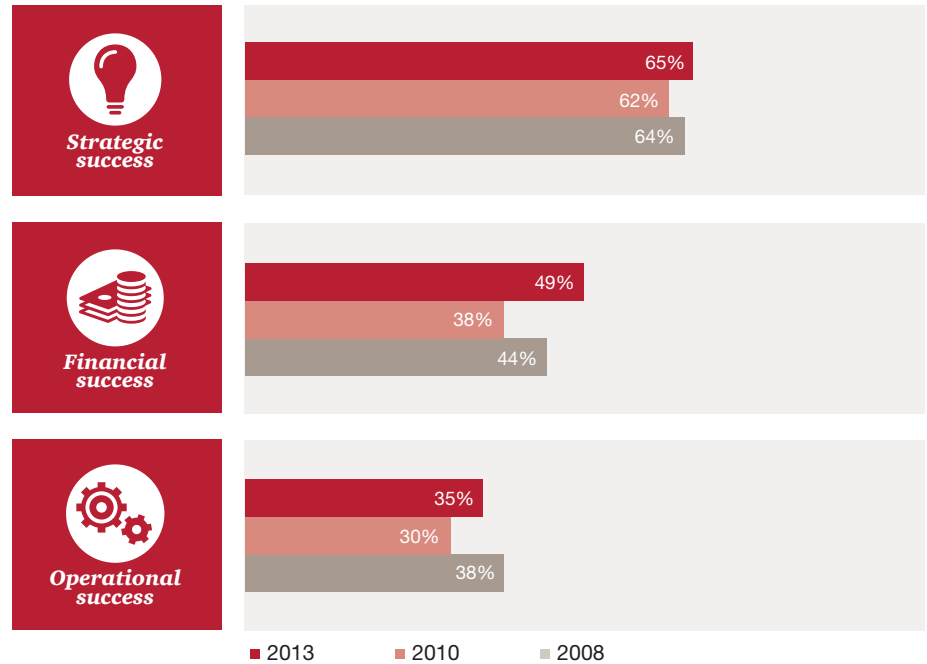
This is when it becomes clear that, consistent with our previous surveys, strategic and financial goals are easier to reach than operational targets, with operational success being almost twice as hard to realize. As **Figure 1** illustrates, the responses supporting this finding have remained remarkably consistent over many years.

In 2013, 65% of respondents characterized recent deals as a significant success from a strategic standpoint, while only 49% reported significant success in achieving financial goals, and only 35% reported significant success in realizing their operational goals.

While strategic goals can be achieved by simply “doing the deal,” financial goals are more elusive, requiring a focus on realizing synergies, and companies tend to focus on these to realize quick wins early on. Ultimately, operational goals are the toughest to realize as they can only be achieved through a sustained commitment to integration completion over the long term.

Figure 1: Strategic and financial goals are easier to reach than operational goals

Percentage reporting “significant” strategic, financial, and operational deal success:



Dealmakers also agree that deals don't always achieve the strategic goals intended. As **Figure 2** illustrates, similar to 2010, less than half of the respondents reported their most important deal objectives were completely achieved. The one exception was access to new markets at 58%.

- Access to new brands, technologies, or products increased in importance by 30%
- Access to new markets increased in importance by 24%
- Access to management or technical talent increased in importance by 27%

Survey respondents did show an interesting shift in 2013 on what they considered to be very important deal objectives.

These results are aligned with the shift towards more transformational deals, as discussed in more detail later in this report.

Figure 2: Deals don't always achieve the strategic goals intended

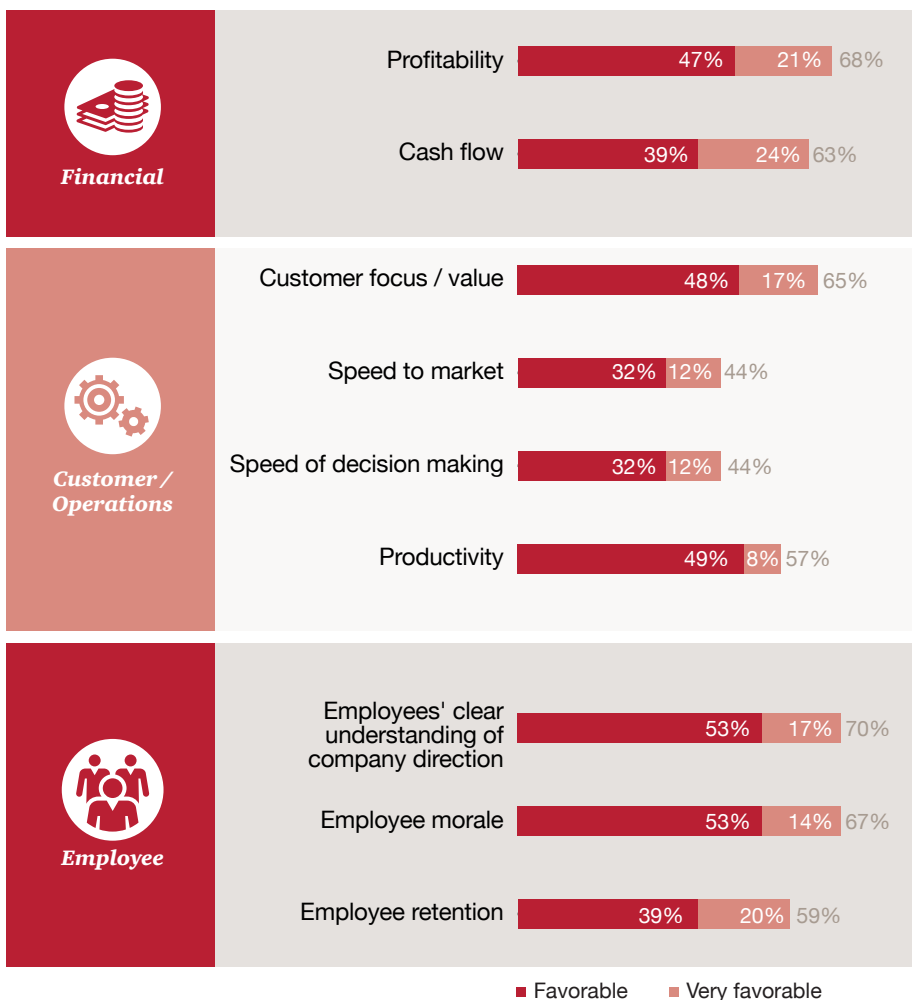
Percentage reporting deal objective was "very important" and "completely achieved":



On the whole, survey respondents did report encouraging success at meeting specific targets in areas of critical performance, as illustrated in **Figure 3**. These results were also significant improvements over prior years, suggesting companies have learned how to address some of the previous integration challenges they had faced. However, speed to market and speed of decision making continue to lag behind the others, both with less than half of the respondents reporting favorable or very favorable results.

Figure 3: Deal makers report some success at meeting their most important financial and operating targets

Percentage reporting “favorable” and “very favorable” results:



Finding #2:

Transformational deals are on the rise, representing more complexity and challenge for integration.

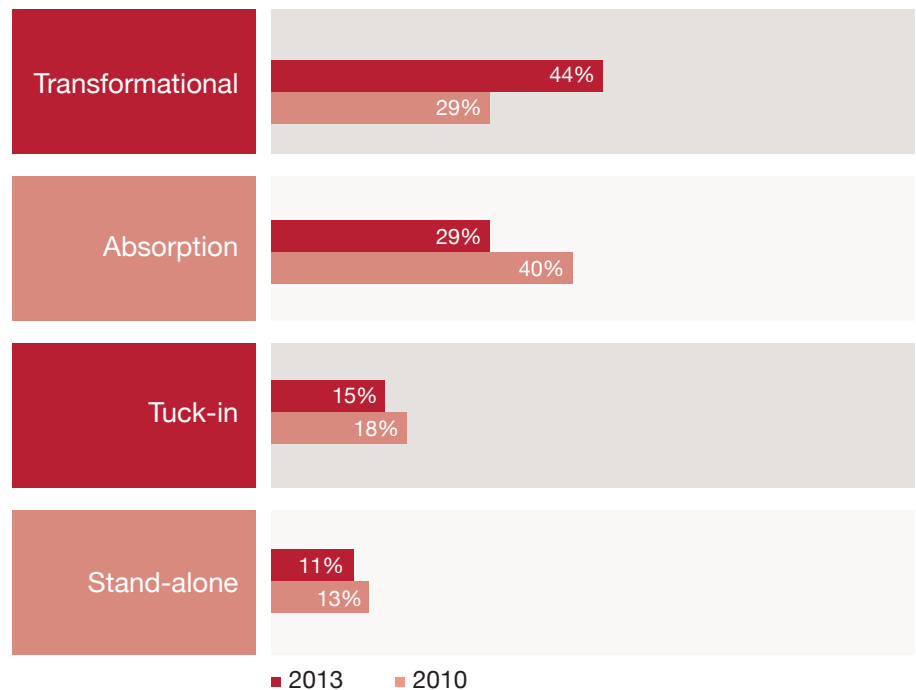
A marked shift in deal type has occurred over the past few years, from absorption deals to transformational deals (refer to the Deal Types box for a glossary of terms). **Figure 4** illustrates this shift, showing that from 2010 to 2013, survey respondents reported an increase in transformational deals from 29% to 44%, and a corresponding decrease in absorption deals by similar amounts, from 40% to 29%.

Deal Types: A Quick Glossary

- **Transformational**—Deals that involve acquiring new markets, channels, products, or operations in a way that is transformative to the fully integrated organization.
- **Absorption**—Deals that involve acquiring and integrating similar companies as their own, such as industry competitors. This is sometimes called consolidation.
- **Tuck-in**—Deals that involve acquiring and integrating relatively small companies, generally to pick up key products or technologies.
- **Stand-alone**—Deals that involve acquiring but not integrating, and keeping the newly acquired entity operationally separate from the rest of the organization.

Figure 4: Transformational deals are on the rise

Acquisition type of the largest acquisition in the past three years:



This offset makes sense when viewed against the backdrop of the overall economy, which was stronger in 2013 compared with 2010. In 2010, companies were still reeling from the recession that began in 2007, and absorption acquisitions (competitive consolidation) were more prevalent.

However, as economic health has improved over the past few years, less consolidation deals became available. As a result, today's companies are in search of new growth options, and increasingly look at new markets, channels, and products as a way to fuel much-sought-after growth.

We also asked survey participants to identify their level of experience with each acquisition type, and found that dealmakers are much more experienced with absorption and tuck-in deals than transformational deals.

In **Figure 5**, 50% or more of companies reported having a “core competence” in absorption and tuck-in deals, compared to only 24% reporting a core competence in transformational deals.

This is up from 2010, where only 10% of survey participants reported their companies as having a core competence in transformational deals. Perhaps not surprisingly, a significant gap still exists between the number of transformational deals being initiated and the much-needed track record and experience level in integrating these deals.

Survey respondents were clear that transformational deals proved the most difficult, likely due to their organization-wide scope and impact, requiring far more forethought and planning to drive successful outcomes.

As **Figure 6** highlights, experience has a profound impact on outcomes—the highest performing deals (those where respondents reported the highest level of success in all three areas of performance—strategic, financial, and operational) are those where companies also report a “core competence” for the deal type. The largest integration success rates were reported with absorption and tuck-in deals, which correspond to the highest levels of core competence.

Interestingly, transformational deals did not see any difference in performance success based on the degree of core competency. This is likely because transformational deals are newer and historically less frequent, and companies are still trying to figure out the best approach to integration. This is also likely why these same companies are still challenged in achieving their most important financial and operational goals.

Figure 5: Integration experience varies by deal

Experience level of respondents by deal type:

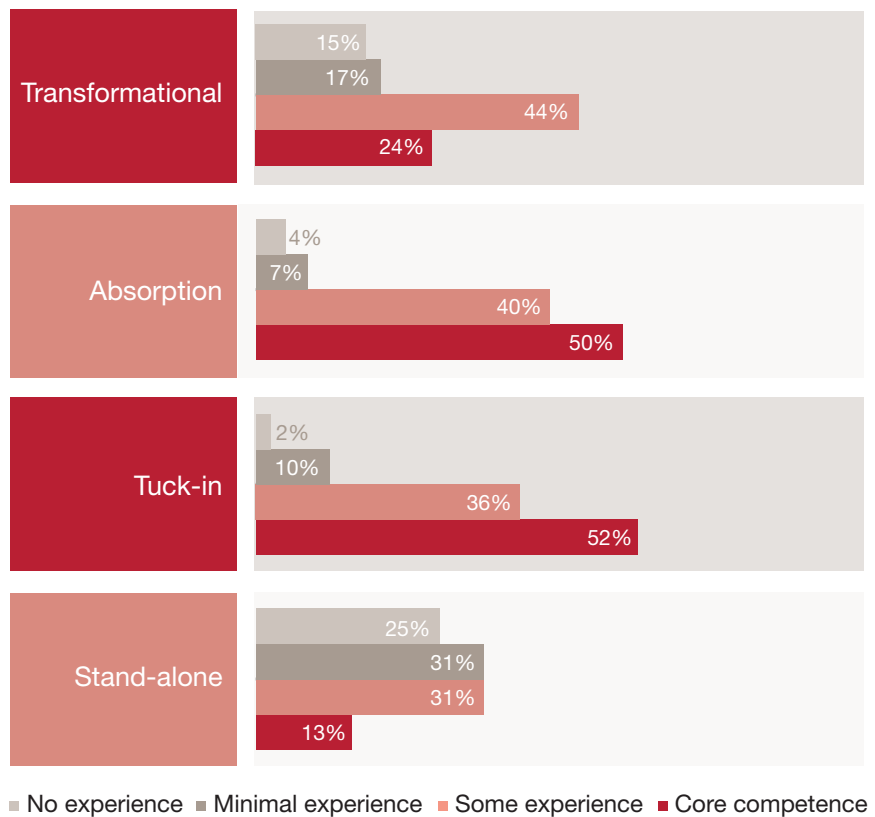


Figure 6: Companies report higher success in deal types where they have the greatest experience

Percentage reporting “core competence” level of experience by acquisition type:

	Among highest performing deals*	Among all respondents
Transformational	24%	24%
Absorption	64%	50%
Tuck-in	72%	52%
Stand-alone	24%	13%

* Deals where respondents report the highest level of success in all three areas of performance—strategic, financial, and operational

An in-depth discussion

Integration risks are plentiful, though some common areas pose the greatest challenges.

Finding #3:

Integrating information systems, operating procedures, and people represent the biggest post-close challenges.

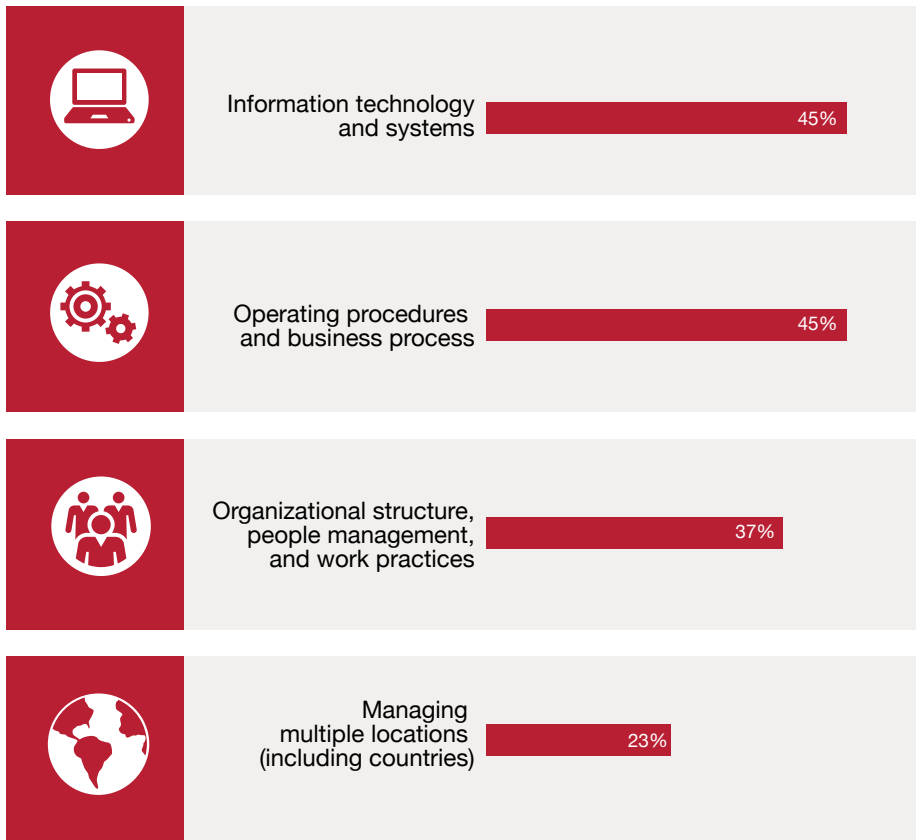
Integration risks can be found almost everywhere, and are in plentiful supply, though certain areas pose the biggest challenges. As illustrated in **Figure 7**, survey respondents reported integrating information technology and systems (45%) and aligning operating procedures and business process (45%) as the most common post-close difficulties, followed by getting the right organizational structure, people management, and work practices (37%).

Consistent with our prior integration surveys, and as expected for 2013, information technology (IT) integration is a major challenge and remains at the top of the list of integration issues. In 2013, of the 45% of respondents that reported IT as an area of post-close difficulty, 79% also reported that moderate to significant delays were experienced in meeting integration goals as a direct result of the IT difficulties.

Survey participants ranked post-close difficulties with aligning operating procedures and business process the same as IT integration difficulties. Perhaps this is due to the uptick in transformational deals that often require greater integration

Figure 7: Most common post-close integration challenges

Percentage reporting post-close difficulties were encountered:



collaboration and alignment between the companies to determine a “best” approach, compared to absorption deals that most commonly follow a simpler path of migrating to the acquirer’s procedures and processes.

Surprisingly, given their prominence and potential impact, people integration issues were ranked third on the list of post-close difficulties. This may be due to the fact that

companies are placing much more emphasis on “the people agenda” and are learning from the hard lessons over the years. This is also consistent with positive survey results regarding employee morale and employee understanding of company direction as previously shown in **Figure 3**.

Finding #4:

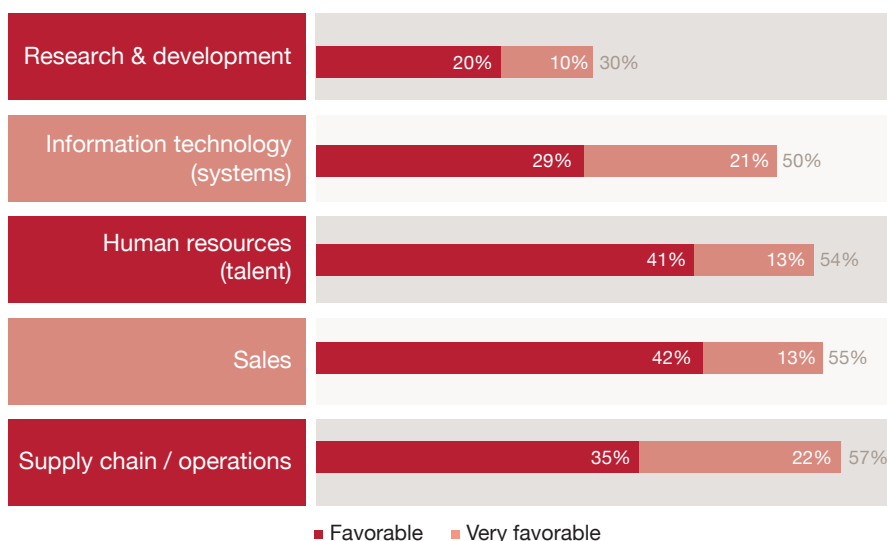
Integrating the Research & Development function and developing new products in connection with a deal have proven difficult.

Of all the functional areas, survey respondents overwhelmingly reported the Research & Development (R&D) function as the most difficult to integrate. **Figure 8** illustrates that only 30% of survey respondents reported either favorable or very favorable results in integrating R&D. While results for the remaining functions on **Figure 8** are consistent with our prior integration surveys, the relatively poor results identified for R&D are new for 2013.

Several factors may be giving rise to these results for R&D. First, the uptick in transformational deals is likely driving more focus on product integration. Second, the time it takes to realize benefits from product integration is often one of the longest integration milestones. And third, culture is often a critical driver of R&D results, and cultural barriers across R&D talent groups can prevent required collaboration to execute on the milestones.

Figure 8: Most challenging functional areas to integrate

Percentage reporting “favorable” and “very favorable” results:



In our experience, R&D is often a significant area of talent leakage after a deal closes. In an attempt to realize both revenue driving synergies and cost reduction synergies, companies may cut R&D talent for short-term gains at the expense of realizing long-term product roadmaps. Or R&D talent may find a more culturally compatible opportunity outside of the combined organization.

Consistent with the poor results reported for integrating the R&D function, survey respondents also reported developing new products as the least favorable result in connection with realizing synergies from a deal. **Figure 9** illustrates that only 39% of survey respondents reported either favorable or very favorable results in capturing synergies from new product development goals.

Finding #5:

Capturing costs synergies is easier than capturing revenue synergies.

Creating and capturing synergies from a deal is a significant challenge, and the results are far from desirable. **Figure 9** shows that 67% of survey respondents reported favorable results for capturing cost synergies, and results from capturing revenue synergies are much worse, with just over half (54%) of survey respondents reporting a favorable result.

The good news is the revenue and cost synergy results reported in 2013 are better than the results reported in our prior surveys.

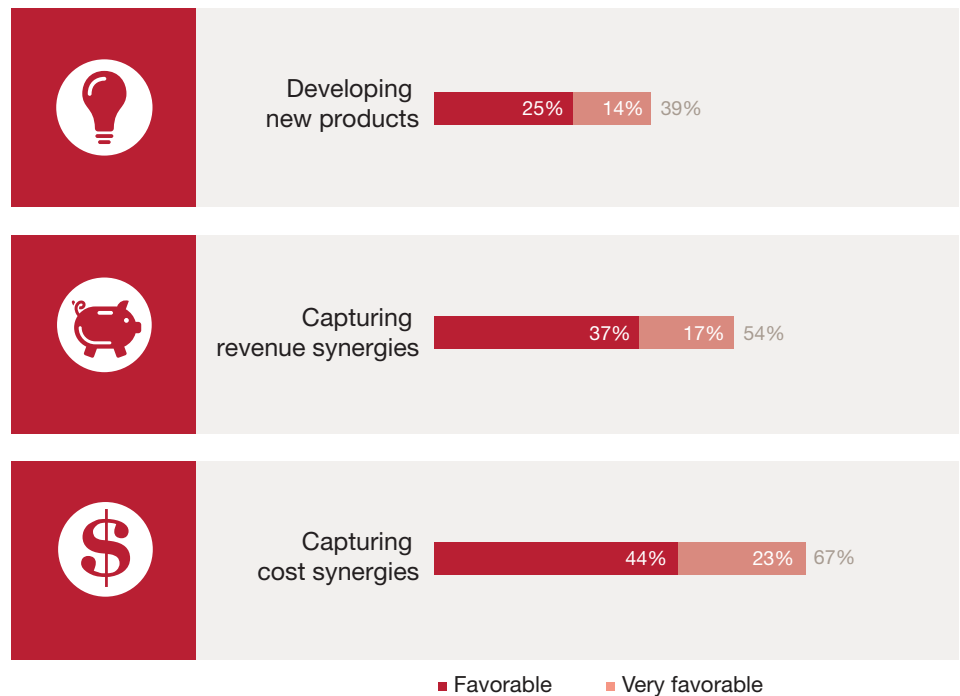
Additionally, realizing cost synergies have also consistently outperformed revenue synergies. One of the underlying reasons is cost synergies can be modeled using historical financial information, which is generally more reliable in predicting the future state than data used to model revenue synergies.

Access to information for cost synergies during and shortly after due diligence tends to be more available and reliable than information for revenue synergies, and the execution of cost synergy initiatives tends to occur much earlier in the integration process.

In contrast, revenue synergies are far more challenging to predict the future state. Revenue synergies are commonly based on prospective activity that relies on several variables to achieve, including what the market environment will be, what the market demand will be for a product, whether cross-selling a product can be realized, and whether a product can be sold into a new footprint or geography, among others.

Figure 9: Revenue based synergy capture and creation remains a challenge

Percentage reporting “favorable” and “very favorable” results:



An in-depth discussion

Success factors for establishing integration momentum involve early integration planning and rapid execution of specific activities.

Finding #6:

Performing integration planning early in the deal process improves deal results.

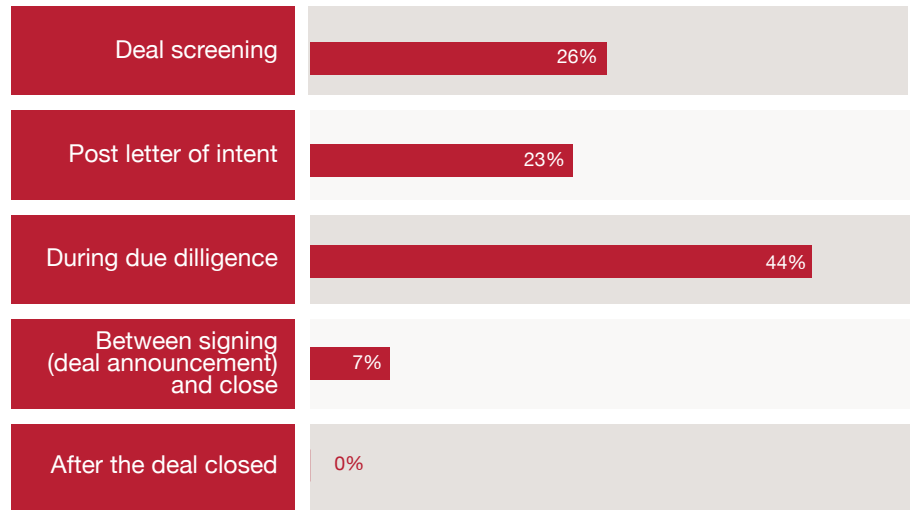
While integration efforts can often take years to fully complete, our survey results suggest a higher probability of achieving deal goals when planning starts early and integration is executed rapidly.

Underscoring the importance of early planning, the highest performing deals (those where respondents reported the highest level of success in all three areas of performance—strategic, financial, and operational) were characterized as having 92% of their integration teams starting work either before or during due diligence. And all of these teams included synergy assessments and integration planning during the due diligence phase.

Even those who believed their deals could have fared better echoed this fundamental belief. In looking back on their deals in hindsight, survey respondents were asked what would have been the best time for their companies to begin integration planning, and their feedback was clear—they would have started earlier in the deal process. **Figure 10** shows survey respondent results for the point when integration teams should get involved in the deal process.

Figure 10: The point when integration teams should get involved in the deal process

When integration team should have gotten involved:



Finding #7:

Speed of integration continues to play an important role in deal success.

Survey respondents indicated that performing integration at a faster pace than their company's normal operations led to greater success with achieving strategic, financial, and operational goals on their deals.

As **Figure 11** illustrates, survey respondents for 48% of the highest performing deals said their company moved at a faster than normal pace for integration, as compared to 30% of all respondents.

With the benefit of hindsight, survey respondents were then asked how their organizations ideally should have handled the integration, and 29% said they would have moved even faster.

Figure 11: Integration pace compared with the normal pace of operations

Integration pace compared with the normal pace of operations:

	Among highest performing deals*	Among all respondents
Faster than normal	48%	30%
Normal	48%	49%
Slower than normal	4%	21%

* Deals where respondents report the highest level of success in all three areas of performance—strategic, financial, and operational.

Finding #8:

Early and timely execution of a few key—but fundamental—integration initiatives are directly related to achieving deal objectives.

Successful integration needs to happen quickly and systematically. The period of time between deal announcement and deal close and the initial period post-close, are critical to realizing quick wins and setting the course to deliver deal value over the long term.

Deals create opportunities to introduce leading practices and redefine business processes and culture. They also provide the opportunity to boost performance by redesigning organizational structures and systems that might have remained the same if not for the deal.

As illustrated in **Figure 12**, there is a clear and direct link between the speed at which certain integration activities are pursued and the success of achieving strategic, financial, and operational goals. Those reporting higher levels of deal success also report a tendency to:

- **Align leadership within the first three months after close.** People naturally follow leaders, and the sooner leadership selections are made and organizations aligned, the faster people can focus on listening to leadership and mobilizing to implement integration tasks.

Figure 12: Connection between deal success and early leadership alignment, stakeholder communications, and operating policy integration

Time to achieve leadership alignment:

	Among highest performing deals*	Among all respondents
Immediately to 3 months after close	56%	44%
More than 3 months after close	44%	56%

Time to achieve stakeholder communication objectives:

	Among highest performing deals*	Among all respondents
3 months or less	68%	53%
4 to 6 months	24%	18%
More than 6 months	8%	29%

Time to fully integrate operating policies:

	Among highest performing deals*	Among all respondents
3 months or less after close	44%	25%
4 to 6 months after close	32%	29%
More than 6 months after close	24%	46%

* Deals where respondents report the highest level of success in all three areas of performance—strategic, financial, and operational

- **Achieve stakeholder communication objectives in three months or less.** Communication is a stabilizer to uncertainty. It helps to mitigate risks by proactively addressing the questions and concerns of all stakeholders, particularly the people within both organizations directly involved in the deal. Early and comprehensive communication increases customer focus, employee commitment and productivity, the speed at

which decisions are made, and overall confidence in the direction of the integrating business.

- **Integrate operating policies in less than six months after close.** Employees better understand how to focus their efforts when operating policies are integrated. Quickly integrating operating policies helps solidify awareness of the company’s direction, and better positions employees to focus on the activities that matter most.

An in-depth discussion

Delivering deal value over the long term requires commitment and focus.

Finding #9:

Staying involved in integration efforts longer improves deal success.

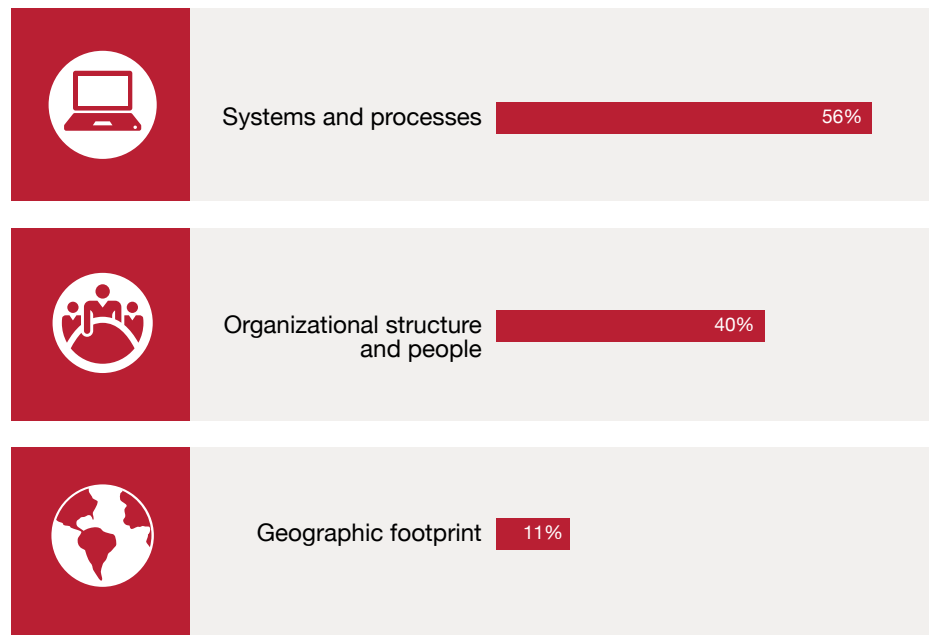
In addition to the link between deal success and the early execution of some critical integration activities, a strong connection also exists between deal success and the duration of integration activity.

We previously discussed that integrating information technology (IT) and people areas have, for many years, represented two of the top post-close integration difficulties reported by survey respondents (refer to Finding #3). **Figure 13** further illustrates that 2013 survey respondents also reported these as the top two integration activities not fully complete on their deals. This makes sense, as IT and people integration are a few of the activities often requiring the longest commitment to achieve.

What is a surprise is that survey respondents did not highlight geographic footprint as an integration area not fully complete. This was a significant concern starting in 2007 as companies began to acquire more overseas. Perhaps companies have gotten better at integrating cross-border, or perhaps they have come to understand cross-border deals do not necessarily always call for full integration.

Figure 13: Integration activities not fully complete

Percentage reporting integration activities not fully complete:



Finding #10:

Achieving full integration requires commitment and focus to delivering synergies, managing talent, and integrating information systems.

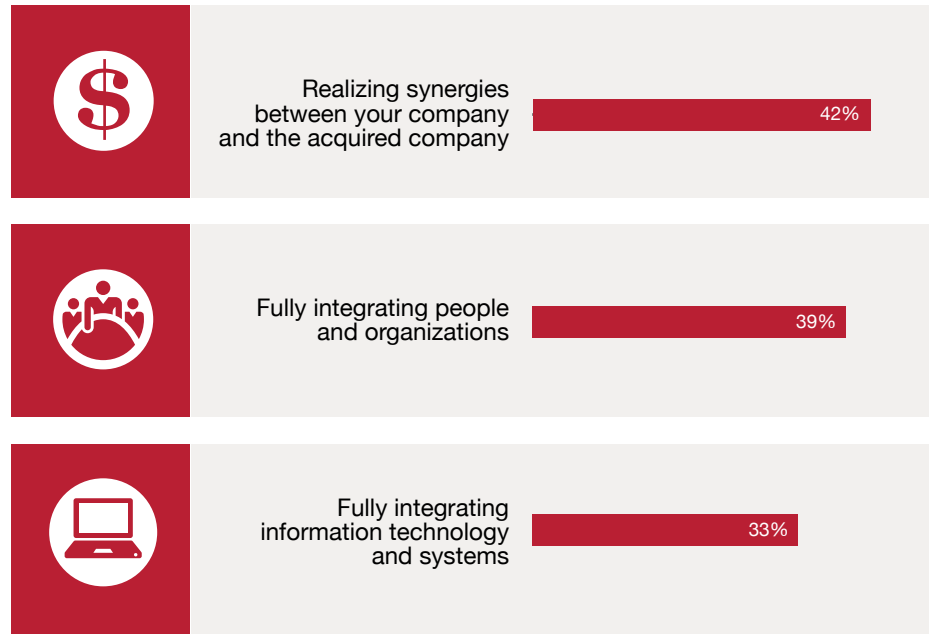
We previously discussed that, for many years, survey respondents have reported poor results in realizing their operational goals—only 35% reported significant success (refer to Finding #1). Ultimately, operational goals are the toughest to realize as they can only be achieved through a sustained commitment to integration completion over the long term.

Despite recognizing that integration commitment over the long term improves deal results, only 50% of survey respondents reported being completely committed over the long term. However, survey respondents for 68% of the highest performing deals did indicate their companies were completely committed over the long-term, showing that results improve with greater commitment.

Figure 14 further highlights the issue of long term commitment in a few critical areas. Only 42% of survey respondents report being completely committed to realizing synergies over the long-term. The results are even worse for long-term commitment to people integration (39%) and IT integration (33%).

Figure 14: Commitment level to completing integration activities over the long term

Percentage reporting “completely committed” over the long term:



Our experience shows that companies often lose integration momentum between six months and one year after deal close. The primary reasons observed include:

- Turnover in executive or deal management that reduces or eliminates accountability
- Changing economic, competitor, or business landscape that shifts focus to other priorities
- Unbudgeted or limited budget for integration costs to execute long term business process and systems integration
- Lack of discipline or set of integration processes to manage the long haul

To improve deal success, companies should stay focused on the value drivers behind the deal, and have a disciplined approach to delivering synergies over the long term. This includes developing a sound synergy model during the diligence process, building robust execution plans during early integration, and committing resources and capital to deliver, and effectively track, synergy progress against goals over the long term.

Without synergy tracking, there is no synergy reporting, and without synergy reporting, there is no evidence that the deal is being measured or managed effectively. Like the old adage says: If it doesn't get measured, it won't get managed.

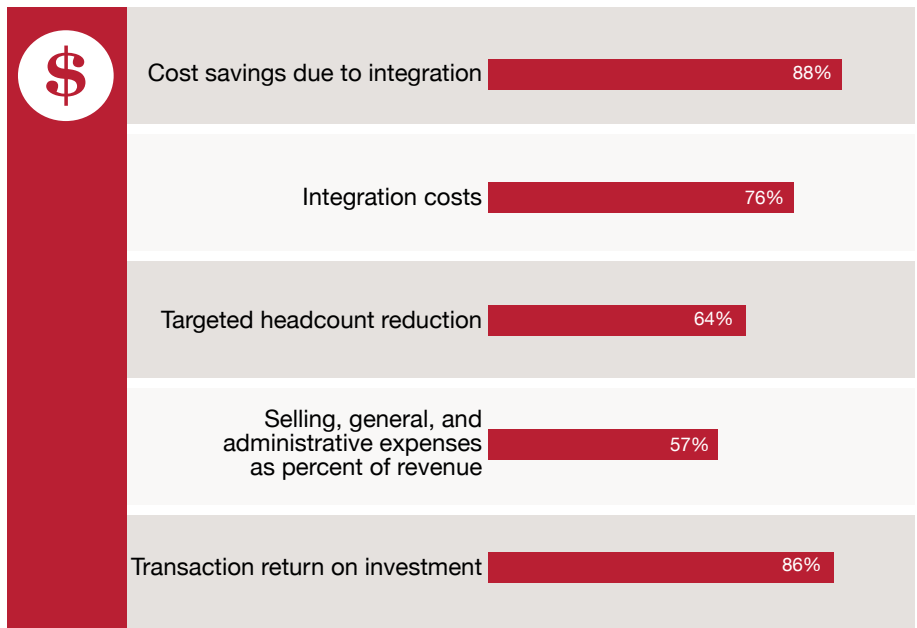
Deal Performance Indicators

Survey respondents with the highest performing deals reported applying more deal performance indicators than those reporting less success. Higher performers also reported that more of those measures were of greater importance to them.

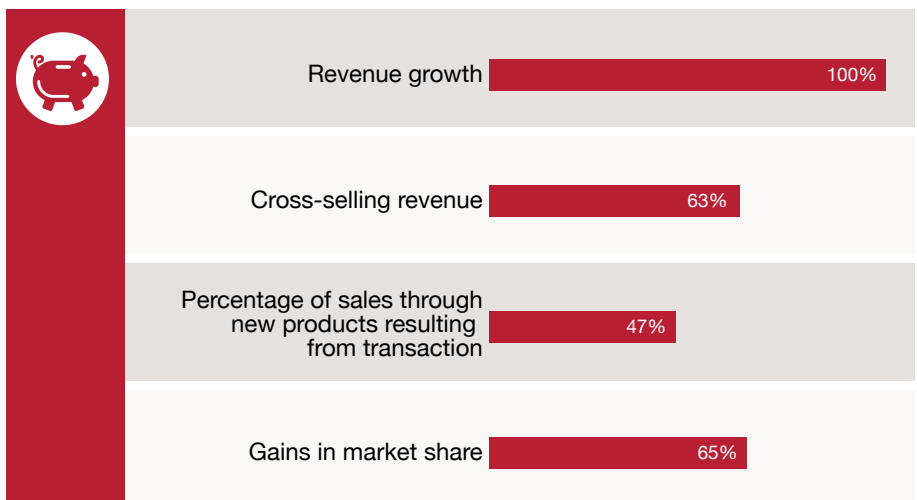
Figure 15 lists the types of cost and revenue related deal performance indicators most often used to measure integration performance and progress during integration implementation.

Figure 15: Use of deal performance indicators to track deal success

Cost-related deal performance indicators:



Revenue-related deal performance indicators:



What this means for your business

Integration planning should be supported by the right level of execution commitment to deliver the full value of the deal.

There's no mystery to delivering deal value. Dealmakers know instinctively what to do, and they have a good sense of how to go about delivering it.

But over-confidence or under-commitment in the face of a highly complex deal can be limiting, if not damaging. You can't afford either one—especially today, when more and more dealmakers are endeavoring to use M&A as a platform for business growth and transformation.

The 2014 M&A Integration Survey Report is clear on this point: If you're not planning early enough, acting fast enough, and thinking strategically about the long term right from the beginning, you could be leaving deal value on the table.

If nothing else, it's time to make an honest assessment of your company's integration practices in light of what you have read in this report.

In the deals you undertake, start by asking yourself a few key questions, answering them candidly and completely.

- 1. Are you focusing on the strategic, financial, and operational objectives that matter most to you and your company?**
- 2. Do you perform the integration activities that have the greatest potential impact on success?**
- 3. How focused are you on synergies and their measurement over the long term?**
- 4. What are you doing to engage your employees in the people side of M&A?**
- 5. When you plan for integration, do you get started early enough—and are you staying involved long enough?**
- 6. Can you benefit from stepping up both the pace and the commitment level for integration?**

Only you know the answers, but then again, so do your shareholders who see the value of their portfolios rise and fall based on the success of your deal making.

With a good strategy, the right target, and appropriate deal terms, M&A success becomes all about execution.

If you start integration planning early, accelerate the transition™, and sustain commitment to integration completion over the long term, you can enjoy the well deserved rewards that benefit both you and your company.

PwC's Seven Fundamental Tenets of Successful Integration

Capturing sustained economic value in a merger or acquisition is a significant challenge. Regardless of deal size, complexity, or geographic reach, some fundamental tenets are key to success for realizing deal objectives.

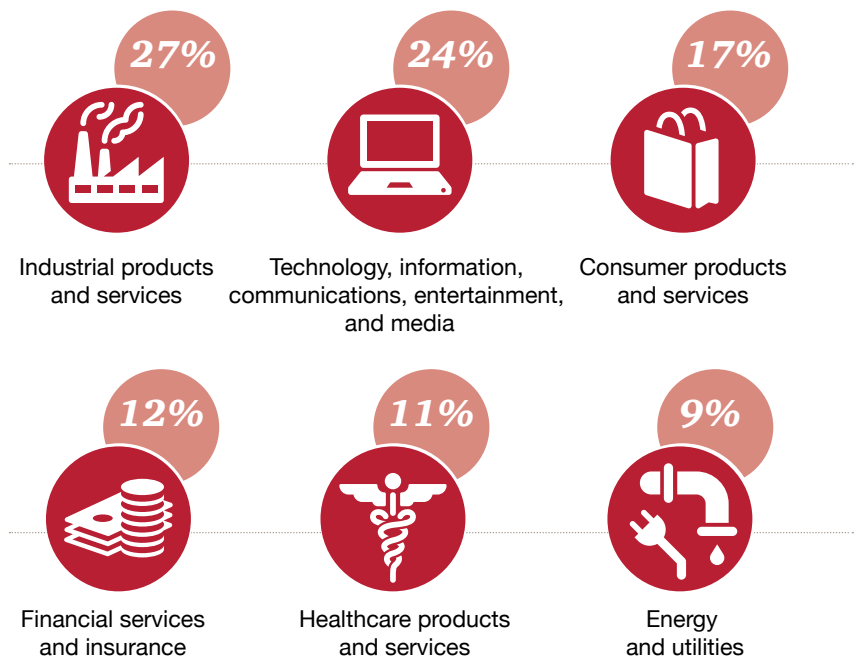
	<p>1. Accelerate the transition™. There is no value in delay. It is critical to focus on obtaining bottom-line results as quickly as possible to maximize shareholder value. Prolonged transitions slow growth, diminish profits, destroy morale and productivity, and can lead to missed opportunities and loss of market share.</p>
	<p>2. Define the integration strategy. Integration is a highly tactical effort, and the tactics must be implemented in ways that capture and protect the value of the deal. Integration priorities are easier to identify and execute when a clear integration strategy is well defined and communicated.</p>
	<p>3. Focus on priority initiatives. Shareholder value must drive the allocation of resources for meeting those priorities. First, potential sources of value capture and value creation must be identified. Then, resources are allocated based on potential financial.</p>
	<p>4. Prepare for Day One. Critical “Day One” tasks need to be identified early, before longer-term, more detailed planning commences. This allows for prompt identification of long-lead-time items, well before they can turn into closing day surprises.</p>
	<p>5. Communicate with all stakeholders. Communicate early and often with all stakeholders, including customers, employees, investors, suppliers/vendors, and the general public. Communication should articulate the reasons driving the deal, reveal timing for key actions, and be candid in nature about what is known and also what is unknown.</p>
	<p>6. Establish leadership at all levels. Integration efforts require significant, high-quality resources, including committed members of the executive team. It is critical to assign accountability, define functional authority, and establish role clarity.</p>
	<p>7. Manage the integration as a business process. The larger the transaction, the more challenging the integration, and the greater requirement for a well defined process to focus resources and capital on the right activities at the right times.</p>

Methodology

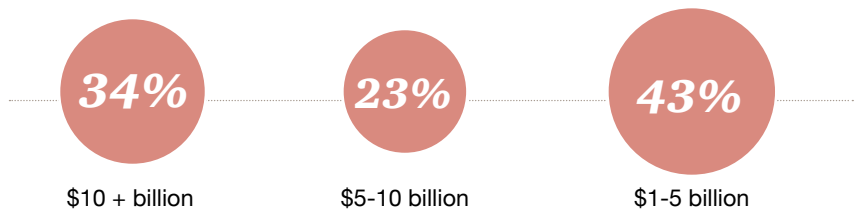
In late 2013, PwC surveyed senior management from a sampling of Fortune 1000 companies that had completed mergers or acquisitions in the previous three years. The goal of the study was to understand the current state of M&A integration practices and evaluate their impact on management's assessment of deal success.

We asked a third-party survey company to conduct telephone interviews with these executives. Respondents participating in the telephone survey were guaranteed anonymity for themselves and their companies and were screened to ensure they had direct, firsthand knowledge of the issues their organizations dealt with during the M&A integrations.

Industry:



Revenue:



Of the 106 respondents participating in the survey, 46% of interviewed respondents were at the senior executive management level, with titles including CEO, President, COO, CFO, EVP, and SVP. The remaining 54% were comprised of Vice Presidents from corporate development, strategic planning, operations, human resources, and information technology, among others.

If you would like to participate in future surveys, please contact pwcddeals@us.pwc.com.

Acknowledgments

For a deeper discussion on the content of this paper or other deal considerations, please contact one of our practice leaders or your local PwC partner.

Gregg Nahass, Partner
US and Global Leader,
M&A Integration
213 356 6245
gnahass@us.pwc.com

Jim Smith, Principal
US Leader, Delivering Deal Value
646 471 5720
jim.smith@us.pwc.com

Martyn Curragh, Principal
US Deals Leader
646 471 2622
martyn.curragh@us.pwc.com

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