

MAKING THE MOST OUT OF A MERGER

James Davies and Alex Moss of Close Brothers Corporate Finance detail the key stages any FD should consider for a merger, acquisition or disposal opportunity.

1. Initial steps in the process

- Assess the reason/rationale for any M&A initiative:
 - Fit, synergies;
 - Entry into new markets;
 - Removal of competitor;
 - Disposal of non-core operations;
 - Unlock shareholder value; and
 - Earnings per share enhancement.
- Public/private company or partnership? Which countries' laws apply?
- Competition Commission, DTI, industry-specific regulators or EC?
- Consider shareholder structure and shareholder attitudes:
 - Consider ease of deliverability/obtaining shareholder approval.
 - Vendor attitude to approach to be welcome or hostile?
- Are there other interested parties or has auction already started?
- Examine publicly available information before signing NDA giving access to private information but which may be too restrictive if you do not proceed.
- Information pack prepared on target by vendor, target or adviser.

2. Evaluate target/disposal

- Corporate structure, including subsidiaries, associates and JVs – may require JV partner approval.
- Is holding company structure needed before acquiring a division?
- Track record, financial history.
- Accounting policies and systems.
- Management strengths, weaknesses, ambitions.
- Personnel/HR information:

- Are there key personnel?
- Do they need to be replaced?
- Any onerous service contracts?
- Restrictive employment laws?
- Markets/products and services – market share/penetration by product/service lines.
- Customer-base, including consideration of key customers and customer spread – by sector and geographically:
 - Any sensitive governmental contracts or change-of-control provisions?
- Product mix and pricing.
- Industry: market forces, threats, opportunities and key competitors.
- Key customers/suppliers – if making a disposal, be wary of providing information to competitors/suppliers.
- Plan integration programme.

3. Advisers

- Can certain functions be performed in-house vs outsourcing to external advisers; eg, corporate finance and debt advisory?
- Who are vendor's advisers?
 - Any overlap/conflict of interest?
 - Are vendors' advisers credible?

4. Financial analysis

- Primary financial statements – historical and forecast.
- Obligations and contingencies.
- Banking relationships.
- Debt facilities and any prepayment conditions.
- Any shortfall in pensions funding?
- Which national GAAP is being used? Reconcile to UK GAAP.

5. Valuation

- Market methodologies: comparable quoted companies and comparable transactions, considering metrics such as total

enterprise value (TEV)/sales, TEV/EBITDA and industry-specific metrics (eg, sales per square foot).

- Other methodologies: asset-based valuation methods and discounted cash-flow analysis.
- Possible changes in operating environment – sustainability of earnings/threats/opportunities.
- Relevance of control premiums.
- Other considerations, such as assets for disposal, expected post-merger benefits and historical trends, one-off/exceptional gains and losses.

6. Financing/sources of funding

- Debt vs equity.
- Cash vs shares? Rights issue?
- Appropriate forms of funding: debt (bank, bonds, private placements, etc), mezzanine finance, leasing.
- Impact on acquirer's existing facilities and lending relationships.

7. Negotiations

- Who should front the negotiations with the vendor? Chairman? CEO? Financial adviser?
- How desperately do you need this acquisition? At what price does it become uncompetitive?
- Any other comparable targets?
- Reconciling buyer and seller price expectations.
- Competitive bidders?
- Timetable with key milestones.

8. Legal and compliance

- Form of offer – sale-and-purchase agreement, scheme of arrangement or offer document?
- Relevant country laws.
- Warranties and indemnities.
- Competition aspects and knock-on effects.
- Statutory, self-regulatory and best practise compliance requirements:
 - Disclosure of share dealing/bids.
 - Use of price-sensitive info.
 - Class test determines documentation and

regulatory requirements.

- Shareholder approval required by vendor and/or buyer? How will deal timetable be affected?
- Directors' duties, such as bid frustration, poison pills and golden parachutes.

9. Accounting issues

- Group accounting.
- Business combinations.
- Accounting disclosures in bid documentation.
- Accounting-based covenants.

10. Tax issues

- Tax liabilities.
- Tax implication of transaction.
- Impact of tax on choice of financing instruments.
- Regulatory requirements.
- Group structuring:
 - Use of intermediate holding co.
 - Flexibility for funding, taking of profit/dividend.
 - Losses in target company?
 - Base cost for capital gains tax.
- Stamp duty.
- Vendor tax issues.

11. Completing the transaction

- Legal due diligence.
- Offer documents/sale-and-purchase agreement.
- Other documentation, eg, any financing arrangements.
- Choice of form of new organisation after transaction.

12. Post-transaction review

- Expected vs actual results.
- Culture change and morale.
- Reorganisation.
- Common strategic vision.
- Lessons learned from process.

Edited by Andrew Sawers

A wide range of Briefings can be found at www.financialdirector.co.uk/briefing

Useful links

- Close Brothers Corporate Finance is at www.cbcbf.com