Fail to prepare, prepare to fail
In the battle for success: How to win the M&A war
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Introduction

In today’s M&A market, the challenges presented to advisers and dealmakers in bringing M&A transactions to completion are only increasing. Global market volatility, especially in the Euro zone, and dislocation of capital markets have exasperated challenges presented by changing and increasing government regulations. When executing deals, advisers must navigate this dynamic landscape, aligning their M&A strategy to the market focus; whether that means consolidating, or pursuing opportunistic buys.

In 2011, we saw a number of high-profile mergers and acquisitions that provided invaluable lessons for future transactions, both large and small. From successful buyouts, such as the Hewlett Packard® $12 billion takeover of U.K. software firm Autonomy®, to public dissolutions of deals, such as the failed merger of AT&T Inc and T-Mobile® in the U.S. There is much to be learned from these examples. What are the critical success factors inherent in all these deals that will help to avoid the common pitfalls that can contribute to the failure of a deal?

Considering these challenges in an ever-changing environment, there are many questions that surround the current state of deal-making:

- Why are certain transactions getting done; while others are derailed?
- Is this a result of market conditions or a fault of poor planning on the dealmaker’s part?
- In this battle, how do dealmakers identify good opportunities, both domestically and globally, and how, more importantly, do they take advantage of those opportunities to bring deals to a successful conclusion?

Merrill DataSite held a facilitated discussion with three industry experts to examine these questions and to find some answers that would provide strategies for successful deal-making.

A key theme that continued to recur was the need to prepare and prepare early in order to give a deal the best chances of success in a difficult market and when negotiating issues of regulation and compliance.

Our panellists shared their wealth of experience from the front lines of the M&A market, which is set out in the following pages of this ROUNDTABLE paper. Merrill DataSite would like to thank the panellists for their invaluable contribution:

- Leon Ferera, Partner at Jones Day®
- Mark Florman, CEO of the British Private Equity and Venture Capital Association
- Adrian Reed, Managing Director of Altium Capital
Panellist and Moderator Biographies

Leon Ferera, Partner, Jones Day
Leon advises clients in a wide range of industries on domestic and cross-border M&A transactions and has particular experience in public takeovers, having been seconded for two years to the U.K.’s Takeover Panel Executive, where he was responsible for regulating many takeovers of U.K. public companies.

Leon’s representative transactions include: Jupiter Property 2011’s takeover of Minerva Plc; CSR Plc’s acquisition of Zoran Corporation; and various transactions for WL Ross & Co. including advising as lead investor in Virgin Money’s acquisition of Northern Rock.

He is also a member of the working group on takeovers of the Corporate Finance Faculty of the Institute of Chartered Accountants in England and Wales.

Mark Florman, Chief Executive Officer, British Private Equity and Venture Capital Association
Mark joined The Northern Trust Bank, Chicago, in 1981 where he co-founded the interest rate swap business in America and worked in corporate banking, U.S. T-Bills and money and capital markets. From the mid-1980s, as a Director of County Bank and then as a Partner of Enskilda Securities Plc, Mark advised on corporate restructurings, M&A and equity capital markets.

In 1992, Mark founded Maizels, Westerberg & Co Ltd, which became the leading independent firm in M&A and corporate restructurings. Maizels established advisory businesses in shipping and structured finance and in principal investing.

Adrian Reed, Managing Director, Altium Capital
Adrian has extensive public and private transactional experience, providing lead advisory for AIM and Full List clients. He has advised on a wide range of public M&A transactions, including hostile and recommended takeovers, as well as fundraisings and disposals. Adrian has undertaken a wide range of private transactions as well, including development capital fundraisings, private equity backed MBOs and multiple disposal processes.

In March 2012, Adrian led Altium to the “Advisory Firm of the Year” accolade at the New Energy Awards and is Head of Altium’s Cleantech and Renewable sector team in the U.K.

Moderator: Merlin Piscitelli, Director, Merrill DataSite – International
Merlin started his career in 1997 with an executive search firm in Los Angeles after graduating from Florida State University. From 2003 to 2006, he worked as a Business development professional for Infotrieve Inc., an information management services company in New York. He spearheaded the sales operations of an internal business unit at Infotrieve and grew the business by over 160 percent.

Merlin joined Merrill DataSite in 2006 to help lead the International sales effort operating from London, the European headquarters. Since then, the International DataSite business has grown at a robust rate of 290 percent. Merlin has personally facilitated virtual data rooms to execute more than 1,700 online due diligence projects. He has also been instrumental in developing a wide client base in U.K., Russia, the CIS Region, Spain, India, South Africa and the Nordic region.
Looking at some of the larger deals that have come up in the last 12 to 18 months, why do you think Microsoft®’s acquisition of Skype™ and Hewlett Packard®’s buyout of Autonomy® were successful; while other mergers, such as the Deutsche Boerse AG and NYSE Euronext Inc, and AT&T Inc and T-Mobile® were derailed? And, to what extent does regulatory intervention and protectionism play a role in these failed deals?

The Deutsche Boerse AG and NYSE Euronext Inc deal was blocked on competition grounds and the grounds that it would create a near-monopoly in European financial derivatives. The same grounds were used to block the AT&T Inc - T-Mobile® deal, which was the largest deal announced in the Americas in 2011. That was blocked for antitrust reasons. But those weren’t the only ones. There have been a whole load of other deals around the globe that have been blocked for regulatory reasons.

To answer the second part of the question: to what extent does regulatory intervention and protectionism play a role? It has done and just to give some examples of deals that have failed: BHP Billiton Ltd’s bid for Potash Corp was deemed to be unlikely to be of net benefit to Canada under the Canada Investment Act; Singapore Stock Exchange for the Australian Stock Exchange; London Stock Exchange (LSE) for Toronto Stock Exchange (TSE); and the list goes on.

So yes, regulatory intervention and protectionism are factors. Some of those deals were legitimately blocked on antitrust grounds; others, you probably can say there were protectionist reasons for blocking the deals. And those factors are on the rise, for example, Brazil and India have new antitrust regimes. Hart-Scott-Rodino, the antitrust law in the U.S., has been substantially revised. It’s the biggest revision for a number of years to widen the scope of transactions that will be caught by the act, and to give broader powers to the regulators.

There are now over 100 merger regimes in the world with different filing requirements, assessment mechanisms and remedies, and this inevitably has an impact on the deliverability and the predictability of deals.

However, it’s not just antitrust - coming back to the protectionism question, in China there is a new national security regime that is being introduced, which will scrutinise large cross-border deals in strategically important sectors, such as defence, technology, key infrastructure, energy, resources and agriculture. Under that act, a deal can be blocked if the deal would have a significant effect on national security, but the problem is that there is no clear definition of what is meant by ‘a significant effect on national security’. There is also no clear indication about what types of businesses will be key and there is therefore a significant amount of uncertainty as to how that act is going to apply. Therefore there is a lot of fear that it’s going to be used in a protectionist way to block acquisitions that the Chinese government doesn’t want to happen for protectionist reasons.

There are three main lessons that can be learned from this:

- First of all, we’re in a period of significant economic uncertainty, high unemployment, and in that sort of climate levels of protectionism inevitably rise. So, it seems, that regulatory intervention and some degree of protectionism are going to be factors in M&A transactions for the immediate future.
- Because of the unpredictability and uncertainty that arises from that, it is even more important to be well prepared and to consider the regulatory aspects of transactions in a detailed manner at a very early stage of a transaction.
- Finally, it’s important to have a dialogue with regulators and key stakeholders very early on, so you can gauge their likely reaction to transactions, and take appropriate measures to address them, or even decide whether or not it’s worthwhile to proceed at all.
Merlin Piscitelli:
Adrian, I know you work on a lot of cross-border transactions. With what’s going on in the Euro zone right now, do you think that protectionism is on the rise as countries start to hunker down and really go for survival in some cases?

Adrian Reed:
I’m not sure that’s necessarily the case. I think ultimately the competition rules have been relative stable for quite a long period of time, and are pretty well bedded in. Big deals are always going to have competition and antitrust issues. Looking at the Deutsche Boerse AG and NYSE transaction, there’s always going to be an antitrust element to that, but what I would look to focus on is that anti-trust issues affect every deal down to relatively small level transactions.

With market addition rules, mandatory notifications in various territories, if you’ve got any sort of cross-border activity, then it’s likely the acquirer of the business, if it’s a trade acquisition, is going to have some activity in a range of similar territories to their target, unless it is a truly international deal where a Chinese or an Asian company is coming into the old-world economies. The key is to make sure, up front, you have thorough and careful planning, and that you know where your potential concerns are. The things that really concern us and shareholders are delays which are out of the control of the various parties involved, so mandatory notifications, split exchanges and completion – those are the things that you’ve got to be very wary of. If you’ve got somebody who you can up-front identify that they are not going to have those concerns, then you can immediately put them into the top tier of your potential buyers.

“The only lesson I’d take from the past few years is to prepare more – do more due diligence ahead of the start of the process.” Mark Florman

What we would say around this sort of question is: large transactions, yes, you’re always going to have an issue; you need to engage in a dialogue, probably up front, and it almost becomes a political question. But in normal M&A, you've always got to ask at the start of a process, in the preparation stage, before you launch it, where are the concerns going to be, where are the areas that your potential buyers might have large overlaps which might cause delays, and splits between exchange and completion, and make sure you factor that in to your broader process. If you do that, and you do the preparation, there shouldn’t be any surprises.

Merlin Piscitelli:
Mark, can you offer some colour on this topic - can lessons be learned or applied to all M&A transactions?

Mark Florman:
The only lesson I’d take from the past few years is to prepare more – do more due diligence ahead of the start of the process, and anticipate any new competition issues or regulatory issues.

Merlin Piscitelli:
From your perspective, what are the market-forces currently impacting the M&A environment? Beyond this regulatory and protectionism topic that we just discussed, what other things are really impacting the M&A environment?

Adrian Reed:
There are two factors in every M&A transaction: you need a buyer and a seller.
Now M&A transactions are being driven by a lot of very large corporates, and recent statistics have come out saying that U.S. corporates alone have almost $2 trillion worth of cash, which is greater than the previous peak in the mid-fifties, and they have very strong balance sheets, so they are increasingly financially capable of making acquisitions.

The key is, strategically, are those acquisitions right? They’re not just going out willy-nilly and going on an acquisition spree; over-stretching themselves. They need to make sure they’ve got appropriate management time, and the biggest theme throughout this is preparation, diligence, taking your time.

Transactions are much more collaborative nowadays, and gone are the days (apart from in a very small number of examples) where you can produce an information memorandum, pump it out to the world, and then run contract races. The large corporates aren’t prepared to play in those games; they want to take their time and make sure that they’re buying the right asset, and also that they’ve got the support of their shareholders.

In the U.K., a good example of that recently is Cooper Industries Plc, who made a hostile takeover for Laird Plc. It was a very public process, and while the Laird shareholders were saying the price wasn’t enough, in the end Cooper, bowing and listening to their own shareholders were prepared to pull out from that and look for more appropriate acquisitions, because there are plenty of other good businesses out there for large strategically and financially capable parties.

To answer your final question, it is less opportunistic nowadays – there is still that opportunity if there are distressed assets, but you’ve got to be careful with those and they also require quite an additional commitment in management time. But it’s more about industry consolidation and people looking for acquisition of products, customers, technology into markets that are complementary and fit within the core business activities of these large corporates.

Merlin Piscitelli:
Mark, what do you see impacting the M&A markets at this time?

Mark Florman:
I was thinking of the word ‘courtship’. Twenty-five years ago in America and Europe, we used to have a long period of understanding and a long period of courtship. If you were trying to buy a family company, for example, you had to be patient. You would make sure you understood the history and the future interests of the family vendor, and build that psychology into your acquisition strategy. You had to understand what you were getting into and that world returned with some vigour two or three years ago.

Adrian Reed:
People need to be realistic about the timeframes of deals. Trying to drive processes where the buyers are uncomfortable really doesn’t work anymore, and processes that used to take four to six months can now take nine to twelve months.” Adrian Reed

Adrian Reed:
People need to be realistic about the timeframes of deals. Trying to drive processes where the buyers are uncomfortable really doesn’t work anymore, and processes that used to take four to six months can now take nine to twelve months. Involving the principals and making sure both parties are comfortable with the deal, you leave a little bit on the table for both parties, which is probably the key way to get deals done nowadays.

Merlin Piscitelli:
In Merrill DataSite, we actually see that elongated due diligence cycle taking place, and it’s obvious that people are willing to take more time on both sides of the fence to make sure that it’s right.

Leon, what would your recommendation to dealmakers be in terms of how to align M&A strategies with current market forces? Everyone has said there are Corporations with large balance sheets, that have the money to do deals; and you have private equity money and private equity companies that have come to a normal term within the investment cycle – so what would be your recommendations be?
Leon Ferera:
There’s an interesting dichotomy at the moment. You’ve got a lot of companies that are sitting on large piles of cash, you’ve got private equity houses that have raised large funds and are under pressure to spend those funds.

Valuations are still low. They are not as low as they were, but they’re still low. You have companies that are de-leveraging, shedding non-core assets, so in theory now is potentially a time of opportunity for acquisitions – it’s a time to be doing deals. But at the same time, people are sitting on their hands to some extent because of what’s happening in the Euro zone, with unemployment and general uncertainty.

[According to the Financial Times] M&A volume was £574 billion for the first three months of the year, and that’s the slowest first quarter since 2004.

Although you have these various factors which suggest people should be doing deals, M&A volumes are down, and it’s just a question of time, of people regaining confidence. It seems, from what we are seeing that there is cautious optimism, but not enough to be driving significant volumes of M&A.

You have an election year in the U.S.; you have a bit of gridlock in the U.S. between the President and Congress; there has been an election in France; you have the Euro zone crisis. There are all these factors that are putting a bit of a block on M&A activity, so it’s a question of waiting for things to settle down and for companies to start regaining confidence that the time is right to do deals.

Merlin Piscitelli:
If we’re going to get deals done, do you think they’re going to be more on the opportunistic side, where people are looking at distressed assets, or will dealmakers take advantage of a low valuations in terms of stock price, or is it going to be consolidation? Where do you think the M&A activity is going to come from?

Adrian Reed:
Opportunistic buys are always there, and obviously there have been more distressed assets in the market recently. Distressed assets are quite a difficult element in the M&A market, because whilst you might be able to get things cheap, they’re cheap for a reason: there’s a problem with them. And, if you’re going to take something like that on, you need to make sure you’re prepared to commit considerable management time to turn them around and make sure it doesn’t become a bad apple spoiling the barrel.

From my perspective, M&A now is more and more opportunistic to the extent that sometimes there are businesses that just come on to other companies’ radar. But again, there needs to be a preparation phase, whereby companies looking to have a value realisation event go out and start speaking to some of the potential acquirers ahead of the process, and actually get them onside. Make sure the buying decision is something that evolves rather than is just sort of “slapped” on their desk and they have to then run and divert resources around it.

“Although you have...various factors which suggest people should be doing deals, M&A volumes are down, and it’s just a question of time, of people regaining confidence.” Leon Ferera

There has been a move over the last few years to a much more considered approach to M&A, and hopefully that will continue because we can’t just go into a situation where people keep buying things at any price and then creating problems for the parent [company].

Merlin Piscitelli:
What are the most sought-after M&A opportunities investors are seeking both globally and domestically?

Mark Florman:
I’ll speak from the point of view of both private equity and the corporate market.

In the U.K., the most attractive sectors in the past year or so have been – and I think they’ll continue this year – business services and support services, retail, the food sector, general manufacturing and...
distressed. I know I may be bias in this, but I think there’s never been a better time in Europe to look at investment opportunities across the continent. We’re still poorly consolidated in many industries. A large number of roll-up strategies and platform strategies are being undertaken by private equity firms building a pan-European industry strategy from one or two leading companies. I think a number of the private equity firms are very good at that.

Similarly, for corporate acquirers there are an enormous number of opportunities, especially in Eastern Europe.

Most of the focus is on industries that require further consolidation, and, if possible, could assume a market-leading position in the world. They could then gain market access to higher growth marks of Asia and elsewhere. I think that’s one of the main themes.

The second theme running in parallel, that is a focus on distressed sellers, and I include in that sellers that have not really admitted for many years that they are distressed, but have now decided that the time has come to reach a conclusion. There is still a lot of uncertainty over valuations and over price.

Merlin Piscitelli:
I thought that was going to be your number one thing: price and that people can maybe take advantage of a distressed Euro zone and feel that they’re getting negotiating power at the table.

Adrian, what according to you are the critical success factors that help while evaluating potential acquisition targets, especially in such a bouncy Euro zone market? How do you do that evaluation?

Adrian Reed:
The best acquisitions are good, strong, well positioned companies; good products and services, technology into a known market. And whether or not that’s being acquired by private equity or industry, they’re going to be the gems.

You can pick up those businesses, probably at a lower value than you could three or four years ago, but that doesn’t mean you can get them cheap. In evaluating acquisition targets, it’s all about strategic fit; if it’s a trade acquirer, they need access to the quality of information that’s required to assess it. Make sure you can speak to the management and the financial and legal information is there - also, time to do the job properly.

“I really do think there are some fantastic opportunities out there.” Adrian Reed

Corporates now are prepared to choose their acquisition targets and concentrate on them. Their M&A themes are smaller. They’re also less inclined to put forward things that are too racy or come too far out of left field, and don’t want to be rushed. You’ve got to have a very clear strategic reason if you’re going to spend that cash, or use some of the parent company balance sheet to under-pin the leverage you would need to make larger acquisitions.

Moving to the private equity – because it’s very relevant – what we’re seeing in private equity is that there’s a considerably lower amount of leverage in those sorts of transactions. You know, if it’s stock market companies, listed companies that have been taken off the market, it’s really just a case of rolling the existing debt (assuming it’s at a sensible level) and then the private equity companies coming in and replacing the shareholders from the listed entity, and then looking at how they can restructure it, take out any fat that could have been in that listed company, position it for growth and provide maybe an easier form of acquisition capital to go out on, roll-up plays.

I really do think there are some fantastic opportunities out there. Prices are at sensible levels. They’re not at rock bottom, meaning people won’t sell, but they’re not clearly at ridiculously high levels, meaning people are going to have to over-stretch themselves. The balance for M&A now isn’t quite as gloomy as you could paint it.

Merlin Piscitelli:
In terms of accessing capital, do you see anything in terms of size, industry, geography that is having a better success-rate than others?
Leon Ferera:
To focus on debt finance, debt finance is not as easy to come by as it was, and people wishing to raise capital still have to use fairly creative means to raise it. However, the strongest companies with the strongest credit ratings are not seeing many problems in raising acquisition finance and that spans sectors and geographies. It’s the borrowers with the credit ratings at the lower end of the scale who are feeling the pain in terms of liquidity and pricing.

Bond markets as well, for top corporate borrowers are one, and it’s those at the lower end of the borrowing scale that are encountering obstacles.

Turning to Europe for a second: when the Euro zone crisis settles, then perhaps companies at the lower end of the scale are going to find it easier to raise finance but that’s probably going to come at a bit of a price. So, we might see higher pricing, more recourse to the high-yield market, and alternative sources of finance. There are a lot of non-bank banks providing funding, for want of a better expression. So, for example, a lot of U.S. funds with access to significant capital seem to be stepping into the shoes of some of the traditional lenders, in the U.S. and in Europe.

Merlin Piscitelli:
Is there anything in “industry” there that you could comment on? You hit on size and geography as a whole, and the ratings that they’re going to have, but is there anything on industry that our audience would pick up on that you could see having easier access to capital?

Leon Ferera:
It’s going to be the industries that at present are viewed as being strong, so Resources, for example; Technology

“...A number of corporates are being encouraged to work with domestic supply chains, and therefore are also looking to control those supply chains, and to make acquisitions domestically of suppliers.”  Mark Florman

Mark Florman:
A number of corporates are being encouraged to work with domestic supply chains, and therefore are also looking to control those supply chains, and to make acquisitions domestically of suppliers. Politically there’s a sense across Europe that this would be welcomed.

Merlin Piscitelli:
What are you seeing in terms of discrepancy about how buyers and sellers are assigning valuations?
Remember 2008 to ‘09, there was just such a drastic difference between what sellers thought it was worth versus what buyers were willing to pay. I know that gap has closed. What are you seeing out in the market?

Mark Florman:
I think there is disbelief over valuations on both sides at times and this has created the need to have long, thoughtful processes and to develop expectations. If you’re an investment banker in Europe and you’re working with the owner of the business, you really need to pace yourself and try and help that family or that owner understand the true value, and current value, not what the value used to be.

If you go back over the past 15 years and look at multiples and other means of looking at value, there are a large number of business owners who felt that up until about 2005, maybe to 2007, their businesses were worth something, and now they may not be worth as much anymore.

I know across the boutique M&A world in Europe many families are trying to understand the long-term prospects for their business and whether it’s the right thing now to accept a more reasonable value for their company.

What is driving this, of course, is the endless volatility and continuous uncertainty. This uncertainty comes from questions about the future of the Euro Zone, as well as political and regulatory concerns. There is more regulation in Europe. Europeans have lived with regulation for 50 years; but for participants from Asia and the United States, this comes as a surprise.

It’s true that there are question marks over the true value of different assets, especially in the financial services industry. However, this discrepancy issue is perfectly normal in markets of high volatility and general uncertainty, and it just means that buyers need to be more patient and plan more carefully. I think a good industrial buyer or a good corporate buyer who is taking more time and being more patient over courting a particular target will succeed.

Adrian Reed:
Sellers always think their business is worth more than people generally are prepared to pay for it. But again, take time to prepare; making sure you understand what your buyers want; be realistic about leaving a little bit on the table, but also demonstrate to those buyers the sorts of synergies that they can achieve. It’s our job, the M&A practitioners, to manage our clients’ expectations, be it the buyer or the seller. And if you are realistic, and the deal can be done or it makes sense to be done, then you can generally find a way through it.

Leon Ferera:
From the legal perspective, ways of bridging the value gap are still being used in legal documentation. So, you’re still seeing earn-outs, contingent value mechanisms, stapled financing packages, and consortium deals, which is obviously a way of sharing the risk and therefore potentially getting more comfortable with valuation.

“Take time to prepare; making sure you understand what your buyers want; be realistic about leaving a little bit on the table, but also demonstrate to those buyers the sorts of synergies they can achieve.” Adrian Reed

Merlin Piscitelli:
I would just add to that, everyone should be wary of earn-outs. They’re very difficult to structure, they’re very difficult to document, and also, from an acquirer’s perspective, if you’re trying to use that to bridge the value gap, it makes it very difficult to integrate the business properly post-acquisition. You need too many protections for the seller. But it’s always an area that you want to try and jump to in order to bridge those gaps and get the deals done. If you’re looking at it from a buyer’s perspective, you might find it better to walk away if you have to.
Merlin Piscitelli:
What are the challenges companies are experiencing, delving deeper into financial, legal, structural, cultural attributes of an acquisition target? You just started to talk a little bit about when you structure a deal a certain way what that means to the buyer – how do you counsel clients to avoid typical pitfalls of conducting due diligence, and then also making that successful acquisition during the Post-Merger Integration stage of it?

Leon Ferera:
Because of the current economic uncertainty, buyers are more risk-averse, and they are looking a lot more carefully at the target’s books, and generally doing their due diligence a lot more thoroughly than was the case a few years ago. That’s obviously a challenge because it means they’ll take longer, and there’s also less certainty for the seller that a deal is actually going to go ahead, or go ahead in a timescale they are expecting. This is hard to address; it’s just a fact of life at the moment.

The one question here is: are there particular geographies where due diligence is proving more difficult to conduct? The obvious answer is yes.

“Because of the current economic uncertainty, buyers are more risk-averse, and they are looking a lot more carefully at the target’s books, and generally doing their due diligence a lot more thoroughly…” Leon Ferera

In certain emerging markets/jurisdictions, due diligence is harder to conduct and there are a whole host of reasons for this. Records aren’t necessarily kept to the same standards that we’re used to in the West, and therefore it’s harder to find the true picture. There are often a whole host of issues that due diligence flags which are not necessarily flagged to the same extent in developed markets – so, for example, corruption, environmental liabilities, and unpaid taxes. Also, national registries might not be as reliable, so therefore it might be slightly harder to prove ownership and title to the assets being sold.

One issue in particular is relevant not just to “emerging markets”, but to the developed world as well, and that’s corruption and anti-bribery legislation, which is a very hot topic at the moment. There’s new legislation that has come into force, sanctions for offenders are being pursued a lot more aggressively than was the case previously. So, when you’re doing a deal, that is now being focused on in particular, and that’s the case for certain sectors which are perhaps more sensitive than others – for example, resources, defence etc.

What you want to look at when you’re doing due diligence into companies that operate in sensitive sectors, and perhaps sensitive geographies, is whether there are clear anti-bribery guidelines, what the reporting procedures are, and you want to make sure you get adequate warranties and indemnities.

Just to finish off: due diligence isn’t just about looking at a target’s books and records. It’s also about understanding the commercial, regulatory and political environment in which the target operates.
And again, this is particularly pertinent to emerging market transactions, where there’s possibly more political involvement in certain strategic sectors, such as resources and energy. That political involvement might be there, in part, due to the added legal risks involved in those jurisdictions, and those legal risks exist because of a lack of clarity on existing laws, or there might be no laws at all governing what you want to do or the asset involved. There might be a lack of consistency of interpretation by courts and administrative bodies, and just a general lack of transparency. All this can increase execution-risk and unpredictability.

The advice to clients is to try to identify early on in the process when doing a deal, particularly a cross-border deal, where there are multiple jurisdictions involved, which are likely to be the problematic jurisdictions, and engage very early on with all the relevant interested parties: regulators, politicians, and other contracting parties. And, if a particular asset or a particular jurisdiction looks problematic, just exclude it from the deal - there’s often no other solution to it than that.

Merlin Piscitelli:
Adrian, can you comment on this, because I think what Leon’s saying is you have developing markets where your growth is, but then you have a lot more risk in terms of due diligence.

Adrian Reed:
I think this really comes down to a question of doing the basics well, and planning properly in advance. Diligence around any M&A – hopefully, if you’re buying on the other side you’ve got an adviser who has done work with the company to do their homework – think preparation, which is key; access to quality information.

And those advisers: when you’re preparing a process now, you can’t leave anything to chance. Ahead of going to market, you want to make sure your information systems are correct, the financial information is really solid that you’re basing your forecasts on because you’ve got to have a decent track record of the sort of trajectory that you’re projecting going forward. You want to test the internal processes, and really your advisers doing any sales process should be giving it a pre-process due diligence sense check, be that legal, be that financial advisers acting as if they’re going to be the financial diligence provider on the buyer’s side.

The other thing is, there needs to be trust in processes. The seller needs to be pretty honest in what they’re doing. Don’t try and hide bad news until the end of the process, because if you go a long way down the track, people will be prepared to cut the transaction and walk away. Make sure you’re presenting the good and the not so good in the part of the process where you’ve potentially got competitive tension, where you can make sure that people are competing to get the best price in there, but they know everything that could come out of the woodwork up-front.

Really, on the cross-border side, the same applies. If you’re selling a business, make sure you do your homework; if you’re buying it, those people have to have done their homework, or ultimately they’re not going to get the deal done or they’re not going to get the value they want.

“Make sure you’re presenting the good and the not so good in the part of the process where you’ve potentially got competitive tension...” Adrian Reed

Merlin Piscitelli:
Interesting feedback, so reveal some information that you may in the past not have revealed up front and there’s a better chance of success in getting the deal done.

Merlin Piscitelli:
What are the primary drivers of M&A activity today: gaining access to new technology, expanding geographical footprint, reducing competition, or other factors that you’re seeing out in the market place?
Mark Florman:
We’re in a very low-growth environment across Europe, and I think we’re going to stay so for many years. For businesses looking to grow through acquisition, you’re really looking to add an earnings angle to what you already do. From what I’m seeing and the experience I have, businesses with a higher-growth platform, access to higher-growth markets in the East, or possibly businesses offering a new technology are the ones to watch. A lot of work is being done in trying to find something different to get growth back on the track that we’re used to.

The other factor is: we still have enormous fragmentation across Europe, and therefore inefficiencies. What the private equity industry is doing is trying to find those inefficiencies and take the opportunity to build stronger, more durable businesses. Much of that work is being done by focusing on the operational change or the value enhancement that the firm could bring to an under-managed European business. What many businesses are bringing in is expertise in supply chain, in procurement, in building management teams, building financial systems. There’s still a lot to be done by private equity across Europe.

Merlin Piscitelli:
Adrian, are people looking to expand geographical footprint, reducing competition and other factors? And, that really depends what side of the ocean you’re sitting on, because somebody in the Far East may be looking to expand their geographical footprint, but what are you seeing from the clients you’re dealing with and the M&A activity they’re looking to?

Adrian Reed:
There are many drivers in M&A, some companies are trying to buy themselves out of a problem – their growth in their particular market is plateauing or even falling away and they’ve got to look for additional growth opportunities. Alternatively, you can either look for growth investment where there’s infrastructure needs – Energy is an area I know very well; new Technology trends, be that the trends for moving to mobile communications and portable computers etc – the infrastructure required to support that; or things like new technology and energy reduction, energy efficiency, energy control systems for the built environment, for travel. Those are areas where we’re seeing quite a lot of activity.

Another area is where companies with a lot of cash often have very large and well established operational infrastructure, which can be leveraged. So, putting additional products through the pipeline can yield synergies whereby leveraging that operational infrastructure allows them to squeeze extra margin out of “bolt-on” acquisitions, which wouldn’t be able to achieve those sorts of numbers on their own, and can enhance the bottom line in their businesses.

It’s such a varied and large pool, you’re going to see a whole range, but I think it’s mostly looking for new products and technologies in growth; geography is always great, but you always have to be [established] in your existing geography to move to another one, or looking to leverage synergies within your existing organisation, or your sales force. I think they are the key drivers.

Merlin Piscitelli:
What action, if any, do you anticipate regulatory bodies to take, as it pertains to M&A activity over the next 12 to 18 months?

Mark Florman:
In private equity it’s AIFMD¹, which is the new regulatory regime for the industry. Secondly of relevance is “solvency” and the application that has to capital requirements for both target companies in the financial services sector, and for the provision of capital by pension funds, insurance companies and others.

¹ Alternative Investment and Managers Directive
Thirdly, the big issue is the discussion around shadow banking, and whether that would lead to more regulation in certain financial services industries.

Leon Ferera:
Just looking at the U.K. for a second, as everyone knows there were some wide-ranging changes introduced to the takeover regime last year, and the Takeover Panel said when it introduced them that it was going to keep the situation under review. Those changes were introduced to make it harder for hostile offers to take place and to put the balance of power more in the hands of target companies. So, it might be that we’ll see the Takeover Panel in the next 12 to 18 months coming out with some sort of statement on how it has seen those rules operating and whether they might make changes.

The Office of Fair Trading [OFT] is being merged into the Competition Commission, and as a result it is trying to justify its existence, and therefore it is scrutinising deals more thoroughly and a bit more aggressively than was the case in the past, and deals that you might not have expected to have been scrutinised are being. Touching briefly on a point that was raised right at the beginning, about whether the size of a deal has an impact on regulatory intervention: it doesn’t. There was a deal last year that was a million pound consideration. No one really thought to pay attention to competition issues, and therefore the parties didn’t make a filing. The OFT scrutinised it and ended up blocking it. This was a million pound deal, so we’re probably going to see more competition scrutiny in the U.K.

Adrian Reed:
I’d like to finish on a positive note. There are some regulations that have been put in place to actually encourage investment M&A. I’m involved in the energy, waste and renewables sector, and whilst the governments have been a little bit flighty in their application of some of those regulations, which has caused some uncertainty, there are good things coming in terms of incentives.

There’s the electricity market reform bill going through U.K. Parliament at the moment, which is going to lead to (hopefully) longer-term incentives for feed-in tariffs, and “Contracts for Difference” (C of D) for new renewable power. There are new legislations being brought in there to encourage investment, so it’s not all just about rules to try and make our lives harder and stop deal-doing.

Hopefully governments are increasingly going to start looking at the sorts of legislation incentives to encourage investment, encourage growth, so it’s not always the “glass-half-empty” approach that we need to take to things.

Merlin Piscitelli:
Thank you to our panellists for participating, and thank you to the audience as well, particularly for participating in the polling questions.
Executive Summary

There are clearly a number of challenges facing advisers and dealmakers when completing M&A transactions in this economic climate and these challenges can be exacerbated by existing government regulation and the new legislation continually being introduced.

Through recent examples of successful and failed mergers and buyouts, some critical success factors have started to emerge, which are actively contributing to the ultimate outcome of a deal. These are factors that all advisors and dealmakers can learn from, and they include:

1. Preparing for regulatory bodies and interventions
2. Courting potential buyers
3. Preparing for due diligence well in advance

Preparing for regulatory bodies and interventions
Worldwide, there are now over 100 merger regimes, with differing requirements, all impacting the deliverability and predictability of deals. A new National Security regime in China, for example, will scrutinise cross-border deals in strategically important areas, but it’s yet unclear how the triggers for this regulation will be defined. It was also highlighted that India and Brazil have new antitrust regimes, and, in the U.S., Hart-Scott-Rodino has been revised to broaden the regulator’s power. It’s increasingly apparent that regulation will continue to develop and affect deal-making in every region of the globe.

In addition to the high-profile deals, such as AT&T Inc – T Mobile®, many other deals across the world have been and are being blocked for regulatory reasons, which means taking time to prepare for this aspect of a transaction is ever more important, because regulatory intervention and protectionism will play an ever increasing role in the M&A market.

It’s apparent that levels of protectionism rise in periods of significant uncertainty and high unemployment, but also that regulatory intervention and protectionism are now just a part of deal-making and will continue to be factors in M&A transactions now and in the near future. This makes it more important than ever to consider the regulatory aspects of a transaction in detail and at an early stage, whatever the size of the transaction. It’s also clearly important to maintain a dialogue with regulators and stakeholders to determine whether or not to proceed with a deal, before the plug is pulled anyway.

Courting potential buyers
While it’s important to carefully plan for the regulatory aspect of a deal and important to get to know the departments or bodies involved, engaging with potential buyers also emerges as an essential theme in successful deal-making, especially in this difficult climate.

Some corporates and private equity firms have significant cash reserves, and valuations are still relatively low, which means the time is potentially opportune for acquisitions to take place. However, general uncertainty and unemployment, especially in the Euro zone, have bred caution into the markets. The issue seems to be largely one of confidence, and, while there is cautious optimism about future growth, there isn’t enough to drive significant M&A volumes.

In the present “low-growth” environment, companies are looking to add an earnings angle to what they already do and to access higher-growth markets or businesses offering new technology. Furthermore, the fragmentation of industry across Europe and the consequent inefficiencies mean companies are taking opportunities that will build a durable business; focusing on operational change and value enhancement through better management. It’s considered that drivers for M&A are either based on infrastructure need or efficiency, where new products and technologies leverage synergies and improve margins. Because of the requirement for rock solid investments that ensure long-term strategic growth, and which also deliver business durability, relationships need to be forged as a priority and maintained throughout, what can be, an involved and protracted process.

As there is now an increasing willingness and financial capability among cash-rich corporates to make acquisitions, strategic purchases rely on management time, due diligence and preparation to ensure the corporate buyers are targeting the right assets with the support of their shareholders. The
market is now less driven by opportunism and more by consolidation and synergy savings, which means it’s vital for sellers to really get to know and to “court” their buyers.

Courtship, familiarity and psychological insight that underpinned acquisitions 25 years ago have evidently re-emerged as a theme in recent years. There is a need to be realistic about timeframes, as deals are taking longer to close, it’s important that all parties remain comfortable with the process along the way, and it’s vital that buyers stay engaged and “invested” with the deal, as it can be all too easy to walk away.

Preparing for due diligence well in advance
The emphasis on greater preparation and complete readiness for due diligence, ahead of a transaction process, has been clearly highlighted as essential to successful deal closure. It helps to anticipate competition and regulatory issues, as well as in the courting of potential buyers.

Where buyers are more risk averse, due diligence becomes more thorough and time-consuming, which can create uncertainty in the process. Add to this that, in emerging markets especially, due diligence can be hard to conduct and issues like corruption and environmental or taxation liabilities are less clearly flagged. However, corruption and anti-bribery legislation is an issue in all markets and is receiving increased focus, especially in sensitive sectors, like Defence, so sellers have to be sure they have robust warranties and indemnities when operating in these sectors and all participants must understand the commercial, regulatory and political environment. The only way of doing this is to have a thorough and robust due diligence process where information can be gathered, viewed, shared and questioned by all parties involved; up front and in advance.

As to evaluating potential acquisition targets, good, strong, well-positioned companies are the gems and cheaper than they have been in recent years, however, evaluation is about strategic fit, making the quality and availability of appropriate information vital in the process, along with time to do things properly in terms of assessment.

People are also having to be more creative in raising capital, as debt finance is clearly less easy to come by currently. Although strong companies in growing industries are not facing problems in raising acquisition finance, companies with lower credit ratings are having to wait for the Euro-crisis to settle before accessing debt finance or bond markets, and even then it will come at a price.

Because of these factors, greater time is being spent on due diligence processes and on developing expectations to help owners realise the true value of their company during a period of volatility. It’s evident that sellers have to be realistic about valuation and able to demonstrate the synergies that could be achieved through a buyer’s acquisition of their asset. And, it’s the job of the M&A practitioner to manage client expectations on both sides. Discrepancies are to be considered a normal function in periods of high uncertainty, and buyers need to be more patient, while sellers must plan, organise and be better prepared.

Advanced planning and preparation ensures that information systems are correct and financial information is solid. It also means that there is trust in the buying process and transparency on the part of the seller, which can only strengthen relationships with potential buyers or with in-country regulators, both of which are essential to successfully concluding a transaction.

Conclusion
While there are clearly challenges facing M&A advisers and dealmakers when it comes to completing transactions in this economic environment, these challenges can be overcome – the key learning here is that if dealmakers fail to prepare they should prepare to fail.
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