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MERGERS & ACQUISITIONS 2019

VIRTUAL ROUND TABLE

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Introduction & Contents

In this roundtable, we are joined by six experts from around the world to discover which M&A markets have been particularly active, learn more about recent regulatory changes and industry trends, and get the lowdown on acquiring companies in administration, effective post-merger integration strategies, and valuation methods for emerging start-ups, amongst much more. Featured countries are: Canada, Japan, the United Kingdom and the United States.

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Meet The Experts

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Shigeki Tatsuno is a partner at Anderson Mori & Tomotsune and specializes in the area of mergers and acquisitions, joint ventures, and cross-border investments. Mr. Tatsuno has extensive experience in advising venture companies and advising on PE funds. He also provides advice to foreign and domestic clients on intellectual property issues/transactions and general corporate matters. He is qualified in Japan and New York, and has received Bachelor of Law from University of Tokyo and LL.M. from New York University, School of Law.

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Andrew Sherman is a Partner in the Corporate Department of Seyfarth Shaw LLP. He focuses his practice on issues affecting business growth for companies at all stages, including developing strategies for licensing and leveraging intellectual property and technology assets, intellectual asset management and harvesting, as well as international corporate transactional and franchising matters.

He has served as a legal and strategic advisor to dozens of Fortune 500 companies and hundreds of emerging growth companies. He has represented U.S. and international clients from early stage, rapidly growing start-ups, to closely held franchisors and middle market companies, to multibillion dollar international conglomerates. He also counsels on issues such as franchising, licensing, joint ventures, strategic alliances, capital formation, distribution channels, technology development, and mergers and acquisitions.

Mr. Sherman has written nearly 30 books on the legal and strategic aspects of business growth, franchising, capital formation, and the leveraging of intellectual property, most of which can be found on Amazon. He also has published many articles on similar topics and is a frequent keynote speaker at business conferences, seminars, and webinars. He has appeared as a guest commentator on CNN, NPR, and CBS News Radio, among others, and has been interviewed on legal topics by The Wall Street Journal, USA Today, Forbes, U.S. News & World Report, and other publications.

Mr. Sherman serves as an adjunct professor in the M.B.A. programs at the University of Maryland and as well as the law school at Georgetown University and is a multiple recipient of the University of Maryland at College Park's Krowe Excellence in Teaching Award.

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Carlos is an M&A integration expert and founding Partner of BTD. He has over twenty years of integration, organisational change and project management experience, and has supported acquisitions and integrations across industry sectors and counties across the globe. He advises businesses on corporate and acquisition strategies, design of post-deal operating models, operational performance reviews, and helps deliver programmes of major business restructuring and improvement.

Alongside his client work, Carlos is also a Non-Executive Director of international energy firm, IPR, and a published author on leadership in M&A.

Meet The Experts

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A Partner at BTD since 2018, Ruth is an experienced business manager and organisational change leader, with strong risk and change management specialisms and a track record of influence and programme delivery across the private and public sectors for multi-nationals and SMEs. Key strengths include: commercially-astute strategies, informed by own academic research that deliver outstanding and quantifiable results; designing and implementing major business architecture and process improvement projects; delivering capability across people, processes and technology to embed new ways of working; and engaging and negotiating with stakeholders at the highest level to ensure superior programme delivery.

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After 10 years of accounting, auditing, M&A transaction advisory and other consulting for Big Four Certified Public Accounting firm PricewaterhouseCoopers, Jim spent 20 years as a member of several boards of directors and in various financial and executive positions, including president and CEO, COO, CFO, secretary-treasurer, chief accounting officer, and corporate controller.

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Pino Bacinello is President and Founder of Pacific M&A and Business Brokers Ltd. His academic background includes Electronics Engineering and Business Administration. Specific to Investment Banking and Business Brokerage, Mr. Bacinello holds mergers and acquisitions industry-specific designations as a Certified Business Intermediary (CBI), Mergers and Acquisitions Master Intermediary (M&AMI), Certified Machinery and Equipment Appraiser (CMEA), and a Certified Senior Business Analyst (CSBA).

Q1. Can you talk us through the current M&A landscape in your jurisdiction?

James F. Davidson

Davidson: In 2018, merger & acquisition ("M&A") activity thrived across almost all sectors of the deal market. The positive M&A environment, reflected in high transaction activity, has continued into 2019 due to a host of factors such as lower taxes, decrease in regulations, and an overall favourable attitude of the government toward business. Amid steady growth in fundraising, participation in private equity has increased, alongside a pick-up in other private investment transactions.

The outlook for 2019 was initially shrouded in uncertainty, given the interest rate hikes, disruptions in retail and oil & gas industries, levelling of real estate activity, and significant geopolitical events in China, Venezuela, Iran and the Middle East. Despite these factors, the M&A industry remained optimistic for 2019.

The value of M&A deals in the U.S. has steadily increased over the past few years, with the trend continuing into 2019. Although fewer deals were struck compared to the same period last year, inbound activity indicates that the United States' position as a sought-after destination for investments remains uncompromised.

Economic and political uncertainties have forced dealmakers in some sectors to exercise caution. However, others, such as those in the aerospace & defence, biopharmaceutical, and financial services industries in the public, large cap and middle-markets, have remained active. The three largest deals in 2019 so far are:

- Merger of Raytheon and the airspace division of United Technologies
- Biopharmaceutical company AbbVie's acquisition of Allergan
- Bristol-Myers Squibb's acquisition of biotech firm Celgene

Several other major mid-market deals materialised in 2019 across sectors such as chemicals, online luxury goods, and technology. Notable among these are:

- Cayman Chemicals' acquisition of Matreya, a biochemical company
- E-commerce company 1stdibs' acquisition of Design Manager, a design project management and accounting platform, in the online luxury marketplace
- Technology company Ascensus's acquisition of Wrangle, a provider of health & welfare Form 5500 preparation and related ERISA compliance services

Continued growth in the U.S. economy and liquid debt markets has resulted in a steady stream of deals, sustaining optimism for much of the 2019 M&A deal market. However, some dealmakers are treading cautiously amid concerns about certain headwinds and M&A stressors such as economic uncertainty, market volatility, tariff negotiations, and trade disputes.

All said, the positive trend in the United States' M&A market extends well into 2019, indicating it has been a good year for mergers and acquisitions.

Shigeki Tatsuno

Tatsuno: The declining population in Japan and consequent shrinking of the domestic market has spurred an upsurge in the number of Japanese domestic M&A transactions in recent years, as more companies seek to consolidate or strengthen their domestic market position. At the same time, large domestic technology companies are increasingly seeking to augment their technological edge through investments in or tie-ups with home-grown start-ups with distinctive technologies, and this has also contributed to the rise in domestic M&A.

Cross-border M&A activity is also seeing sustained growth. Many foreign investors still see untapped potential in the Japanese market, while Japanese firms continue to seek opportunities abroad in response to slowing growth at home.

Private equity funds ("PE Funds"), both domestic and foreign, have been especially active in the Japanese M&A market in 2019.

M&A involving small to mid-sized companies facing succession issues is also experiencing an uptick. The owners of these companies, many of which possess innovative technology, are often compelled by the prohibitively high inheritance tax rates in Japan to sell their companies instead of passing them on to posterity. Such companies consistently attract reputable domestic and foreign PE Funds, among others.

Andrew Sherman

Sherman: The M&A landscape in the United States remains robust, but with the possibility of clouds on the horizon in the near to mid-term future. Geopolitical uncertainty, a changing domestic political landscape, the possibility of an impending recession, M&A digestion and integration cycles and social unrest are all looming. Certain economic conditions, such as interest rates and access to affordable transactional capital, are also influencing the mix of unknown variables. Most M&A advisors and professionals expect the M&A landscape to remain active through Q1 of 2020, but until we get a clearer picture of the aforementioned variables, the forecast for the balance of 2020 remains uncertain.

Pino Bacinello

Bacinello: British Columbia Canada has a relatively small base of larger businesses and therefore by default the M&A activity in western Canada, specifically BC, is not overwhelming. That said, it is active within its small pool. There is clearly a continued increase in local private equity groups both big and small with greater growth in the smaller sector. A seller market continues to be present with much more buyer demand than there are good businesses available for sale.

Q2. Have there been any recent regulatory changes or interesting developments?

Shigeki Tatsuno

Tatsuno: On 16 January 2018, the Sub-Committee of the Legislative Council on Corporate Governance Matters under the Companies Act issued an interim proposal for certain revisions to the Companies Act. The proposed revisions (the "Revisions") are expected to be tabled at an extraordinary session of the Japanese Diet in or after late 2019. The revisions, if passed, will introduce (among others) the following changes:

a. Revision of Rules Concerning Shareholders' Meetings and Proposals

Companies will be permitted to provide shareholder meeting materials to shareholders through electronic or magnetic means without the need for shareholders' consent, if certain conditions are met. The Revisions will also restrict the number of proposals a shareholder may table at general meetings, to prevent shareholders from abusing their rights.

b. Revisions concerning Directors

The Revisions will enable proper incentivisation of directors, while enhancing disclosure of such remuneration. Specifically, the Revisions will make it easier to include stock grants in a director's remuneration, while requiring directors to explain the company's remuneration policy for directors at shareholders' meetings. Companies will also be permitted to indemnify their directors for damages suffered in the course of performing their duties, and to insure their directors against such damages. Additionally, the Revisions will broaden situations where outside directors will be appointed.

c. Introduction of Share Delivery System

The Revisions will introduce a "share delivery" transaction structure to facilitate corporate acquisitions by way of stock exchanges in Japan. Share delivery, in essence, is a scheme in which a Japanese stock corporation (the "Acquirer") acquires stocks in another domestic or foreign stock corporation (the "Target"), as a result of which the Target becomes the Acquirer's subsidiary, and pays its own stocks to the Target's stockholders as consideration.

Although other stock-for-stock acquisitions schemes are available under Japanese law, the Share Delivery scheme has the following unique characteristics:

- it is applicable to situations where the target is a foreign or unlisted corporation;
- it involves a simple procedure relative to over-the-counter stock consideration, which requires compliance with regulations on contribution-in-kind and favourable issuance of shares as consideration; and
- it allows for partial acquisition of a target.

A marked increase in the number of stock-for-stock acquisitions, including partial acquisitions of foreign targets by Japanese corporations, can be expected if the share delivery scheme is introduced.


Pino Bacinello

Bacinello: Business obligations to pay medical services plan premiums on behalf of employees on businesses of a certain size and an increase in the minimum wage has had a negative impact on businesses performance and hence impacts seller expectations relative to buyer realities.

Q3. Which industries or jurisdictions currently provide the best opportunities?


James F. Davidson

Davidson: The energy, industrial products, technology, and pharma industries have been among the top performers for 2019. Each sector has witnessed noteworthy mega deals already this year. The automotive sector will likely see major activity—the industry faces headwinds that may drive companies to consolidate in their bid to survive.

Rapid disruptions in the financial services industry are contributing to deal activity in this sector. Similarly, in the life sciences and healthcare industries, portfolio optimisation (including divestment of noncore assets) is driving the increase in M&A volume. The momentum in deal activity in these sectors is set to continue, as it also extends into the coming year.

Despite the robust M&A activity so far in 2019, the number of deals in the US declined vis-à-vis 2017 and 2018. Amid economic and political uncertainties in the country, dealmakers are reacting differently, based on their specific industry and economic situations. For instance, despite abundant availability of capital and low financing costs, some dealmakers are treading carefully. While sectors such as biopharmaceutical, technology, and financial services have remained active in terms of deal activity, others such as the manufacturing and consumer goods sectors have recorded declines.


Shigeki Tatsuno

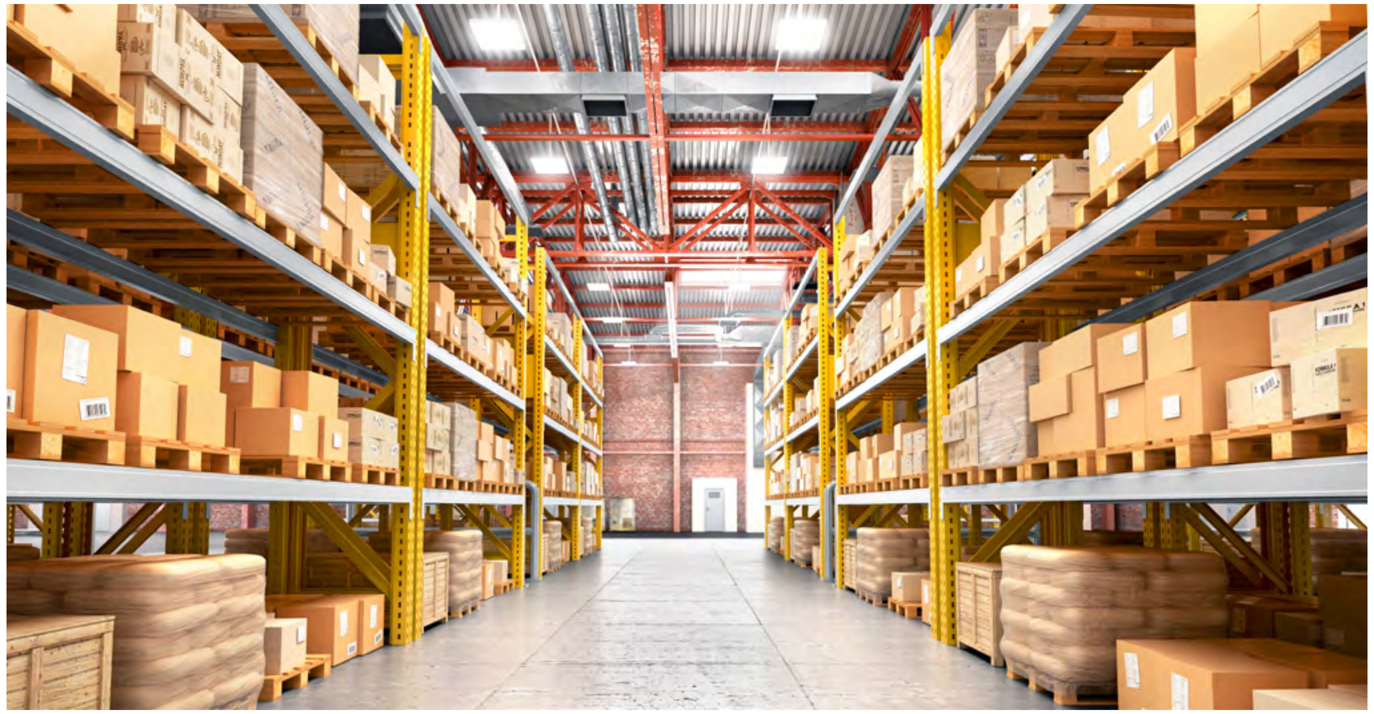
Tatsuno: With the population decline in Japan, policymakers are hoping to promote greater interest in Japanese start-ups involving the latest technologies, such as the internet of things (IoT), artificial intelligence (AI) and financial technology (FinTech), in the hope of leveraging them to enhance productivity and economic growth. As the Japanese government is expected to introduce more initiatives in the coming years to incentivise investments in these areas, they present opportunities for foreign investors.

Investments in the healthcare technology sector have been particularly favoured in 2018 and 2019 by both domestic and overseas companies. Opportunities in this sector have been abundant, with the continued rise in the number of local "med-tech" start-ups and the recent inclination of large domestic companies, such as Hitachi, to spin off some of their ancillary medical technology divisions to focus on their core businesses.

Beyond the domestic market, Japanese companies in recent years have been particularly focused on the emerging markets of Southeast Asia, where sizable and young demographics provide an attractive counterpoint to Japan's shrinking population. The flourishing tech ecosystem that is emerging from the Southeast Asian region is also drawing venture capital from Japan. With that said, the legal, commercial and political systems differ significantly from country to country within Southeast Asia, and care needs to be taken in navigating the potential pitfalls presented by the diversity of systems.


Pino Bacinello

Bacinello: Distribution, manufacturing, and senior care in general. The tech industry in BC has grown and become more in demand. Likewise, the industries related to the upcoming Alberta's Bitumen pipeline to Kitimat BC. Some infrastructure businesses are also in a good opportunistic environment including ready mix and quarries where some consolidation has taken place over the years.



Q4. Can you talk us through the process for valuation methods, transactional structures and tax implications for M&A deals in your jurisdiction? To what extent does this become more challenging when transactions involve emerging start-ups with high valuations based on exponential growth potential?

Carlos Keener

Keener: Going back to basics, any premium to be paid over and above the stand-alone value of a business needs to reflect the buyer's confidence and ability to add value to that business post-close. High deal multiples, despite – or indeed because of – their historical basis, remain an inherently-risky way to judge the value of that acquisition as an integral part of your own business. Put another way, why would you base the price of your next acquisition based on what someone else paid for an entirely different business? Beauty is in the eye of the beholder; and similarly deal value is only found in the integration and/or improvement of your target into your business. While multiples may provide a useful double-check (and in many cases I doubt even this is true), the only reliable way of valuing an acquisition is through a discounted cash flow, provided this model:

- Gets into the detail of commercial and operational forecasts and synergies;
- Is realistic about the risks, uncertainties and timings of each – that is after all one of the key reasons why multiples for high-tech forms are so high;
- Builds your integration plan, and associated costs, directly into the model (hence the need to do this thinking pre-close);
- Considers the P&L/EBITDA impact of integration on both target and acquirer (e.g. to reflect acquirer business cost increases that often occur when back-office workloads increase);
- Considers real worst-case scenarios that include external factors such as inflation and ForEx volatility;
- Does what it can to minimise the 'terminal value' contribution to valuation – understandably not always easy!

Dr Ruth Murray-Webster

Murray-Webster: A special consideration is indeed required for start-up businesses and those in the high-tech sector where multiples tend to be higher, but this premium is not solely due to the higher-risk nature of the proposition or market. It relates instead to the high dependency of business success on specific individuals: strong-willed and passionate owner-managers; highly-visible leaders in which market credibility and customer relationships are concentrated; or technical individuals who retain much of the real IP of the business in their heads.

The traditional way of retaining such individuals is through earn-out structures, however our clients and our own experience clearly tell us a more sophisticated approach is required. Owner managers often act as a brake on the very change that's needed to realise deal value and, where their contribution to future growth is not critical, their immediate exit from the business is commonly a better decision. Other key staff can and should be retained, but rather than simply 'pay to stay', retention strategies that focus on 'pay to perform' or 'pay to integrate' should be considered. More important still, most individuals are strongly influenced by other factors – the role, the work environment, the title, the opportunities, etc. Think through and use a combination of incentives, soft and hard, to keep people firing on all cylinders during those critical months post-close.

Andrew Sherman

Sherman: In the United States, valuation methods and transactional structures have been evolving to keep pace with the changing nature of the assets typically being conveyed in M&A deals. Over the last 10 years, the focus of transactions have shifted from tangible assets such as real estate, equipment and inventory, to primarily intangible assets such as brands, channels, data, system processes, social media and digital assets, know-how, show-how and strategic relationships. The valuation method and transactional structures have needed to be adjusted accordingly and EBITDA has become increasingly less relevant as a measure of enterprise value.

In addition to the aforementioned variables impacting valuation methods and transactional structures, the capital markets are struggling to address the proper valuation of the "unicorns" (high growth emerging start-ups with ridiculous valuations) as can be evidenced by the large valuation fluctuations for WeWork as it considers its initial public offering.

Pino Bacinello

Bacinello: Emerging start-ups in technology and VC has always been a challenge and will continue to be so. Valuation methods for this segment appear to defy logic or gravity. In most cases, highly volatile markets either win big or lose big, and little in between.

Q5. In the UK, the Competition and Authorities Market (CMA) proposed that any merger between Asda and Sainsbury should be blocked for 10 years amidst concerns that the retail giant would control more than 60% of the market share. However, it has been argued that the metric for determining competition criteria is outdated as it does not take into consideration the emergence of online retailers such as Amazon and Ocado. (i) How does the competition criteria work in your jurisdiction and how effective is it? (ii) Does this issue pose a wider problem given the recent global growth of online retailers and the increasingly blurred lines between sectors as a result of their vastly diversified product range and portfolio?

Carlos Keener

Keener: We only have to look at the news and the disruptions in markets that have been stable for decades to know that the CMA must move with the times and continually update their thinking on what constitutes anti-competitive behaviour. Technical convergence across traditional sectors makes the demarcation of areas of competition a minefield for the regulators, and an opportunity for organisations trying to represent their apparent competitive footprint: Is Amazon competing in the retail, marketing or software space? Does Uber offer personal transportation or courier services? Even non-technology firms such as WeWork are more regularly crossing traditional boundaries.

Indeed the inability to cross traditional sector boundaries is increasingly spelling doom for many firms: Without taking a view on the past decisions of Thomas Cook, it's clear that the complex mix of changing behaviours and technologies related to package holidays have made a consolidated owner of aircraft, resorts and high-street shops far less flexible and cost-effective than they needed to be.

Markets are likely to value agility and flexibility on an increasing basis in future. This speaks to operating models and leadership behaviours within the organisation and to the need for a clear view of potential post-close disruptions when doing deals. It also speaks to the increased pace at which deals are done. In our view working with clients across jurisdictions, regulators worldwide need to:

- Continue broadening their definition of 'customer benefit/disadvantage' to include a consideration of how well the combined business will serve customers post-close. During the wave of airline mergers in the United States a few years ago, U.S. regulators pushed back on the quality and credibility of integration plans that promised that savings from integrated ticketing systems would be passed on to the customers. Their concern was not that such synergies would be reallocated to the benefit of the market, but rather that the costs and timings to deliver integration was unrealistic. If a deal promises benefits to the customers (and which one's don't?), regulators need to get better at assessing whether this is not only theoretically possible, but actually achievable.

- Improve their thinking around the occasional requirement that businesses remain separated post-close (e.g. while remedies are implemented). Acquirers are regularly left in confusion around what this means, and the degree to which change is or is not possible within the acquired entity. Can acquirers speak to their new employees post-close? Can new management be placed in the business? Can initiatives to improve the acquisition be initiated or supported while retaining organisational separation?

Acquirers will continue to have a responsibility – and opportunity – to help regulators through these challenges to ensure that the right acquisitions are allowed to proceed smoothly and deliver benefit to the market, while still performing their valuable role in defending the interests of customers and others.

Pino Bacinello

Bacinello: It is not an issue in British Columbia. This is mainly because we don't have a "large" enough business pool.

Q6. Staying with retail, the sector has suffered significant bankruptcies around the world in recent years while 2019 has already seen more store closures than the whole of the previous year. (i) What challenges and opportunities currently exist within the retail industry? (ii) What additional due diligence considerations need to be factored in when acquiring a company that is in administration or are experiencing cash flow pressures regardless of the sector?

James F. Davidson

Davidson: The retail industry has been undergoing a massive shift for some time and it continues to do so. In 2018, some high-profile bankruptcies occurred, and that slump has continued into 2019. The industry has reacted by driving even more into online, non-store buys which in themselves provided much of the impetus for the monumental industry-wide change. Categories such as sporting goods, health, and personal care products showed positive changes, while grocery, clothing, general merchandise, and home furnishings declined. Others such as electronics and appliances remained generally unchanged during 2019.

Significant and constant disruption may be the single largest challenge facing the retail industry today. Armed with technology, consumers have become more demanding and expect personalised service that is both readily available and convenient at the snap of their fingers. Security and data privacy are also dominant priorities. Consumer buying patterns indicate a sharp shift in focus toward balancing value versus price. As tariffs hover, consumers are now weighing purchasing choices based on necessity, in addition to selling price.

The retail marketplace is cluttered with a myriad of newer and smaller tech-enabled players. Retailers are shifting their investment strategy beyond sales growth via new store additions alone. Investments are being expanded to other areas that include launching digital sales models, transforming fulfilment processes, and acquiring related businesses.

More than ever, the retail industry is now optimising technology that aligns people and processes with technologies such as artificial intelligence ("AI") and augmented reality ("AR") to enhance consumer experience. Retailers are seizing opportunities that increase speed to market and optimise inventory management, translating into increased revenues and profits.

The importance of due diligence cannot be overstated, especially for a company in distress. The company's historical run rates will likely not be reliable, and that will only exacerbate the challenge of predicting future cash flows. The loss of key personnel in underperforming and distressed companies may also hamper turnaround and restructuring as well as due diligence efforts. Acquisition of distressed companies can generate huge returns for those experienced in distressed situations. However, regardless of the industry, these acquisitions are fraught with challenges that are not for the faint of heart.

Carlos Keener

Keener: The challenges faced by retail are well documented but lazily reported. Brexit-related nervousness in consumer spend, a bloodbath on the high street and increasing rents are all examples. Many of these are true in their own context but do not represent the complete picture. Those businesses with strong leadership, more agile operating models and an outward focus can shift to align with changing consumer habits quickly to weather the storm and therefore be more attractive to buyers. Why else would Zara be doing so well?

The basic rules around retail have not changed – the right product in the right place at the right price. All that's changed is that the definition of 'right' shifts more quickly than ever, and not necessarily at the behest of the retailers. The opportunity for buyers is to price a responsive and agile business accordingly and build a credible plan to deliver acquisition benefits quickly while aligning to or retaining a more agile model.

An increasing factor in this operational agility revolves around how much debt a company is carrying before an M&A-driven change in focus and operating model. Would Thomas Cook had fared better in finding funding if they had not had to write down £1.1bn of goodwill from a previous acquisition and borrowed £425m in a failed bid to transform? Would Giraffe (part of BRG) have collapsed without the burden of debt from doing the rounds of ownership by private equity and Tesco just at a time when margins shrunk and revenues decreased? The problem with liquidity is that it's never there when you need it!

Dr Ruth Murray-Webster

Murray-Webster: When cash is tight, due diligence needs more than ever to focus not on confirming the past performance of the target, but on validating the feasibility of your future plans as a combined business. The cost and operational impact of integration and other post-close changes must be robustly confirmed and presented in a detailed cashflow forecast, along with the commitment and ability of management to deliver on the promise alongside business as usual, including effective management of CapEx, working capital etc. On what specific aspects of the target business are your acquisition goals depending (e.g. time-sensitive supply chains, customer insight systems and data, brand equity and customer relationships)? If acquiring out of administration, what major longer-term investments may not have taken place in the run-up to the deal which will pose a risk or require funding post-close? Due diligence in support of key talent identification and retention in the acquired business will also be critical as stressed businesses typically see many of these individuals exit shortly before or after the deal.

Shigeki Tatsuno

Tatsuno: The consistent growth of e-commerce in Japan has spurred M&A activity among operators of online retail platforms. For example, Yahoo! Japan Corporation is in the process of acquiring Zozo Inc., the largest online fashion website in Japan, in order to generate a younger customer base, achieve greater economies of scale, and compete with Amazon.com and Rakuten for e-commerce market share in Japan. Rakuten, in the meantime, has this year also announced its acquisition of a significant stake in restaurant search engine Gurunavi Inc., in an effort to boost its market share in the online reservation market. The growth of e-commerce is expected to give rise to increasing M&A opportunities.

When acquiring a company that is in administration or experiencing cash flow problems, a shorter payment deadline after sight is crucial. Sometimes, suppliers to such companies may request for a deposit from them to secure payment of their receivables. The cash flow needs of such companies should be carefully determined at the stage of due diligence, based on which post-transaction business and cash flow plans may be appropriately formulated.

Andrew Sherman

Sherman: The retail sector in the United States is most certainly going through a transformation that is impacting M&A and financing transactions in this industry. The number of retail industry bankruptcies, as well as retail store closings, have reached an all-time high. In fact, according to a report from global market research firm Coresight Research, there have already been 40% more store closing in 2019 than in all of 2018.

Turning to M&A, the big businesses are buying the small where it makes sense. The strong are buying the weak where value is inherent, and online giants like Amazon are buying and improving traditional retailers such as Whole Foods Market. Due diligence has become more rigorous in retail industry transactions and the need to deal with angry vendors, creditors and landlords who have not been paid for many months and may threaten litigation, or forcing involuntary bankruptcy has only made these transaction that much more complex and expensive.

Pino Bacinello

Bacinello: Retail remains a tough market here with much reluctance in buyers desiring to participate in retain business acquisitions. Many of the retail businesses themselves have suffered over the years and have not yet fully recovered while seller expectations have not necessarily been adjusted to reflect the market reality.

Many factors have influence the retail market recently and includes government interventions, tax increases, business obligations to pay medical services plan premiums on behalf of employees on businesses of a certain size, increased minimum wage; low unemployment making it difficult to hire people, expensive rents for both business tenants and employees wanting to live close by, increased build out costs, decrease in international capital being invested etc.

"Retail remains a tough market here with much reluctance in buyers desiring to participate in retain business acquisitions. Many of the retail businesses themselves have suffered over the years and have not yet fully recovered while seller expectations have not necessarily been adjusted to reflect the market reality."
- Pino Bacinello -

Q7. We are seeing a new focus for due diligence as companies navigate copyright and patent issues as well as additional complications such as the use of open source software. (i) How does the due diligence considerations alter depending upon the industry? (ii) What are the biggest due diligence challenges you most frequently encounter? (iii) What measures do you take to ensure due diligence best practice?

Carlos Keener

Keener: Building on the philosophy of 'testing the future not the past' from our response to question 6 above, the key practices we would like to see more of during due diligence are:

- Deeper, more extensive customisation of due diligence areas of investigations/checklists to assiduously test plans, assumptions and risks related to your integration objectives, post-close operating model design and integration plans;
- Direct accountability by those responsible for delivering integration in conducting or approving due diligence findings – those who will ultimately deliver the deal benefits must be comfortable with the results of due diligence;
- More time taken to ensure cross-communications between due diligence teams. We regularly see one DD group discover, and fail to appreciate or pass on, something of critical importance to another group.
- Circling back to our first point, direct communication between the due diligence teams and those designing and planning for integration and improvement post-close. If due diligence is used to validate integration plans, those plans must conversely reflect learnings from due diligence.

Pino Bacinello

Bacinello: I don't see changes in the DD process or requirements of buyers. The measure we take is to perform our own internal due diligence ahead of going to market with a business so that we are prepared and are then able to mitigate potential issues by being in the know and disclosing ahead of surprises that kill.

Q8. Can you outline the importance of implementing an effective post-merger integration strategy?

James F. Davidson

Davidson: Acquisitions are accompanied by complex and oftentimes unique strategic, financial, operational and cultural challenges. Post-merger integration is a necessary and integral component of a successful acquisition. The transition plan, which is critical, should be aligned with the strategic and business objectives of the acquisition throughout the process – from diligence through integration. Oftentimes this is as or more difficult than the deal-making itself. A weak or non-existent integration plan will likely lead to a failed transaction.

The integration plan must factor in a myriad of issues: retention of customers, employees (particularly, right employees), and management; products – mix and potential cannibalisation; company image and branding; performance measurement and management; administrative and facilities consolidation to rationalise operations; and IT systems and processes.

First and foremost, the management must consider how best to blend or transition company cultures while renewing the sense of employee commitment. Quick transfer of competencies and synergistic value creations are critical to ensure the success of an acquisition.

Important steps of integration planning include:

- Implementing quickly within a few months rather than many months or even years
- Offering customised incentive programmes to drive productivity and loyalty among the acquired employees
- Communicating the strategy clearly and reinforcing it across all levels during the transition period
- Retaining quality employees while culling marginal employees as part of the consolidation process

During the transition process, the management team must aggressively protect the bottom line, measure productivity, and maintain profitability, while simultaneously staying customer-focused and repositioning to serve the defined marketplace.

Therefore, to ensure an acquisition is successful, integration planning should be centred on stabilising the merged organisation methodically and quickly.

Carlos Keener

Keener: Beyond any initial market effects of M&A at deal announcement, deal value is obviously realised post-close. Whatever the deal rationale, delivering value requires detailed thought about future operating model and a clear, risked and costed plan to get there that considers the people who could make that task easier or harder to achieve (customers, staff, suppliers, funders etc.). Despite this inherent and obvious logic, studies consistently show that M&A performance hasn't improved over the past three decades. Even as recently as earlier this year, PwC confirmed that more than 50% of acquisitions underperformed industry peers, on average, over the 24 months following completion.

Our experience of post-merger integration over the past 18 years, verified through our own learnings (as published in '*Inconvenient Truths*', 2017) points to well-intentioned executives believing they have an effective post-merger integration strategy when in fact not all the pieces are in place. Our findings point to the critical combination of three factors:

Established structure and method: a playbook of good practice approaches and tools that guides the team and ensures everything has been considered. This must at a minimum include an approach in which post-close planning takes place alongside due diligence; a clear, measurable connection is maintained between anticipated acquisition benefits, integration objectives and operating model; and use of a formal governance and measurement regime post-close that ensures attention to delivery well beyond day one.

Experienced people who have 'been there before', either staff, consultants or a combination; people who can use this experience and judgement to know when and how to apply good practice within the specific context of the deal and integration.

Leadership shown by the board, executives and their middle managers – both pre- and post-close – that makes all the difference between synergies in theory and measurable value realised in practice by an engaged, accountable, objective and committed team.

All are necessary but it is the right combination of methods, experience and leadership that is the difference between mediocre M&A performance and that elusive, consistent, repeatable deal success. While perhaps a reflection of obvious common-sense, the impact of their application may not be: Long-term deal performance has been shown to be over four times higher when organisations adopt the right balance of these three on their deal.

Dr Ruth Murray-Webster

Murray-Webster: An effective post-merger integration strategy is not only important in realising deal value, but also in ensuring that the future organisation is ready for on-going organic or inorganic growth. Our experience is that often organisations approach deals with their current operating model in need of serious work even before they start. This makes the job of designing a coherent future more time-consuming and frustrating for the people involved.

We passionately believe in the importance of thinking about the whole, not just the parts. For the engineers reading this, you'll get systems thinking – a holistic approach to analysis and decision-making that focuses on the way that constituent parts of an overall system interrelate. We love the quote from *Making the Jump To Systems Thinking* that says (paraphrased) *"people don't start using systems thinking because it's cool, but because they realise that relationships between people and things in their organisation are not linear – not a simple cause and effect between two things."* Organisations are complex systems, yet we desperately try to make them simple – trying to fit connections into cause and effect type logic – we do this at our peril.

Major projects that arise out of investments in M&A need to look at the desired operating model as a system. Only this week in BTD we have spoken with clients about the risks of investing in a new organisational structure without understanding the knock-on impacts on processes, systems, incentives, behaviours, culture etc. (Re)design and transformation of operating models is a challenging exercise in 'connecting the dots' between multiple moving parts and being able to accommodate multiple feedback/learning loops into the change process.

Systems thinking also applies to people – stakeholders and their relationships with others. Adopting a social-systems thinking approach – mapping networks of relationships and alliances, we can start to think more deeply about relationships between stakeholders that help us to navigate sources of organisational politics and soft power.

Our learning over the years is that thinking about stakeholders and operating models as systems – as connected wholes – is always important. When we are planning to change, we need to create imbalance in those areas from which benefits will arise while at the same time recognising the areas where we can maintain stability where there is a benefit in doing so.

When working in the context of M&A, it is critical to have a solid understanding of what must be changed and where stability can be maintained for sanity (if nothing else); and to help those leading the change to really connect the dots, to dive into the detail where that's needed, but to also help them avoid getting dragged down into too much detail.

Shigeki Tatsuno

Tatsuno: A successful and efficient integration process is often dependent on key persons at the target company. It is therefore important, even as early as the due diligence stage, for the acquirer to identify personnel capable of contributing to a smooth integration and successful future operations. The acquirer should as soon as practicable after identifying such personnel, induce them to stay with the target company through reassurance or discussion of future incentives.

Placing key persons from the acquirer within the target company would also enable the acquirer to win over the target's employees, whether through the establishment of rapport between the acquirer and the management team of the Japanese target, or the creation of a corporate vision among the target's employees that unifies with the acquirer's objectives. The importance of showing respect to the target's employees should also not be overlooked.

Andrew Sherman

Sherman: It is both disturbing and frustrating to accept the fact that nearly 60% of M&A transactions continue to fail to meet their pre-closing business objectives. Perhaps expectations were set too high prior to closing or the parties simply "hoped for the best," but the primary reason that these transactions have failed to meet their objectives are the lack of effective post-merger integration planning.

Boards and company leaders must be more pro-active to ensure that transactions make good sense and not just "rubber stamp" proposed transactions. A post-merger integration strategy must take into account technology, culture, supply chains, distribution channels, customer relationships and differences in pricing and business models in order to be effective. Many buyers either fail to develop an integration plan at all, or are guilty of waiting to start their planning well after closing when it is probably too late.

Pino Bacinello

Bacinello: Yes employees and their moral would benefit from such as in most mergers there are many unknowns that make employees and management nervous, especially mid-management.

Q9. How has Brexit impacted current M&A activity for both inbound and outbound targets? Have companies changed their M&A strategies following the increasing possibility of a no deal Brexit?

Carlos Keener

Keener: Uncertain and tentative, to state the obvious: the final destination and timing for Brexit continues to hover over global M&A as much as European or even UK inorganic growth. Unlike other 'pauses' in M&A in the past however, this uncertainty doesn't just revolve around a lack of clarity around future market conditions or macroeconomic developments. The legal, political and structural impact of the UK's relationship with the EU and the rest of the world means that business are needing to consider deals much more in the light of how they, and their acquisition, will work operationally post-close, post-Brexit. Will this acquisition address or exacerbate potential supply chain challenges? Will HR, GDPR or HSE legislation begin to diverge, leading to the need for multiple, possibly conflicting, policies and practices in these areas? Might those back-office efficiencies and synergies used to justify your latest cross-border deal end up reducing the ability of the business to operate locally, and if so, does your integration strategy reflect this balance? While we see businesses considering these aspects of a deal much more carefully regardless of their location or that of their M&A activity, at present the lack of clarity is only adding to their inability to do deals that they can be confident will work for the long-term.

One positive of this uncertainty however is more attention to other, more flexible, inorganic models that help manage the deal risk: joint ventures, partners, strategic alliances etc. While trickier to implement and manage than traditional M&A, businesses can, and are, adopting these kinds of relationships more readily to help them face the future, whatever it looks like.

Q10. What are the most common disputes in cross-border M&A transactions?

Carlos Keener

Keener: Reflecting the general importance of communications during integration, one of the most significant amplifiers of cross-border dispute is nothing more complex than distance and time zones. Conversations to resolve issues that would otherwise take a few minutes by email can take days, while important relationships requiring face-to-face time to foster never get the opportunity due to the need for lengthy and expensive travel. One of the most important universal success factors in cross-border integration: Accept and make liberal use of an excessively large travel budget to help align objectives, build teams and strengthen relationships, both for the integration and the broader business.

Dr Ruth Murray-Webster

Murray-Webster: Contrary to conventional wisdom, regionally-different cultural differences are rarely the cause for significant M&A underperformance. (Organisationally-driven cultural differences are another matter however!) Instead, some of the most common disputes in cross-border M&A in our experience relate to more pragmatic issues such as territorial pricing strategy; adoption of acquiring firm 'best practice' in conflict with local ways of working, custom and legislation; and post-merger planning. All of these issues are based in the same root cause: the perception by the seller that the acquiring company sees their own country, business maturity and operating model as inherently superior. M&A, especially in the emerging markets, takes on a somewhat patronising flavour, or at worst becomes a form of 'missionary work'.

Unconscious hubris lies at the heart of this on either or both sides. Its consequence presents itself in the mindset and conversations within and from the target team: "You don't understand me; you don't understand my country or my business. You think you're better than we are; why else would you put a discount on my price just because of my country and choose your laws over mine?"

When acquiring overseas, keep these questions front of mind:

- How much misalignment and misunderstanding of the deal rationale and subsequent operating model design can be attributed to simply not fully understanding what is being said – both due to an uncommon spoken language and differences in cultural interpretation?
- How much resentment or suspicion might be building up over time (often long past the day the deal has closed)? What impacts might this have on the operational ability for the business to achieve long term deal benefits?
- Some Western corporates can view entry into an emerging market via M&A as a roll of the dice. Is this attitude conducive to a high level of new employee engagement?
- How important are the processes and relationships between your cross-border group companies? Have you built this value and importance into your post-deal plans for value creation? How much leadership attention and commitment will be needed to make sure this works?

Shigeki Tatsuno

Tatsuno: Cross-border M&A disputes in Japan often arise from breach of representations and warranties, whether as a result of inaccuracy in the target's financial statements, the seller's failure to disclose material documents or information, or other reasons.

Disputes about purchase price adjustments mechanisms are also relatively common, particularly in respect of earn-out calculations. This is because earn-outs are typically dependent on future developments, whether in respect of the target company or economic conditions at large, and as such, it is often difficult to devise a formula that produces a earn-out figure mutually acceptable to buyers and sellers.

Transactions using short-form agreements with general provisions, sometimes preferred by Japanese parties, also give rise to a higher likelihood of disputes about the interpretation of matters not expressly provided for in the agreements.


Andrew Sherman

Sherman: The most common disputes in cross-border M&A transactions are typically tied to either the lack of an effective post-closing integration plan (see answer to question 8 above) or to legal, political, cultural or workplace related differences in the two or more relevant jurisdictions that had not been adequately analysed by the parties. For example, an earn-out clause, which was tied to post closing profitability that did not reflect significant differences in salary, benefits, vacation policies or typical perquisites could easily lead to a post-closing dispute in a cross-border deal.

Similarly, differences in international accounting systems, internal controls and financing best practices could lead to a wide variety of disputes affecting financial reporting and working capital adjustments.

Finally, cross-cultural differences in risk perception, risk management and risk tolerance can have a direct and indirect impact on disputes which involve indemnification claims, escrow amounts, hold-backs, breaches of warranties and the need for one or more insurance policies to close the gap on different perceptions of responsibility for risk allocation.


Pino Bacinello

Bacinello: I would have to say business culture understandings and implementation.

Q11. What key trends do you expect to see over the coming year and in an ideal world what would you like to see implemented or changed?


Carlos Keener

Davidson: Currently, the M&A deal market remains strong, despite the headwinds arising from geopolitical and trade tensions, coupled with growing economic uncertainty. Capital availability remains high and financing costs are at record lows. We expect the following trends to continue into the coming year:

- Buyers focused on acquisitions, based primarily on their strategic, synergistic value resulting from a combined entity, rather than standalone value
- The fourth industrial revolution permeating every aspect of businesses, as the U.S. continues to lead in innovations
- Continued rise in partnerships for knowledge sharing and technological capabilities
- Availability of private equity and flow of new players and funding options continuing to boost M&A activity
- Robust deal activity, revved up due to U.S. stock markets remaining buoyant through most of 2019 (despite high volatility) that is likely to continue in 2020
- Certain sectors continuing to exercise restraint, as they await the outcome of the U.S. elections and easing of geopolitical tensions, before plunging into deal making; M&A activity remaining high in other industries such as biotech and healthcare

Overall, optimism regarding the M&A landscape bodes well for 2020, despite the multitude of competing dynamics. This positive deal making trend will continue into the coming year. The generally high optimism, coupled with the intense drive to deploy dry capital powder, mandates the importance of an objective, thorough due diligence performed with a healthy scepticism.

Finally, drafting a well-thought out post-merger integration plan with detailed steps for transition is critical to the success of an M&A transaction.


Carlos Keener

Keener: Over the coming year, we anticipate a greater volume of divestitures as organisations look to focus on core business and take the opportunity to deal with 'problem children' in their portfolio.

One thing we'd like to see changing is the view held by some that divestitures and their ensuing separations do not warrant the same attention as integration of acquisitions.

This view is logical to some extent – the price of the sale is in the bank when the deal is done. But taking a mature risk-based view, there are many opportunities to prevent value destruction, or even build greater value from the remaining organisation if the questions that it's necessary to answer for M&A is answered for divestitures (i.e. what objectives must you realise? What does the future operating model look like to realise those objectives? What is the plan to get there? Are your leaders ready?).

We take an integrated view to carve-out and separation design and planning ensuring that clients have a clear, connected view of how to realise the value of the asset as quickly as possible without disrupting the remaining business. This includes preparing the remaining business for day one and support with transitional service agreements and operations post-close.


Dr Ruth Murray-Webster

Murray-Webster: One trend we expect to see increasing is the scrutiny of deals pre-close from a value creation perspective.

Quoting one of the respondents from our *Inconvenient Truths* study (2017), *"In any other field of strategic activity, boards and CEOs would simply not tolerate a success rate of 60%. Would you?"*

We know that acquisitions continue to fall short of their intended benefits post-close, despite intensive analysis and planning pre-close. Many acquirers experience:

- Escalating integration costs and timescales
- Increased post-close business costs and disruption
- Customer confusion, dissatisfaction and flight
- Markets punishing those unable to tell – or deliver – a compelling story about the deal
- Investors losing confidence in M&A as a route to strategic growth
- Lack of appetite or readiness for further deals.

We hope to see more focus on readiness to realise synergies from the deal pre-close. Deal readiness, in our world, is not about being ready to do the deal, but being ready to successfully (quickly and cost-efficiently) deliver the promised value.

It would be great if senior executives were approaching day one with true confidence – based on evidence, not gut-feel – that:

- Plans to deliver deal benefits post-close are sufficient and fit for purpose.
- All routes to possible value generation have been considered and the ones chosen are realistic and achievable.
- People are ready and able to deliver the benefits of the deal.
- The risks associated with successful delivery are understood and plan B's are in place.

Shigeki Tatsuno

Tatsuno: Retained earnings in corporate Japan are now at record levels. In view of this, the Japanese government is reportedly considering the introduction of a tax credit system that provides tax breaks for Japanese companies that use available cash in M&A activities that promote innovation and new business models. This proposal is expected to be included among the tax reform outline that is currently being prepared for fiscal year 2020. Some market watchers believe that such tax credit system, upon implementation, will result in a hike in M&A activities. This is because many of the Japanese companies that are in urgent need of innovation see acquisitions of local and overseas start-ups as a means of reinventing themselves, and the tax credit system could induce them to undertake acquisitions they were already planning.

Andrew Sherman

Sherman: Key trends in the United States for 2020 and beyond will be influenced by a wide variety of political, economic and technological trends that will unfold the next 12 months. For example, a shift in the Presidency could easily lead to an uptick in healthcare, energy and environmental industry transactions and a downtick in defence and aerospace transactions. In addition, it is still unclear how the on-going trade wars with China will impact cross-border transactions and whether this administration will resolve the issues in a material way versus the issues being kicked down the road to the next administration, if there is even a change at all.

Irrespective of the political landscape, there are certain demographic trends that will significantly impact M&A activity, such as the need to deal with an increasing growing number of ageing baby boomers, as well as significant shifts in the work place, including AI and robotics transforming the nature and economics of work. Other areas likely to drive M&A transactions in 2020 and beyond include the emergence of blockchain, online gaming and professional gaming leagues, virtual reality, and facial and related biometric recognition.

Pino Bacinello

Bacinello: I don't see any major bubble burst or anything like that in Canada other than perhaps the real estate market. However, I say this with caution as the law of supply and demand is clearly at work.

An ideal world for me would be one where there is greater M&A activity and the major national, North American and international corporationscontinue to enter the British Columbia market. Now if only, we can get Provincial and Federal Governments that are more pro-business, and less pro-government, that would be ideal!

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