

THE DEALMAKER

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M&A is in vogue. But even during this upswing in activity, deal frenzy is definitely out. Now, says Vicky Meek, it's all about tight due diligence, maximising sale prices and finding value post-deal.

COME TOGETHER

M&A IS BACK. For several years now, private equity houses have been making up the lion's share of M&A activity – they've been the only ones with the spare cash and confidence to buy up businesses in the UK. But that's changing.

"This year has been a lot more active than the last two to three years," says Michael Reeves, joint MD of Clearwater Corporate Finance. "Trade buyers are back, driven by an increase in confidence in the economy." Rising share prices have also made public companies more acquisitive.

And while last year may have been all



Michael Reeves: trade buyers are back, but acquirers are taking a more realistic view of potential synergies.

about retail, company valuations in that sector are now so high that the value has been squeezed. So new areas have heated up over the last few months: healthcare (especially care homes), media, financial services and support services.

We haven't quite reached the stratospheric heights of the late nineties (see graph). But that's no bad thing. Advisers say that companies are taking a more cautious attitude that could soon consign to history the old adage about a vast majority of acquisitions failing to create value.

Boards have seen the damage that poorly handled acquisitions can do. Many are wary of falling into the same trap as supermarket chain Morrisons in its acquisition of Safeway. "People used to take a much more aggressive view of the synergies they could achieve," says Reeves. "Now, companies are taking a more sophisticated, realistic approach."

John Kelly of KPMG Transaction Services agrees. "We used to see management teams focus mainly on getting the deal done," he says. "Nowadays, they are putting much more emphasis on post-acquisition issues while the deal is going through. It's a huge step forward."

As a result, due diligence has become something of a mini-industry. "You used to get financial due diligence and that was it," says Reeves. "But DD is no longer just for the bank's purposes – it's now a core part of understanding what strategic benefits

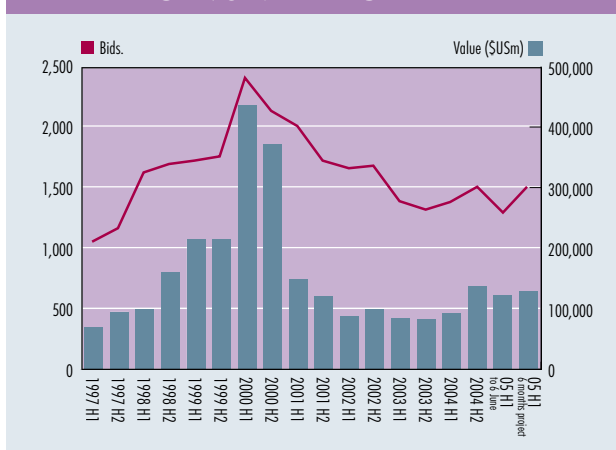
you can gain from an acquisition." Hence the need for market DD. "Due diligence used to be about how you could pay less for a business," says Kelly. "Now, it's about how you might be able to pay more."

That's important in what has become an extremely competitive market. Few businesses these days are sold without doing the rounds of several potential buyers. "There's a trend towards auctions," says Robert Ogilvy-Watson at Ashurst. "It's pretty brutal – you usually end up with a list of two to three buyers who have to come up with an answer within 24 hours."

But although you're likely to be paying more, you're also likely to have to base your assumptions on weaker data. "M&A in 2005 is very much about data rooms," says Kelly. "You may find yourself surrounded by boxes and boxes of leases, but the one piece of sensitive information that you really need isn't available. There must be an awful lot of FDs that wake up on day one after the deal with a hangover, thinking: what have we bought?"

So it's a seller's market. And with debt markets so hot at the moment it's a trend that looks set to continue. Debt issuance in Europe for the first half of this year reached record levels, according to recent research by ratings agency Fitch. Low interest rates, low default rates and a relatively benign economic environment should see this follow through for the rest of the year. There's cash out there – and sellers know it.

UK M&A: THE BIG DIPPER



The last ten years have been something of a roller-coaster ride for M&A in the UK. Deal values and volumes rose steeply in the late nineties, fuelled by the tech boom: nearly \$450bn of deals were done in the first half of 2000. The market's been quieter since the crash in 2001, but things are picking up. Values in H1 2005 outstripped the same period in 2004 by 40 per cent.

AFTER THE GOLD RUSH

What you do during an M&A deal goes a long way to determine how the integration goes, say our FDs.

Name: Paul Hampden Smith

Company: Travis Perkins

Sector: Construction services
and retail DIY

Acquisition: Commercial
Ceiling Factors (CCF)

Value: £46m

Deal date: October 2002



COMMENT “We decided to buy CCF because it had a good name in insulation and ceilings. That was an area in which we were not particularly strong before this deal. We felt that as part of Travis Perkins, it would be able to buy much better and would gain from distribution through our 600 stores. The rationale was pretty clear to us.

“Acquisitions are bread and butter work for us, I’ve worked on several during my time here. Mind you, on this one, the final stages were fairly fraught. The main stumbling blocks in the last stages were the final salary pension scheme and property, both of which we had to get a lot of advice on. We signed the deal at one o’clock in the morning, but actually, that’s not especially unusual. There’s a rule of thumb in M&A: lawyers are incapable of getting deals signed at reasonable times of the day.

“Acquiring a business is a bit like a job interview. You’re only exposed to a limited amount of information on which you have to make your decision. But we felt that CCF’s management team was strong. That was one of the most important factors. We needed their

that until after the deal had been signed.

“Integrating the business was relatively simple. We tried to get the new people involved in other parts of Travis Perkins and transferred some staff across early on. We also encouraged our people to buy from CCF, which meant the company generated an additional £20m to £30m of turnover in the first year. That helps build communication and trust between the two sides.

“We kept two head offices for about a year. That may sound like a long time, but we felt it was important to ensure that commercial and trading relationships remained stable. That meant initially we also kept CCF on its stand-alone systems, too. But as we integrated the company more and more, it made less sense to duplicate processes, such as those for rebates.

“One of the first changes was the Epos system in the branches. But eventually we migrated all the CCF activities over to Travis Perkins’s back-office systems. We have bespoke systems – we don’t buy large packaged applications. That means that we can integrate another company’s processes into it more quickly than with off-the-shelf packages. It’s also a lot cheaper to execute.

“But we didn’t just swap all of their systems onto ours. We spent time evaluating what they had

in place, too. We found that their stock control system was better than ours, so we brought that into Travis Perkins. That was another thing that helped with integrating the two businesses culturally.

“Overall, the process has been a win-win situation – we still have a good relationship with the vendor and we buy some of our materials from them. If there was anything I might have done differently, then it would have been to get information on the final salary pensions earlier because that held the process up a little. But overall, we’re very happy with the way things have turned out.”

“WE KEPT TWO HEAD OFFICES FOR A YEAR – IT WAS IMPORTANT TO ENSURE THE TRADING RELATIONSHIPS REMAINED STABLE”

expertise on board to ensure the business continued running well. The fact that most of the management team were staying on was also helpful because it meant the potential for nasty surprises was that much lower.

“In the event, we discovered that the vendor had been very open with us and the FD had done a very good job in preparing the company for sale. But one thing that this deal demonstrated to me was the value of looking at current numbers. Don’t rely on historic figures, especially if the acquisition takes a while to complete. With CCF, a large bad debt emerged that affected the company’s profitability and therefore the price. It totalled £1m and Travis Perkins had never had a bad debt of that size on its books. If we hadn’t been determined to look at the most up-to-date figures during every stage, we might not have spotted

Paul Hampden Smith, finance director of Travis Perkins, was named “First Among Equals” Overall FD of the Year, in association with Bank of Scotland Corporate, at the Real Finance/CBI FDs’ Excellence Awards 2005

“THE KEY IS TO GET ALL THE TEAMS WORKING BEFORE YOU COMPLETE. THAT WAY, YOU GENERATE SAVINGS WITHIN THE FIRST THREE WEEKS POST-DEAL”

COMMENT “Astron itself was the product of three mergers in the outsourced print management industry, so we had a lot of experience in merging companies. We’d also acquired Hays Commercial Division the previous year, which involved integrating a business with 2,500 employees.

“So the Edotech deal was just a continuation of our growth through acquisition. It was number one in its market – outsourced bill printing – which was an area we hadn’t yet built up at Astron. We felt that combining the businesses would give cost savings as well as adding a new business line.

“The integration work starts before you sign the deal. We were backed by PPM Ventures [now PPM Capital]. As a private equity-funded business, we had to be extra prepared because of the high gearing the company had. We had to ensure that whatever happened, we continued to meet our banking covenants.

“We did a very detailed strategy plan in advance and assigned a project manager to it. We had the plan independently due diligenced by Deloitte to ensure we weren’t being over-optimistic in our assumptions.

“Because we’ve completed so many acquisitions, we have a plan in place to deal with acquisition integration – and that’s what we used with Edotech. We put together small teams consisting of both in-house people and external experts that were dedicated to specific areas. These are: strategy, people, procurement, systems, equipment and property. The work on all areas bar systems is focused on gaining savings.

Systems, however, is always a cost.

“The key is to get all the teams working before you complete. So, for example, in procurement you’d get the teams to see what the business is paying suppliers and then go out and get new quotes. That way, you can generate savings within the first three weeks after the deal. Time is critical in all this. If you lose time, it’s very easy to lose momentum and if you have covenants to meet then even just a month’s slippage is not acceptable. Get your teams to sign off the savings they can achieve within the first 100 days – and offer rewards for achieving those targets.

“This process with Edotech went reasonably smoothly. But there’s always an element of the unknown. The biggest surprise we got was that we’d planned all along to work with the Edotech chief executive – he was supposed to stay on after the deal was complete. But it quickly became apparent that this arrangement wasn’t going to work. We had to face up to that early on and deal with it or we wouldn’t have met our timetable. We had to get a new team in place – and quickly.

“Property is often a difficult aspect of an M&A deal to get right. It’s hard to shift rental property and you can find yourself with empty premises for some time. With Edotech, this was one part that was a bit disappointing. But there was a happy ending – overall we managed better savings than we’d anticipated.”

Mark Haselden, finance director

Name: Mark Haselden
Company: Astron
Sector: Business services
Acquisition: Edotech
Value: £130m
Deal date: April 2004

“I FOUND MYSELF HAVING TO WEAR AN AWFUL LOT OF HATS AND RESOURCES WERE A BIG ISSUE BOTH DURING THE DEAL AND AFTER”

COMMENT “We operate in a space where there aren’t many competitors, and those there are don’t have much intellectual property on the books. So we looked at companies that were associated with science parks and universities that had developed similar technologies to ours. That was the main reason for the three acquisitions we did.

“Although we hadn’t done M&A deals before at Corpora, most of the management team had completed them in previous roles. So we knew what

to expect to a certain degree. But in my previous roles I’d been in larger companies and that meant that I could surround myself with advisers when buying a company. Corpora is much smaller. I found myself having to wear an awful lot of hats and resources were a big issue both during the deal and afterwards. You have your normal day-to-day job to do – and it’s important you don’t slip on any of that – and you somehow have to find another eight hours in the day to devote to an acquisition.



Name: Richard Jennings
Company: Corpora
Sector: Software and IT
Acquisitions: Exago, Infonic, Algorithmics
Value: between £5m and £10m in total
Deal date: May to August 2004



“One of the trickiest aspects was getting the finance sorted out. We spent a lot of time convincing the City that we had a new and exciting strategy. It wasn’t easy because we had to go to the markets in 2003 – at a time when raising money for technology acquisitions was particularly tough. So I’d advise anyone to start the fundraising process as early as possible. And you really have to make sure that your Nomad and broker understand exactly what you do.

“You hear a lot of stories about acquisitions in which divisions of the company don’t know about the deal until after it’s done. That didn’t happen in our case, partly because of the size of the businesses, but also because we were keen to ensure that everyone knew what was happening and what roles they needed to undertake after the deals.

“Mind you, a lot of the work is done before the acquisition takes place. We did very solid due diligence and went through HR issues, supply contracts and client contracts with a fine-toothed comb. Not only did this help with understanding what we were buying, but it also forms a large part of your plan post-acquisition. It’s all very well looking at the big picture, but there are also all kinds of nitty-gritty details to sort out

– change of VAT registration, getting people onto our payroll system, new banking arrangements, and so on. We planned for all of these and put them on a big sheet of paper, a sort of giant to-do list. It’s nothing fancy, but it ensured we hadn’t overlooked anything vital.

“One of the things that really helped us on integration was having an operations director. He smoothed the process by dealing with all the contractual matters, things like that. It helped us save time as well as cutting down on lawyers’ costs. As an insider, he also understands the business thoroughly and, as hard as an external lawyer may try to get under the skin of the company, there’s no way they can know it as well. We’ve also hired an HR manager now, which will really help with any future acquisitions we make.

“Since completing the deals we’ve changed a lot of our advisers, including our broker. We’ve opted now for smaller firms and we get much better attention from them. If we want to raise a small amount of money in future, we know that we’re not going to be at the bottom of the pile.”

Richard Jennings, finance director

“I WISH I HADN’T SPENT SO LONG TRYING TO HARMONISE EMPLOYMENT CONTRACTS – IT’S VIRTUALLY IMPOSSIBLE IN A CROSS-BORDER MERGER”

Name: Philipp Bouteiller
Company: IGA Partners
Sector: Advertising
Merger: In-Game Partners
Value: N/A
Deal date: 2004

COMMENT “We set the company up in March 2003, so we’re a relatively young business, even in this market. We offer advertising campaigns that can be worked into computer games.

“But since the games industry is global, we recognised fairly early on that we needed to be a global organisation. But we didn’t actually acquire In-Game Partners in the US to achieve that. We simply arranged a merger between the two existing businesses so that we had US and European operations. Our next step will be to go into Asia.

“One of the hardest aspects for us post-merger has been the complexity surrounding the different accounting standards. With offices in the US, London and Berlin, we now have to have different versions of accounts to satisfy the different jurisdictions and that can be confusing. At a company level, we also run a straightforward internal cash management tool so we know where we are on our burn rates and cash flow.

“The other issues we’ve grappled with are cultural differences, local legislation and employment con-

tracts. We’ve found that here in Europe we tend to be more process-driven than our US colleagues, who are more entrepreneurial and visionary in their approach. At the beginning that caused some tension. For example, when our European people arranged a conference call for a particular time with the US, they’d call to the minute. Our US office had a more lax attitude towards this. But having different approaches has actually turned out to be an advantage. We soon realised we could take the US vision and apply some European method to it.

“In retrospect I wish I hadn’t spent quite such a long time trying to harmonise the different employment contracts. That’s something that may be more possible if you are merging two domestic businesses, but it’s impossible internationally. Expectations about vacations, health insurance and other terms of employment are just so different. Trying to get people on the same terms is bound to fail miserably.”

Philipp Bouteiller, COO and CFO

M&A LESSONS

What FDs have taught us about M&A and post-deal integration.

1 Front-load the work. All our FDs said time spent preparing the integration before the deal actually completed was well worth it. And our advisers agreed. “Use the period before you buy to plan,” says John Kelly of KPMG Transaction Services. “It may mean spending more time and money early on, but at least you’ll know how to tackle the main issues from day one.”

2 Feel the numbers. “Always look at the most up-to-date financial information available from the target company while the deal is going through,” says Paul Hampden Smith, FD of Travis Perkins. “What’s the current run rate on profit? Have there been any big customer losses since you put in a bid? A lot can change in a very short space of time – especially when management is busy working on a deal.”

“Always consider that your counterpart in the other business may not be there in the medium term,” advises Kelly. “You have to get confidence in the numbers straight away, so put someone in there in whom you have absolute trust and who will stop you worrying about whether the numbers stack up or whether there are black holes.”

3 Bring the integration team in before signing. “Get people involved early on,” says Mark Haselden, group FD of Astron. “Get them to agree the savings they are committing to and reward them if they achieve them.” Kelly agrees: “Get your operational people involved in the transaction so they have bought into the deal. Agree the numbers with them and get them to sign in blood. They won’t be committed if you bring them in once you’ve already made the decisions.”



John Kelly of KPMG: try to avoid the “conqueror syndrome” of assuming your systems or processes are better just because you’re the acquirer.

4 It’s all about people. “Around half of all problems with integration are to do with people,” says Kelly. “Communicate with your new team. This isn’t a tree-hugger thing, it has business benefits. It’s especially important in people businesses. But it’s easy to underestimate the people factor in asset-heavy firms. They aren’t just factories, they rely on customer and supplier relationships too.”

And let people know what’s going on – otherwise your grand plan will be scuppered by the rumour mill. “Be open with staff,” says Haselden. “The chief exec needs to let people know where they stand in the 100-day plan – and that there will be changes. It can be uncomfortable for a period, but at least people know. Where we’ve had to

“HIRE AN HR EXPERT IF YOU CAN AFFORD IT. IF I’D KNOWN HOW TIME-CONSUMING HR WAS GOING TO BE, WE’D HAVE DONE IT LONG BEFORE”

close sites, if we let people know early on, they tended just to get on with it.”

But think long-term too, says Robert Ogilvy-Watson of Ashurst. “Work out how you are going to motivate the key people who already know they have limited career options at the company. Golden handcuffs are one solution.”

5 Keep to your timetable. “Be prepared to alter your plan,” says Haselden. “You can’t possibly predict every eventuality and you can’t get

everything right. But don’t get behind schedule if things don’t go quite right. Keep it on track.” And respond quickly. “When you ask people what they could have done better, it’s usually that they wish they’d acted faster and implemented change more swiftly,” says Michael Reeves of Clearwater Corporate Finance.

6 Get the right people on board. Both internally and externally. “If you’re a public company, you have to have a good broker,” says Richard Jennings, FD at Corpora. “Not just to help you raise money in the first place, but also to manage your reputation and look after your stock price after the deal has been done. And hire an HR manager if you can afford it. If I’d have known how time-consuming the HR aspects of the deal were going to be we’d have had one before.”

7 You’re not always right. “Avoid the conqueror syndrome,” says Kelly. “Just because you bought a company, that doesn’t mean your systems are necessarily better than theirs. Mergers are usually 80 per cent emotional and 20 per cent rational. You can have debates lasting months about where to base your headquarters, but the likelihood is that it’ll end up being close to where the CEO lives.”

“Understand that there may be some things you simply can’t streamline,” says Philipp Bouteiller, COO and CFO of IGA Partners. “That’s especially true if you are doing a cross-border merger. Spend time with your new colleagues and be aware of the cultural differences and try and use them to your advantage.”

WHERE NEXT...

<http://snipurl.com/MnAfailures>

Why acquisitions fail

<http://snipurl.com/DD4integration>

Integration planning at an early stage

www.cipd.co.uk/subjects/corpstrtg/mergers

HR factors in M&A deals

www.bankingmm.com/Features/featurespage3.htm

The importance of IT integration