

Mergers and Acquisitions 101

Some basics you need to know when doing a deal...

Rural Bankers Association of the Philippines

*Rural Banks: Reliable Partners of Local
Communities for Growth*

November 10, 2014

Presentation by: Butch Gregorio



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BSP – Circular No 854 “Minimum Capitalization of Banks”

Section 1 of the Manual of Regulation for Banks on Minimum Capitalization

Bank Category	Proposed Minimum Capitalization
Rural and Cooperative Banks	
Head Office in National Capital <ul style="list-style-type: none"> ▪ Head Office Only¹ ▪ Up to 10 branches¹ ▪ 11 to 50 branches¹ ▪ More than 50 branches¹ 	P 50 million 75 million 100 million 200 million
Head Office in All Other Areas Outside National Capital Region (All Cities up to 3rd class municipalities) <ul style="list-style-type: none"> ▪ Head Office only¹ ▪ Up to 10 branches¹ ▪ 11 to 50 branches¹ ▪ More than 50 branches¹ 	P 20 million 30 million 40 million 80 million
Head Office in All Other Areas Outside National Capital Region (4th class to 6th class municipalities) <ul style="list-style-type: none"> ▪ Head Office only¹ ▪ Up to 10 branches¹ ▪ 11 to 50 branches¹ ▪ More than 50 branches¹ 	P 10 million 15 million 20 million 40 million

¹ Branches - inclusive of Head office

Background



Definitions

Mergers and Acquisitions

- A merger is a combination of two companies to form a new company
- An acquisition is the purchase of one company by another in which no new company is formed.

Recent Bank M&A

WHEN	BUYER	TARGET
August-14	China Banking Corp	Planters Development Banks
June-14	BDO Unibank	The Real Bank (A Thrift Bank)
March-14	Philippine Bank of Communications (PBCOM)	Banco Dipolog
March-14	Philippine Bank of Communications (PBCOM)	Rural Bank of Nagcarlan
March-14	BDO Unibank	Citibank Savings Banks
July-14	East West Banking Corp	Green Bank A Rural Bank
February-14	China Bank Savings Corp	Unity Bank, A Rural Bank Inc
November-13	Producers Savings Bank Corp	Iloilo City Development Bank
May-13	One Network Bank Inc. (A Rural Bank)	Rural Bank of San Enrique (Iloilo) Inc.
Feb-13	Philippines National Bank	Allied Banking Corp
Jan-13	First Community Copperative Bank of Misamis Occidental, Cooperative Bank of Davao del Sur and Cooperative Bank of Surigao del Sur	Consolidated Cooperative Bank
Nov-12	Country Rural Bank of Tagig Inc and Builders Rural Bank Inc	Country Builders Bank Inc. (A Rural Bank)
12-Oct-12	Producers Savings Bank Corp	New Rural Bank of Victorias Inc
6-Sep-12	Asia United Bank Corp	Cooperative Bank of Cavite
24-Jul-12	BDO Unibank Inc (BDO)	Rural Bank of San Juan Inc.
2-May-12	Valiant Rural Bank (Iloilo City) Inc and Rural Bank of Sapián (Capiz) Inc	Valiant Bank Inc. (A Rural Bank)

Acquisition Process

Strategy and Planning	Evaluation and Screening of Opportunities	Deal Negotiation and Closing	Post Closing Assistance and Integration
<p>Assess Strategic Goals and Financial Alternatives</p> <ul style="list-style-type: none"> ▪ Business opportunities ▪ Target identification ▪ Capital structure analysis <p>Preliminary Due Diligence</p> <ul style="list-style-type: none"> ▪ Industry and business fit ▪ Competitor analysis ▪ Industry perspectives ▪ Market studies ▪ Value driver and risk assessments ▪ Business intelligence <p>Preliminary Valuation Model</p> <ul style="list-style-type: none"> ▪ Financial projections and sensitivities ▪ Transaction pricing ▪ Synergy considerations 	<p>Financial Accounting Diligence</p> <ul style="list-style-type: none"> ▪ Value driver and risk assessment ▪ Financial structuring ▪ Quality of earnings/Cash flows ▪ Balance sheet exposures ▪ Unrecorded liabilities ▪ Working capital trends ▪ Capital expenditure requirements <p>Financial Projections Update</p> <ul style="list-style-type: none"> ▪ Market assessments ▪ Key assumptions and drivers ▪ Revenue forecasting analysis ▪ Capital expenditure requirements ▪ Sensitivities analysis <p>Operational Review</p> <ul style="list-style-type: none"> ▪ Strengths and weaknesses ▪ Management assessment and screening 	<p>Negotiation and Documentation Support</p> <ul style="list-style-type: none"> ▪ Purchase and Sale Agreements ▪ Price/term adjustments resulting from commercial and financial review ▪ Representations and warranties <p>Communications</p> <ul style="list-style-type: none"> ▪ FTI Consulting's strategic communications group provides next-generation communications advisory services ▪ Provide financial, corporate and public affairs communications management 	<p>Purchase Price Allocation</p> <ul style="list-style-type: none"> ▪ Fixed and intangible assets ▪ Impairment assessments <p>Management and Board</p> <ul style="list-style-type: none"> ▪ Audit Committee financial report ▪ Independent risk assessments ▪ Internal control reviews ▪ Disclosure control assessments

Divestiture Process

Strategy and Planning	Business Evaluation and Issue Resolution	Auction Process, Negotiation and Closing
<ul style="list-style-type: none">▪ Evaluate strategic goals and financial alternatives▪ Perform business assessment to understand value issues and develop near-term fixes▪ Develop value proposition for positioning purposes▪ Development of divestiture plans	<ul style="list-style-type: none">▪ Perform commercial and financial review▪ Evaluate quality of earnings and cash flows▪ Bridge historical results to projected financial information (i.e. identify non-recurring costs)▪ Analysis of non-core operations	<ul style="list-style-type: none">▪ Identify and resolve business separation and transition issues▪ Address other carve-out issues, if applicable▪ Valuation and pricing model development▪ Develop business/product line/technology valuation▪ Assess pros/cons of accounting and tax structuring issues <ul style="list-style-type: none">▪ Oversee preparation and distribution of offering memorandum▪ Prepare management presentation▪ Oversee bid process, data room setup and management follow-up▪ Evaluate offers and prepare counteroffers▪ Oversee negotiations of Purchase and Sale Agreements and other legal documents▪ Management and Board transaction approval

Initial Approach



Initial Approach

A. Shareholder or Management

- If professional management, then interests may diverge in takeover
 - Management: Concerned with retaining power, prestige or livelihood;
 - Shareholder: Gain on investment (don't care how it will be run after)
- Two undesirable consequences
 - Management may discourage takeover if convinced no future for them;
 - Management may be wooed by acquirer and convinced of merits of takeover



Initial Approach

B. Use Intermediaries

- Mutual acquaintance / Merger adviser
- Seller more willing to deal with third party
- Adviser role – “break ice”
- Interest lies in seeking ways to reconcile buyer/seller

Negotiations



Negotiations

M&A: Difficult to consummate, prone to breakdown

- Hard to remain detached and objective while selling a business which has taken years to build

A. Knowledge of other party

- Find out about other party
- First Approach: Chairman/CFO/Controlling Shareholder?

C. Team

Team of advisors

- not easy for one person to grasp all aspects of a transaction
- accountant/lawyers/M&A adviser



Negotiations (continued)

C. Timing

State of mind of seller critical

- Times of difficulty, best time as seller is more open. Once market recovers, seller will see no need for a sale
- Corporate Restructuring (non-core)

D. Keep in reserve

People like to believe they are successful negotiators

- Therefore, purchaser should keep something in reserve which can be conceded later
- Chairman/Adviser can feel that extracting this concession is their contribution to the deal

E. Setting limits

Upper price limit must not be carried away in “hot pursuit”

Due Diligence

What is Due Diligence (not an Audit !)

Due Diligence		Audit
Support deal rationale/value	Why needed	Report to shareholders Useful for accounts users
Prior to transaction	Timing	Annual, closing etc
Comfort only, not an audit	Opinion given	True and fair
Research & investigation	Process	Interim and final Procedures and balances
Agreed upon procedures	Governing rules	Auditing Standards/SEC
Varies according to concern	Materiality	Effect on profitability
Pressurised	Atmosphere	Controlled
Controlled access	Working Environment	Full access



Key Pre-acquisition DD Objectives

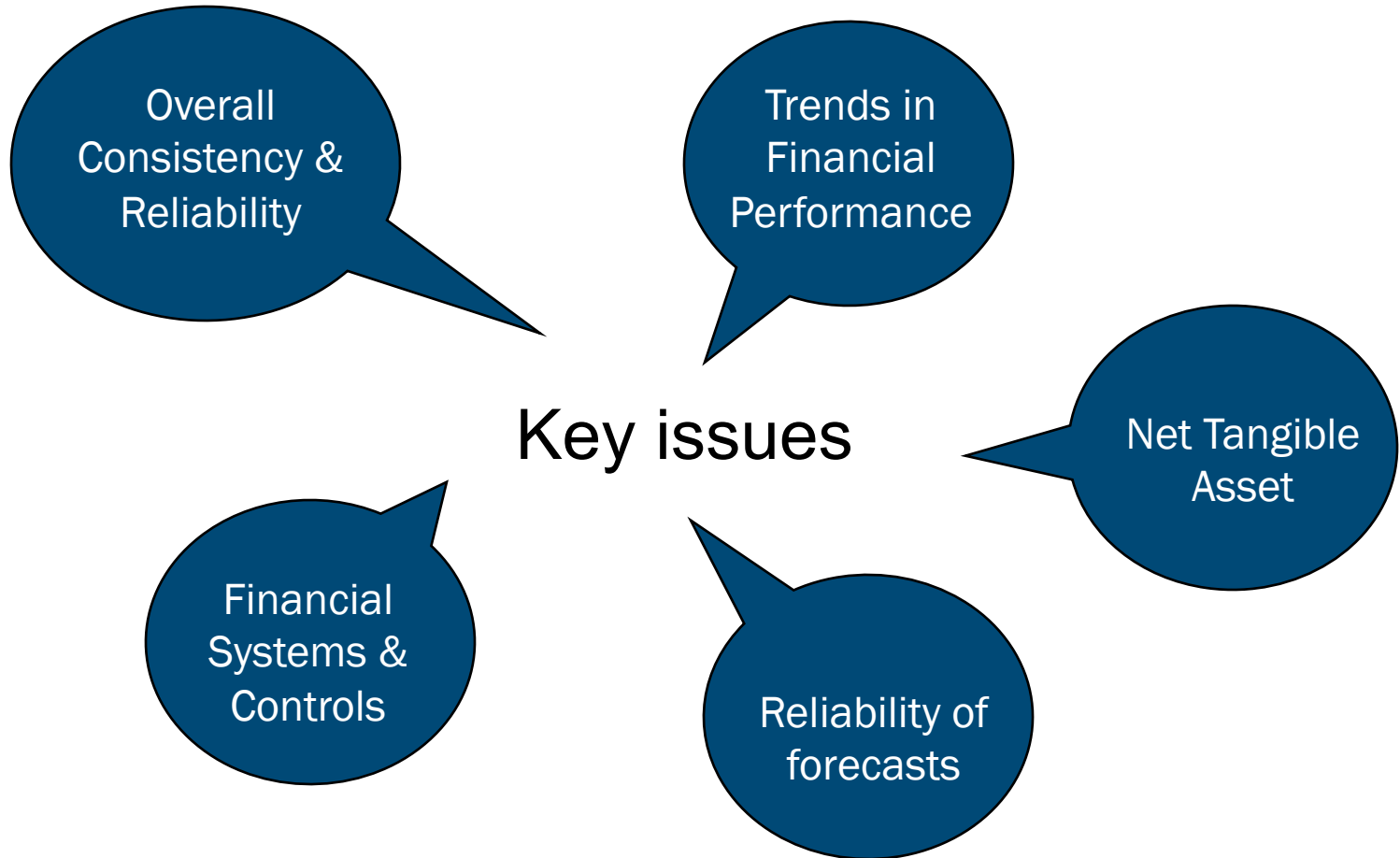
- Identify deal breakers early
- Identify risks and mitigate
- Validate/verify financial information
- Pricing/valuation information
- Sale and purchase agreement (e.g warranties, indemnities, completion accounts) – client protection
- Post-acquisition integration (facilitate the process)



Some Keys to Successful DD

- Effective project management
 - Buyers multifunctional deal team (Strategy, Finance, Operational, Tax, Financial modelling personnel)
 - Appoint Internal co-ordinator and point personnel to liase with advisors
 - Clearly define roles and responsibilities
 - Regular progress meetings and updates
- Define/communicate expectations to all parties involved
- Proper scoping indentify risk areas to focus on – eg
- Open/structured communication channels. Ensure all parties are on the same page, focussed on deal objectives
- Key issues tracking and resolution

Financial Due Diligence



Taxation Due Diligence

- Tax exposures
 - national
 - local
 - employment
 - property
 - sales
- Future tax rate
- Deferred tax
- Transfer pricing
- Double taxation considerations
- Thin capitalisation

Examples of matters to consider



Legal Due Diligence

- Review of contracts
- Legal ownership
- Legal threats
- Environmental laws
- Intellectual property
- Real estate ownership
- Competition law
- Sale and purchase agreement

Examples of matters to consider

Restrictive clauses

Potential court awards

Related costs (eg. interest)

Mitigation of risk changes

Alternatives open

Timeframes

Other Specialist Areas

- Pensions
- Real estate
- Environmental
- Insurance
- Human resource

Examples of matters to consider



Valuations

What Is Value?

- It depends on:
 - Basis of valuation
 - What is being valued
 - a business
 - a company or a share in a company
 - intangible assets (e.g brand names)
 - options
 - Individual assets and liabilities
 - Why is the valuation being prepared
 - Valuation method
 - When the valuation is taking place
 - Opinions of the valuer

Why Are Valuations Important?

- Valuations are critical in determining the price at which a company is sold or acquired
- Valuations determine whether a stock is under or over valued when making investment decisions
- Pricing an acquisition correctly is extraordinarily important
- The right price is relative
- The key to success is knowing the maximum price you can pay and having the discipline not to pay a cent more

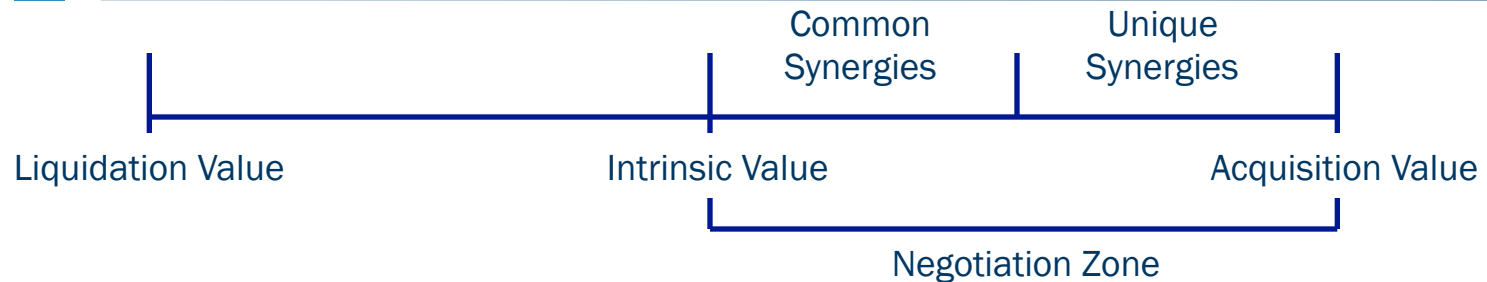
The Starting Point

- Fair Market Value

The amount for which an asset would be exchanged between a knowledgeable, willing but not anxious buyer and a knowledgeable, willing but not anxious seller, acting at arm's length in an open and unrestricted market

- Understand the value drivers of the business

Value Spectrum



- Intrinsic Value is the value of a target as a going concern under its current or anticipated operational and financial strategies.
- Acquisition Value is the value a target may have to potential acquirers.

...., the purchase price of an acquisition will nearly always be higher than the intrinsic value of the target company. An acquirer needs to be sure that there is enough cost savings and revenue generators – synergy value – to justify the premium so that the target company's shareholders don't get all the value the deal creates.

Harvard Business Review

Assumptions for Expected Synergies

- Synergy value forecasts are generally based on the following expectations:
 - Cost savings
 - Revenue enhancements
 - Process improvements
 - Financial engineering
 - Tax benefits
- Uncertainty levels increase with the length of the planning period, when defining the future strategic landscape
- Let your assumptions not be driven by the “strategic love” for the target

Valuation Methods

Earnings

Discounted
Cash flow

Capitalized
Earnings

Dividend
Yield

“Rules of
Thumb”

Net Assets

- Usually historic
- Ignores cost efficiencies
- Used to validate conclusions

- Historical book figures have no direct relevance to value
- Relevant in context of valuation of asset oriented companies, investment trusts or if business in loss making



Why Deals Fail

1. Lack of planning
2. Limited synergies
3. Difference in management or organization structures
4. Wrong implementation of strategy
5. Negotiation mistakes
6. Difference in company culture
7. Lack of knowledge by management
8. Overpayment
9. Difference of culture of countries
10. Too high expectations
11. Wrong integration approach
12. Different Strategies in R&D and Innovation

Critical Thinking at the Critical Time™