

Overseeing Mergers and Acquisitions

A FRAMEWORK FOR BOARDS OF DIRECTORS

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Preface

The Risk Oversight and Governance Board (ROGB) of the Chartered Professional Accountants of Canada (CPA Canada) has commissioned this publication *Overseeing M&A – A Framework for Boards of Directors* to help directors of public and private companies that are considering an acquisition or divestiture. It addresses the role of boards throughout the M&A oversight process, including the perspectives of both the buyer and seller in a transaction.

This Framework identifies why a board needs to be involved in M&A and key issues and risks for directors to consider. The publication approaches the necessary oversight activity within three key phases of M&A:

- M&A Strategy development
- Transaction development
- Post-closing activities.

M&A Strategy is an integral part of the enterprise's overall strategy. The company must be clear about its strategic rationale, develop M&A screening criteria, and search for targets. An M&A strategy should ultimately create value for shareholders, if executed effectively.

Transaction development involves several steps including approaching targets and beginning discussions, valuing the company and structuring the transaction, due diligence and finalizing the transaction.

Board oversight of post-closing implementation is critical for a successful transaction. Proper monitoring by the board during the post-closing phase includes planning, stakeholder communications, and the reporting and tracking of appropriate metrics and milestones. The publication also addresses how boards should examine what can be learned from each transaction so that future opportunities can then be evaluated in light of this prior experience.

In summary, this Framework provides an overview of the responsibilities of directors in overseeing M&A.

The ROGB thanks the authors, John E. Caldwell and Ken Smith. It particularly acknowledges the contribution of John E. Walker for his detailed review of the draft publication and suggestions to the authors throughout the course of their work.

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Who This Document Is For

This document is designed to equip directors with a framework for their role in overseeing the mergers and acquisitions (M&A) process, to identify critical steps and issues that will require their attention, and to provide useful tools to assist them.

It was developed for directors of public and private companies, but many aspects also apply to directors of crown corporations and not-for-profits. It is written assuming both the buyer and seller are public companies, but notes the differences (if any) if either party is a private company.

The document focuses on acquisitions and divestitures, whether the consideration is in the form of cash, equity or a combination of both. It applies equally to companies that are buying or selling, since many of the same key steps and director responsibilities apply.

For simplicity and to avoid duplication, we have written it to address the process of the buyer (or *acquirer*) first, and then noted the interpretation for the seller in sections called *The Seller's Perspective*.

Acknowledgements

We wish to acknowledge the contributions of Bennett Jones LLP Partners Gary Solway and Kris Hanc to this publication. More detailed information about the legal obligations of directors in M&A transactions can be found in the reference publication *Directors' Duties in Canada*, 5th Edition, authored by lawyers at Bennett Jones (see additional references).

We also wish to acknowledge the contribution of John E. Walker for the tremendous time and expertise he offered throughout the process of completing this publication.

Introduction

M&A Is a Growing Part of Corporate Strategy

M&A is now an integral part of the growth strategies of many companies.

Many industries are restructuring in response to fundamental changes in technology, deregulation and globalization, and companies may be involved in M&A transactions as buyers, sellers or both.

When M&A becomes an important part of strategy, the company enters a new arena of competition. Just as a company must have competitive skills related to its underlying business, in areas like product development, sourcing, manufacturing or sales and marketing, it must also have competitive skills in M&A. Understanding the role of M&A in strategy and mounting a superior M&A program can be a source of significant competitive advantage, growth and value.

But with this opportunity there is also considerable risk, since the stakes are often high and M&A involves many uncertainties.

Generally, boards should have heightened involvement in M&A not only because of the associated risks but also to provide a thoughtful and objective assessment of whether the fundamental strategy, transactional elements and implementation plan are sound and effective, and whether they have been implemented well.

Why the Board Needs to Be Involved

By their nature, acquisitions are complex, often taking buyers into uncharted territory as they seek to expand into new markets, acquire new products and technologies, participate in industry consolidation and face different forms of competition and market dynamics. While the statistics about failure rates may be debatable, a substantial number of acquisitions do not deliver their intended results, often resulting in the destruction of shareholder value.

Companies that are or expect to be active in M&A should have at least one director who has M&A experience because he or she will bring a useful perspective to assessments of risk and reward in M&A, as well as a useful understanding of the appropriate board process.

Management is tasked with developing and executing overall strategy, so it must bear direct accountability for M&A strategy—from acquisition rationale through to post-transaction implementation. But management can benefit from board member experience in M&A. Management should be encouraged to draw upon those resources.

While individual board members may assist management at various stages of the M&A process, it is important for the board as a whole to provide effective and independent oversight.

The depth of the board's involvement in M&A will vary, depending on the size and nature of the transaction and the organization's experience and capabilities. For transactions that are small relative to the size of the company, board oversight may be limited and it may delegate authority to management below a certain financial threshold or within other defined parameters. Conversely, a very large transaction may require a special board committee and extensive board involvement.

The board's overall responsibility to act in the best interests of the corporation, and its specific duties of care and loyalty, require it to oversee any material transaction. In most instances, there is alignment with maximizing value for all shareholders.

It is not just the transactional component of M&A that should be of concern to directors, however. Ultimately, creating shareholder value from M&A depends on the effectiveness of the entire process, from M&A strategy through implementation. In fact, oversight of the strategies that lead to

M&A Oversight A Framework for Boards of Directors

The M&A oversight framework has three phases:

- M&A strategy development
- transaction development
- post-closing activities.

These include the steps that are common to most M&A transactions, but directors should not expect any transaction to unfold exactly as outlined here. There are as many versions of this process as there are advisors, and the steps will vary depending on the kind of transaction.



transactions—and the effectiveness of implementing value-creating integration initiatives after closing—may be equally or more important than the transaction itself.

What We Mean by M&A

In the business vernacular, M&A refers to acquisitions, in which one company buys another. From the seller's perspective, this is a divestiture.

The term merger (the “M” in the abbreviation M&A) can be confusing because it is used in a variety of ways—e.g., for combinations of companies of similar size, or to indicate intent to treat both company's management, people or perspectives equally, or to indicate “pooling of interest” vs acquisition accounting (although pooling of interest accounting is now extremely rare). In today's context there is always a buyer and seller, so when we discuss M&A in this document we mean acquisitions, and we will avoid the use of the term merger in favour of acquisitions, divestitures or, more generally, transactions or business combinations.

Refresher on Basic Directors Duties

Under the *Canada Business Corporations Act* and the *Business Corporations Act* (Ontario):

- Directors have a fiduciary duty (duty of loyalty) to act honestly and in good faith in the “best interests of the corporation” (not just interests of shareholders or any particular shareholder). Even if the director is a nominee of a shareholder (i.e., selected by a shareholders to represent its interests), the director's duty is to **the corporation**.
- Directors are entitled to rely on the advice of professionals such as financial advisors, lawyers and accountants with respect to matters within the professional competence of those advisors.
- Directors also have a duty of care which requires that they must exercise reasonable care in the circumstances.
- Directors also have unlimited personal liability if they are found to have committed wrong doing.

- Directors can sometimes be liable even without fault — such as liability for 6 months' wages, environmental liability and employment standards liability (e.g., vacation pay).
- Directors have the benefit of the business judgment rule which provides that courts are reluctant to interfere with board decisions made after a proper process has been undertaken if the decision made is within a range of reasonableness.
- If the test is satisfied, courts will give the board the benefit of doubt even if the decision is, in hindsight, a bad one. Consequently, board process is important.
- Directors should have indemnification agreements with the company, as well as suitable directors & officers insurance.



PHASE 1

Strategy
Development

PHASE 1

Strategy Development

Directors should be involved in developing M&A strategy for two key reasons:

1. Directors are ultimately responsible for assessing and approving corporate strategy

M&A strategy is often an important part of overall corporate strategy. Most companies should at least consider the role of M&A in their plans for the company, to complement organic growth or as an alternative to it. Many companies in restructuring industries must consider M&A, even if only as a seller. For private equity firms and holding companies owning a portfolio of businesses, M&A strategy is central.

Boards need to think of M&A as an integral part of overall enterprise strategy.

2. The seeds of success or failure in M&A transactions are planted early

Companies that simply react to exciting opportunities presented to them frequently find themselves in bidding wars, unsure of how high is too high to bid, and then —if they “win”—trying to implement without the right skills and experience, ultimately destroying shareholder value instead of creating it.

Companies that are proactive in M&A know how to create value and search for targets that offer the greatest value creation potential. They negotiate better transactions and implement more effectively because they make choices based on their core strategy, skills and experience and because they have the skills they need to complete the M&A process.

OVERVIEW

1.1 Determining Where M&A Fits in the Corporate Strategy

	Management's Role	Board's Role
Identify issues	identify strategic issues	provide input
Define a process	define how the organization will develop its M&A strategy	review the process
Analyse options	analyse alternatives to acquiring or divesting	understand context and offer advice on options
Develop a plan	develop a strategic plan that specifically outlines the role of M&A (if any)	review and approve strategy, including the role of M&A

1.2 Acquisition Rationale and Screening Criteria

	Management's Role	Board's Role
Define how M&A will create value	define the ways acquiring or divesting will create value	assess the value creation potential
Identify risks	identify the key risks	review and provide input on key risks and assess these risks against value potential
Develop screening criteria	develop criteria for screening candidates based on corporate strategy, potential sources of value and risk management	review screening criteria

1.3 Candidate Search and Target Selection

	Management's Role	Board's Role
Define a universe	define the universe for the search	assess whether the process is objective and proactive (search universe not limited by biases or self-interest)
Screen candidates	screen candidates based on the criteria in 1.2	
Prioritize candidates	prioritize candidates to approach	

1.1

Determining Where M&A Fits in the Corporate Strategy

This section reviews

- Key things for boards to consider (page 12)
 - Risks for smaller companies (page 13)
 - Why boards choose to put the company up for sale (page 13)
 - Unsolicited offers (page 15)
-

The strategy development process and the role of M&A have critical overlaps. In fact, M&A generally forms an integral part of a company's overall strategy.

The role of M&A in the organization's corporate strategy should be explicit. Having no M&A strategy is acceptable only if the company does not intend to seek acquisitions and does not expect to be targeted by others, either to buy or be bought—an unlikely scenario in most industries today.

Where to Learn More

You can read more about strategy development in CPA Canada's other publications, including *20 Questions Directors Should Ask About Strategy*.

Key Things for Boards to Consider

The board should oversee a company's M&A strategy as part of its oversight of overall corporate strategy.

This includes assessing:

- the need to acquire or divest
- how M&A alternatives align with the company's vision, objectives and strategy to enhance its competitive advantage
- management's capacity and ability to execute an M&A strategy.

It is particularly important for directors to understand industry context as it relates to M&A, especially long-term trends and any risks related to inaction if an industry is changing.

For example, if the company is in an industry that is consolidating, or is likely to consolidate or restructure, the company needs to carefully consider its M&A options:

- Should it be a buyer or a seller?
- Should it lead the entry into new markets abroad or follow others?
- Does it need greater scale or scope or new skills to stay competitive?
- Are there attractive opportunities for growth through M&A in the current or evolving industry structure?
- Does it have (or can it assemble) sufficient capital and skills to entertain a major transaction?

Sometimes organic growth without acquiring (or being acquired) is the preferred alternative, but companies should continue to evaluate their M&A strategy because conditions can change quickly.

It may also be necessary to consider partnering with a larger firm to execute the company's M&A strategy.

If acquiring smaller firms, target criteria should reflect the buyer's implementation skills (for example, a buyer with turnaround skills should look for underperforming targets). Firms that are considering merging with or selling to a larger firm should consider whether the partner has the right skills to implement the expected synergies.

Directors should be aware that the pressure for growth, combined with the challenge of sluggish organic opportunities, is driving corporations to M&A. Growth for growth's sake, however, can lead to imprecise M&A strategy and fuzzy acquisition rationale, which are more likely to destroy value than create it.

Risks for Smaller Companies

The forces driving mergers in a consolidating industry can put smaller companies at a disadvantage unless they can find and defend a specific market niche. In businesses with commoditized products, however, niches are harder to find, and boards and management frequently overrate the uniqueness of their products and the loyalty of their customers. As a result, many companies that choose not to be involved in some form of consolidation become sub-scale and uncompetitive in the consolidated industry —and sometimes even unattractive as an acquisition target.

The Seller's Perspective

A board may consider selling the entire company proactively or in response to an unsolicited offer. Both scenarios involve complex decisions.

Although management may recommend it, deciding to sell the entire company is solely a board responsibility. It requires careful and thorough analysis, including evaluating other alternatives, like closing or selling part of the business (including intellectual property), restructuring debt or installing new leadership with different skills (see *Responding to Unsolicited Offers* on page 53 for a discussion of this).

Why Boards Choose to Put the Company Up for Sale

Boards seek buyers for two main reasons: because the prospects for future value creation are limited (or value destruction is very likely) or because the company's current valuation materially exceeds its estimated future value.

If the company's prospects for future value creation are limited or at risk, the enterprise is likely to be vulnerable for many reasons. It may be severely disadvantaged competitively, have an over-levered balance sheet, or it may be losing major customers or key employees. In these circumstances, a board could conclude that the enterprise might be worth more today than tomorrow, so selling it is better option than allowing its value to erode.

Occasionally, the current value of a business may far exceed its future value or it may have significant strategic value for the right acquirer—for example, when an emerging technology captures the fascination of investors and propels the value of the company to stratospheric heights.

Private Equity and Venture Capital investors invest in companies with the express purpose of building them to be sold. Accordingly, once the company has reached a stage where those investors are ready to sell, the board may be asked by the investors to facilitate the sale.

Directors should be mindful of the company's prospects and potential for value creation and how that compares with its potential value if sold. Formal periodic valuations are not necessary, but directors should compare the company's expected future performance and value to its current value, with and without a control premium. Boards should also consider getting independent valuation advice when there is an unsolicited offer and before putting the company up for sale.

Selling the Whole Company

Board discussions about selling a business often coincide with a significant downward trend in market capitalization, but decisions should not be focused solely on the short term. Instead, the board should also consider the company's long-term prospects and opportunities to change the trajectory of the business. Boards should also consider engaging advisors to provide a valuation in these circumstances.

Boards should be cautious when management recommends selling the company. Management's recommendation may be based on in-depth analysis and an objective judgment about what is best for the company, but it may also be motivated by personal considerations, like control premium valuations that may apply to their long-term incentive holdings, or lucrative change of control arrangements.

Selling Parts of the Business

If the company consists of a portfolio of businesses, directors should understand how the parent company is adding value to the portfolio and whether some or all the assets should be sold. To support this, the company should periodically review each holding by asking the following questions:

- Is it of strategic value to other assets in the portfolio?
- How does its market value compare to its intrinsic value?
- Why would others pay more—is it underperforming or would it be worth more in other hands?
- Would capital invested in the segment be better invested in growing other parts of the portfolio?

For each business, questions about the future and viability of the industry should also be considered.

Unsolicited Offers

An unsolicited offer to acquire the business triggers a difficult decision for the board. Buyers almost without exception prefer a confidentially negotiated (or *friendly*) transaction to promote an orderly sale process and increase the chances of closure. But if the board rejects the unsolicited friendly offer, if the target is a widely held public company, the buyer may choose to proceed with a hostile offer, bypassing the target's board and directly soliciting support of the offer from the target's shareholders instead (see page 57).

Whether friendly or hostile, the fundamental issue boards face when presented with an unsolicited offer is valuation: that the sale and related value is in the best interests of the corporation, taking into consideration conditions in the offer, the likelihood of closure and other alternatives (an issue that is further complicated when there is significant institutional shareholder involvement (see page 55).

There are complex legal and regulatory requirements that govern how and when a board can respond to both friendly and hostile offers, the board's alternatives and its disclosure requirements (see page 53–59). Boards should seek appropriate advice.

1.2

Acquisition Rationale and Screening Criteria

This section reviews

- The four sources of value in M&A (page 17)
 - Identifying risks (page 21)
 - Developing screening criteria (page 24)
-

The company needs to be clear about its strategic rationale for making an acquisition:

- Why it is pursuing the acquisition?
- How does it fit with and complement the current organic strategy?
- What minimum risk-adjusted returns are expected?
- What will the end state look like and what competitive advantages will be gained?

An organization's M&A strategy, if executed effectively, should ultimately create value for shareholders. Determining how M&A is likely to create value also helps assess the potential opportunity and risks, and dictates the criteria for screening possible targets. Risks inherent in the strategy will guide the company's choice of targets or merger partners.

The Four Sources of Value in M&A

There are four broad sources of value in M&A as shown in the framework below. Each should enhance competitiveness and drive shareholder value. Many transactions offer a combination of all four sources of value, but it is useful to examine each separately because they present different challenges and risks and require different skills for success. Note that there are other such frameworks for evaluating value that may use different classifications or definitions.

Cost synergies

The benefits of increased scale in operations and administrative functions (common in industry consolidations)

Revenue growth

When the combination offers revenue synergies, like access to new markets, new products or new channels for existing products

Strategic value

When the combination creates a better positioning or better platform for future growth

Other sources of value from change of ownership

Many private equity firms try to create value by changing the financial structure of a business or the way it is managed

Cost synergies

During periods of consolidation, some companies identify opportunities to achieve competitive advantage through increased scale or scope, and others follow to remain competitive. These opportunities are often triggered by changes in technology, market and customer dynamics or regulation, which make larger scale or scope possible or simply more important.

When companies buy others in the same industry, they can usually reduce their costs while combining their revenue (simply put, it usually takes less than twice the costs to run a company with twice the revenue in the same business).

Depending on the industry, companies may look for cost synergies in:

- **Operations**—increasing purchasing power and eliminating manufacturing and distribution redundancies (for example, when branches are consolidated in bank mergers)
- **Administration**—reducing staffing for corporate functions and shared services, like human resources, IT and finance, and eliminating excess building capacity, redundant administrative activities and external services
- **Sales and marketing**—eliminating redundant channels and benefiting from branding and marketing scale and scope efficiencies (for example, consumer product mergers)
- **Research and product development**—better diversifying risk and optimizing the development process across a broader research and development portfolio (for example, pharmaceutical mergers).

Cost savings is a principal motivation for many corporate combinations.

Revenue Growth

Revenue growth is a key strategy driver for most companies. Bigger is not necessarily better, but growth in revenues tends to be associated (over time) with growth in shareholder value.

Any acquisition adds some revenue growth, even if it simply adds the revenue of one company to the other, as long as the additional revenue is not lost through margin erosion or customer attrition.

The more desirable kind of revenue growth is new revenue made available because of the acquisition—revenue from adding new customers and expanding sales from existing customers.

Revenue synergies can offer incremental growth in four ways, depending on the mix of new and current markets and products involved:

	Current products	New products
Current markets	<p>New revenue is most likely to come from product improvements or efficiencies.</p> <p>Example: Google is constantly acquiring innovations to improve its core product, to increase use with current customers.</p>	<p>When new products can be introduced to existing customers, revenue can grow substantially with little impact on total costs.</p> <p>Example: The acquisitions of Lotus by IBM, Kraft by Cadbury and Shoppers Drug Mart by Loblaw.</p>
New markets	<p>Taking existing products into a new market segment or geography creates new value and revenue growth.</p> <p>Example: Burger King taking Tim Horton's into the U.S. and other international markets.</p> <p>Example: Loblaw acquiring T&T as a way to enter the speciality Asian food market segment in Ontario, Alberta and BC.</p>	<p>Bringing new products to new markets can create value when there are product or market synergies or both.</p> <p>Example: Cisco's M&A program grew its position as a leader in digital network technologies while creating a spider web of market channels.</p> <p>Example: German based Zwilling J.A. Henckels has simultaneously expanded its geographic footprint and product line through acquisitions such as Staub and Demeyere.</p>

Strategic Value

Many acquisitions offer genuine strategic value in the options they open up for the buyer.

Some of the highest-value strategies may not create value immediately or directly, but will position the company for other moves that may create value over time. Three of these are important to M&A strategies:

- **Growth options**—provide the potential to pursue new markets in the future (for example, an acquisition that provides a foothold in a new market segment or geography). Target criteria include size (Can the company minimize the upfront investment and risk?) and quality (Can the target provide a robust base for possible expansion later?)
- **Flexibility options**—open up different ways to exploit the assets acquired, depending on what happens in the future (for example, the real estate acquired with a retail chain could be sold or used for a different commercial purpose). Assessments of any target should consider the value (or

potential value) of its underlying assets, including manufacturing plants, physical distribution assets, intellectual property or financing that could be used in other ways

- **Divestiture options**—mitigate risk by enabling a company to sell off all or part of an acquisition in the future (for example, when a company with more than one business is acquired). Assessments of any target should include valuing what some or all of it may be worth to others (Are there many other potential buyers? Will the asset hold its value? What are the implications for integration if the buyer wants to keep the asset separable and saleable?)

Other Sources of Value from Change of Ownership

A company made up of a portfolio of businesses, like a holding company or private equity firm, is not necessarily looking for synergies between its holdings.

Instead, its M&A strategy will be driven by insight into the potential upside in the value of the target enterprises, generally with input from the parent company. This input may come in the form of restructuring, financial engineering or new management and performance improvement initiatives, directed by the parent company or corporate centre and usually independent of other businesses in the portfolio.

In this case, value creation comes mainly from the corporate centre's choices or actions as owner, rather than from integrating the new enterprise with the buyer's other businesses. For example, many private equity firms have turnaround skills and seek underperforming companies, while others deliberately avoid turnaround situations and choose not to build the capacity to manage the enterprises in their portfolio.

According to Michael Goold of the Ashridge Strategic Management Centre and Nathaniel Foote of McKinsey & Company, there are five broad parent company strategies that derive value principally from actions of the new owner:¹

- **Controllers**—create a diversified portfolio but do not intervene in the individual businesses. The parent company's role is essentially to grow and allocate shareholder capital by buying and selling companies (or shares of companies) and monitoring performance (for example, Berkshire Hathaway Inc.)

¹ Michael Goold, Ashridge Strategic Management Center and Nathaniel Foote, McKinsey & Company; as referenced in "The Art of M&A Strategy," McGraw Hill 2012.

- **Coaches**—aim to help companies in the portfolio perform better through better management tools and processes (for example, applying Six Sigma across the holdings of General Electric Corporation)
- **Orchestrators**—build portfolios of businesses that are not integrated, but benefit from shared corporate assets (for example, shared content at Time Inc.)
- **Surgeons**—seek underperforming assets to turn around (for example, KKR)
- **Architects**—implement transformational change through a series of acquisitions and divestitures (for example, IBM’s transformation from hardware to software and services involved several divestitures and acquisitions)

Although there are grey areas between these five strategies, each has different acquisition criteria and requires different skills from the parent company or corporate centre. Directors should be satisfied that the strategy, the acquisition criteria and skills at the corporate centre are well aligned.

Identifying Risks

The four main sources of value in M&A each have risks associated with them. These should be assessed for each acquisition target and managed if the opportunity is pursued.

Risks Related to Cost Synergies

Surprisingly, acquisitions motivated by cost synergies often fail to create value above the purchase price because savings are often overestimated, the time needed to realize cost reductions is underestimated, and the possibility of unanticipated additional costs and investments is ignored.

Potential cost synergy benefits are easy to calculate (especially in a consolidating industry) and available to all bidders. Since valuable targets will attract multiple bidders, the value of these synergies will tend to be negotiated away in the bidding process. The ‘winning’ bidder is often the one who is most aggressive in estimating potential cost synergies and bids accordingly—transferring most or all of the value to the seller, and setting savings goals that may be almost impossible to achieve as quickly as estimated.

Merger proposals may also understate how much it will cost to achieve projected cost synergies (the investment required to rationalize manufacturing operations, for example, may ultimately exceed any savings).

But if an industry is consolidating, directors should also understand the risks of not participating in M&A. Notwithstanding the difficulties in achieving cost synergies and the history of disappointments for buyers, those standing on the sideline may be at even greater risk.

Managing the Risk

To manage risk related to cost synergies, post-transaction management incentives should be tied to any estimates of scale and cost synergies. The board should be satisfied that there is an experienced team capable of making accurate and realistic estimates, and that the company has superior execution skills in each relevant area (operations, administration, sales and marketing, or R&D).

A reliable, dynamic financial model that calculates return on investment under different scenarios can help avoid overpaying for an acquisition.

Risks Related to Revenue Growth

It can be difficult to realize revenue synergies in M&A. While cost reduction measures can be directed top down and have immediate impact, revenue synergies ultimately depend on customers making choices that benefit the organization. This can take time and may require significant change in products, distribution or marketing.

In the meantime, directors need to be aware that there is a risk of *negative revenue synergy* (a net loss of revenue, instead of a gain). When competitors merge, for example, it is unlikely that they will keep all of their existing customers.

This and many other forces may influence management to focus more on concrete, short-term cost synergies, and risk-averse boards may be more inclined to approve mergers based on these, even though revenue synergies have, historically, created more value in the long run.

Managing the Risk

If a company's M&A strategy calls for growth, directors should encourage programs that create new revenue and take a longer-term view of the payoff. They need to be satisfied, however, that the acquisition rationale does not stretch reality and that the company has the skills to implement the program.

Acquisition criteria should call for new product lines that are excellent fit and new channels that are highly suitable to the company's full range of products. Management must have (or be willing to hire) in-house experts in any new market segments or geographies.

Directors should also be satisfied that management has formulated adequate strategies for keeping the target's existing customers.

Risks Related to Strategic Value

Strategic value is sometimes used as an excuse to acquire a company when the rationale for acquiring it is weak.

Genuine strategic value is based on real (although uncertain) opportunities and a qualitative case can be made for this value—for example, the opportunity to grow from a small acquired base in a new market, the potential for improved sales volume or margins because of an improved market position or acquired skills, or the possibility of spinning off some of the acquired assets.

Although strategic value is uncertain and difficult to quantify, it should not be ignored. In a dynamic environment, the greater risk may be to avoid these uncertainties and be outmanoeuvred by competitors.

Managing the Risk

Real strategic value is based on identifiable future steps the acquisition makes possible. Directors should know the difference between valuable future options inherent in an M&A strategy and a cover for a weak acquisition proposal.

Quantifying this kind of value can be difficult, however, and may not be necessary if there are other compelling and (ideally) quantifiable sources of value to support the case for acquiring the company.

Risks Related to Other Sources of Value From Change of Ownership

The examples on page 19 of firms that have successfully created value by changing the financial structure of the business or the way it is managed, are positive illustrations of how strategies based on change of ownership can work. As an example, private equity firms often add leverage to the capital structure to boost shareholder returns.

There are also many examples of failures of each type.

Managing the Risk

Because the value in these strategies comes mainly from the parent involved, not synergies between the companies, it is important for directors to be satisfied that the parent company has the experience and skills needed to deliver value. Directors should understand exactly how value will be created and make sure the skills of the parent match the strategy before approving acquisitions based on value from change of ownership.

The Seller's Perspective

While the four sources of M&A value are important for any company acquiring or divesting, they are most important to companies making acquisitions, because they have to live with the consequences of their assumptions and make sure the expected sources of value materialize.

The seller has much less exposure, if any, to the post-transaction outcomes, except as they relate to the way the transaction was structured and the price paid (see page 78).

Understanding and quantifying the value an ideal buyer will derive from the transaction can, however, enhance the process of divesting an asset or selling a company. Armed with this information, sellers can approach companies that have the most to gain and help them see the potential value in the acquisition (you can read more about this on page 19). Although most divestitures will ultimately involve competing offers or an auction, seeking and developing strategic and financial buyers with the most to gain usually results in a better buyer, a higher price or both.

Developing Screening Criteria

Once the company has clearly articulated its M&A acquisition rationale, it should develop a comprehensive list of acquisition criteria, ranked in order of importance.

The rationale should clearly state:

- what gaps the M&A strategy is intended to fill
- how value is to be created
- what the company's M&A risk tolerance is.

Screening criteria will vary, but should always relate to the buyer's M&A strategy and how it plans to create value. Well-delineated criteria concentrate the company's efforts on candidates that fit and avoid wasting time on those that do not.

You will find sample screening criteria in Appendix 1. Common categories include:

- size
- location
- valuation
- apparent synergies
- depth and quality of management
- uniqueness of products or services

- condition of tangible assets
- quality of intellectual property and other intangible assets
- nature and loyalty of the customer base
- history of profitability and cash generation
- level and structure of indebtedness.

Directors should be satisfied that the company's screening criteria will lead to opportunities that will:

- advance corporate strategy
- bring significant acquisition synergies
- be implemented using skills the combined entity has, or will have.

Since no target will meet all of the criteria on a buyer's list, it is important to set priorities. Criteria should be weighted since some will have more value than others.

When to Think About the Acquisition Rationale and Target Criteria

Boards should review the company's M&A rationale and target criteria at four points in the M&A process:

- in phase 1** before targets are identified
- in phase 2** when management presents its preliminary candidate universe to the board
- in phase 3** when the company starts reviewing a prospective target closely
- in phase 4** at the end of due diligence.

Keeping the company's acquisition rationale and screening criteria top of mind at these key points in the process will help directors make sure the right candidates are being pursued, and that the proposed transaction will advance the company's strategy.

1.3

Candidate Search and Target Selection

This section reviews

- Defining a universe for the search (page 28)
 - Screening candidates (page 30)
 - Prioritizing candidates (page 31)
 - Unplanned acquisition opportunities (page 32)
-

Once a company has defined its M&A strategy and determined its acquisition rationale and criteria, the next step is to compare and select possible acquisition targets or merger partners.

It is important to consider several different companies, even if one company seems like a perfect match for the company's strategy (or so good that it inspires a new strategy). At the very least, knowing the alternatives will help determine an appropriate price for the preferred target.

If there are only a few alternatives to the preferred candidate, they can all be considered in detail and even approached. More often, though, there will be many possible alternatives, including companies the buyer does not yet know, and companies that may not have considered a merger, sale or acquisition before. The company should go through a proactive process to search beyond obvious and convenient targets to develop a rich universe of possibilities.

The list should even include apparently disinterested targets or partners and, in prioritizing candidates, companies should consider factors that may influence candidate interest and the likelihood of completing a transaction.

This, however, presents a dilemma: a strategic approach calls for proactively considering all of the available alternatives, since responding only to opportunities that walk in the door is not strategic. It usually is not practical, however, to analyse every alternative in enough detail to truly understand its value potential. Skilled third party advisors can be part of the answer.

About Engaging Advisors

It is common to engage advisors at the candidate selection stage of the M&A process, although they are sometimes only engaged later. It is important to establish clear mandates and deliverables for each advisory engagement, and a clear reporting structure (whether the advisors will report to management, a board committee or the full board).

It is not usually necessary to have the board engage advisors directly, as long as the board has direct access for briefings and questions. If the company is selling most or all of its business, however, the board will usually take the lead, although any advisors they work with will also work closely with management.

Although advisors often play an important role in acquisitions, they should not be involved in decision making or directly involved in negotiations without clear instructions.

Directors should assess the depth of M&A capability and capacity among management and the board to determine how much and what kind of help may be needed from advisors.

Types of Advisors

Strategy consultants—advise management on the broader aspects of strategy and examine M&A alternatives. These firms may also provide useful advice about acquisition rationale and screening criteria and they can identify and qualify candidates. They are usually engaged on a fee for service basis and report to management.

Investment banks—their role at this stage is usually to advise on acquisition rationale, screening criteria and candidate identification and qualification. Investment banks can also give public companies advice on market reaction to their planned M&A strategy. Investment banks are often willing to present acquisition opportunities without formal engagement, and may choose to be paid a service fee (usually called a *work fee*) that can be applied against a *success fee* if the transaction closes.

Directors should be cautious when taking advice from advisors if their fees depend on completing a transaction, since there is an obvious bias toward the outcome.

Defining a Universe for the Search

While the search should be kept consistent with the chosen strategy and the skills of the firm, expanding options beyond the obvious can lead to new and valuable ideas. The following are some key things to consider when defining the target universe:

- **Looking to consolidate**—the most likely scope for consolidation seems obvious: competitors. But because globalization has blurred the definition of a relevant geographic market, it may be valuable to search adjacent markets and other geographies too (TD Bank's expansion into the U.S. is a good example of this).
- **Looking for revenue growth**—the target universe for acquisitions motivated by revenue growth is defined well by the four dimensions of growth presented earlier: current markets with current products, current markets with new products, new markets with current products, and new products in new markets (see page 19).

- **Building a portfolio**—holding or private equity companies that are not integrating their acquisitions will define their target universe differently. Because the value creation opportunity for these firms lies mainly in the value gap they perceive (or can capture as a new owner) rather than any significant synergies with the current business, the universe should be defined by the buyer's knowledge of the target industry or its ability to execute any required changes, whether as a controller, coach, orchestrator, surgeon or architect (see page 20-21).
- **Large acquisition or small**—large acquisitions require different skills than small acquisitions. The size of a potential acquisition should be based on the skills and experience of the buyer, the capital available and risk tolerance.

For example, although a major transaction with a company of similar size may present a large value creation opportunity, it also brings significant integration challenges and higher risk. Post-merger implementation can prove difficult, particularly if the scope of the integration plan is broad. There are usually years between such transactions, and they fail more often. The success rate for smaller acquisitions is higher and the consequences are less severe if they fail. Companies can execute many small acquisitions if they can standardize the pre-and post-merger processes so that they become routine, consuming less management capacity and facilitating multiple small acquisitions in rapid succession (Cisco is an example of this).

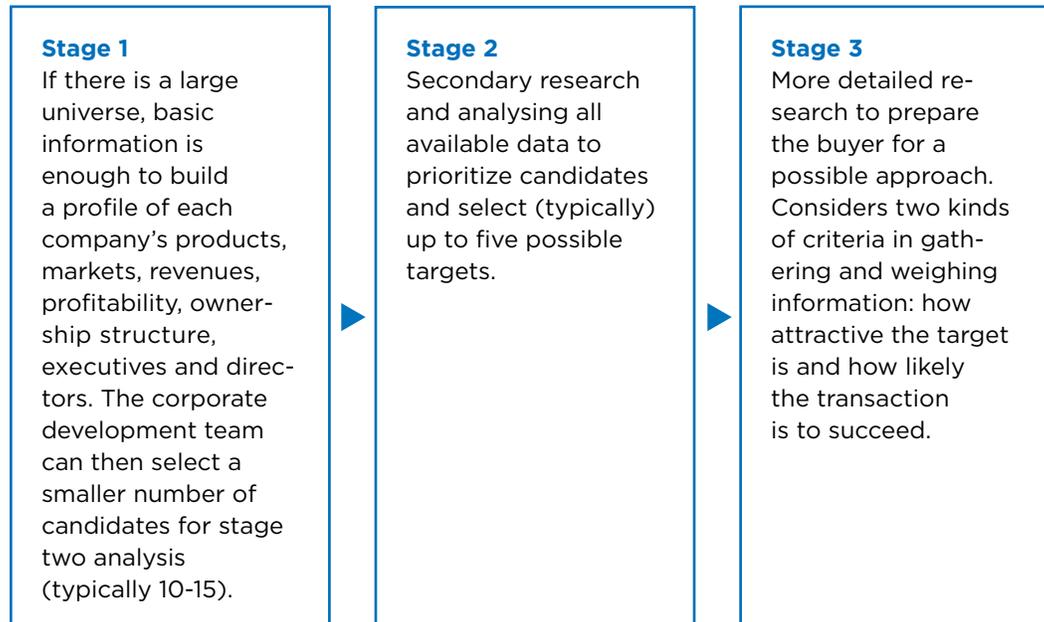
In a consolidating industry, larger acquisitions may be necessary to build a leadership position. Experience in integrating smaller acquisitions can help companies prepare for this.

About Acquiring Competitors

Acquiring a competitor has many attractive benefits—the opportunity to rationalize costs, eliminate a competitive threat and mitigate risk, since the buyer already knows the industry well. But boards should be aware that integrating the cultures of merged competitors is time-consuming and complex. The time and effort needed is often seriously underestimated and this type of merger is not likely to be successful without significant management changes.

Screening Candidates

Having deliberately expanded the search universe to consider a richer set of options, how can targets be screened without excessive analysis? The best way is to look at candidates in stages, analysing and making cuts at each stage. (You will find a sample framework for staged candidate screening in Appendix 1.)



Candidates that are not advanced to stage three are not rejected, just set aside in favour of candidates that seem more attractive or more likely to be interested. If candidates the company chooses to analyse in detail or approach prove unattractive or unlikely to complete a transaction later in the process, candidates that were not reviewed in detail can be reconsidered in priority order.

Board involvement in early stage candidate screening is generally limited to reviewing the screening criteria and receiving updates on progress.

The Seller's Perspective

The three-stage screening process can also apply to sellers in search of a buyer.

For example, when a large pulp and paper company was restructuring, it identified downstream manufacturing and distribution businesses that were not core to the primary business, and would be worth more in another company's hands. There were several businesses that could be sold separately for well over \$1 billion in total.

A simple auction of these businesses would have been quick and easy, but would have resulted in significant discounting. Instead, the company looked for the best buyers for each business. Financial buyers were considered, but the search also identified buyers in similar or adjacent businesses to the ones for sale. The company considered its attractiveness to each potential buyer and the probability of a deal with each to narrow the field to the best prospective partners. Before approaching any buyer, the company also outlined the acquisition rationale from the buyer's perspective and estimated the value of the revenue and cost synergies each short-listed buyer could achieve.

Although there was competitive bidding in the end, the best buyers were at the table. All assets were sold to buyers that had synergies with the businesses sold, some of which were not looking and would not have considered such an acquisition if they had not been approached. In every case, the transactions closed at prices higher than standalone value.

Prioritizing Candidates

Screening provides important information about options and opportunities, but management and the board must still choose which candidates to approach, and in what order.

The following best practices can help:

- **Use fact-based analysis**—screening analysis should include data from independent sources. To avoid being swayed by emotion and bias, analysis should become more rigorous at each stage and be verified as accurate before candidates are approached. A solid fact base for each candidate is critical.
- **Focus on value creation**—analysis should be focused on the value of the target to the buyer. Value to the buyer considers cost and revenue synergies, the target's strategic value and other sources of value in the buyer's hands. These things can often justify a price well above the target's market

value. While the board's objective must be to protect the company against a poor deal, directors should not discourage value-creating acquisitions simply because the control premium seems high. The premium to market value may not matter if there is a substantial opportunity to create value.

Directors can have a more constructive role and add more value to M&A activities if they are engaged at all key points in the process, not just in approving the final transaction. For example, giving directors the acquisition rationale, search criteria and universe, short list of target candidates and the basis for the list will tap their knowledge and generate useful input before targets are approached.

- **Keep an ongoing list of potential transactions**—candidates may become more or less attractive, or more or less likely to be acquired based on events in the market. New candidates may be added. The acquisition of candidates may change the position of others.
- **Do not assume no means no forever**—the stated position of a potential target is not always the last word. It is common for an acquisition target that once rejected an approach to become receptive to a transaction if business conditions or the owner's circumstances change. Assessing short-listed candidates in more detail to understand industry or company issues and assessing sale opportunities from the target's perspective can provide insight into the target's strategic options, whether a sale is called for and (in some cases) even what the right price should be.
- **Do not settle just to do a transaction**—if the top choices are not available, companies further down the list are, by definition, less attractive and may not be compatible enough with the company's acquisition rationale and list of "must haves" to make pursuing a transaction worthwhile.

Unplanned Acquisition Opportunities

It is not uncommon for a company to be asked to consider a potential acquisition before its own M&A strategy has been developed.

Attractive acquisition opportunities should not be turned away for that reason alone. However, the board should insist that management at a minimum articulate how M&A fits with the company's overall strategy, define the acquisition rationale, and identify other acquisition candidates.

Although management may see this process as onerous (especially if there is a short timeline to respond), not reviewing M&A strategy more broadly first can lead to a poor decision because the transaction itself may end up defining the M&A strategy instead of the other way around.

Three Kinds of Approaches

Unplanned opportunities to purchase a company usually arise in one of three ways:

- directly from the company itself
- by invitation to auction
- through an advisory firm.

The timing requirements in all three situations can vary, but generally boards and management of the buyer have to respond quickly.

Company to Company

Contact may come directly from a company looking to sell itself entirely or in part. In most cases, this type of approach occurs through communication from the seller's executive, usually CEO to CEO.

Companies that approach others to buy or merge with them may be at different stages in developing their divestiture strategy. The organization may have decided to sell the asset, determined the most likely buyers and decided not to run a formal sale process, instead choosing to contact a short list of parties it knows may be interested. The other end of the spectrum is an approach that is more exploratory in nature, where the seller has not reached a definitive decision but is interested in finding out if both parties would benefit from some form of transaction.

If an unplanned M&A opportunity seems to have merit, the company should enter into confidential preliminary discussions to explore it. For a transaction that would be material if pursued, the board should be informed either in a formal board meeting (in person or by phone) or by communicating with each board member individually.

Buyers should resist entering into formal confidentiality agreements however, until the fundamental merits of the transaction have been explored, since these agreements typically include restrictions on the buyer in exchange for receiving confidential information from the seller. Such restrictions may preclude hiring seller employees and normally prohibiting the prospective buyer from

acquiring an interest in the seller except under specified terms (known as a *standstill agreement*—see page 52 for a description and Appendix 5 for an example).

Exploratory discussions usually involve a few executives from the buyer and seller organizations. Advisors may or may not be involved. In these situations, it is customary for the seller to present its rationale for a transaction, identifying the benefits and value creation opportunities without revealing non-public information. A common outcome of these initial discussions is to form buyer/seller work groups to explore the value of the transaction in specific areas (for example, a joint work group made up of financial and operations representatives from each party may be formed to assess potential cost synergies).

If the buyer concludes that the merits of the transaction seem compelling, the next step is to enter into the formal process known as *due diligence* (see page 60 for a discussion of the stages and steps typically involved in due diligence).

Auction Invitations

Advisors or other intermediaries may approach potential buyers on the company's behalf. This type of approach involves an invitation to participate in a formal process called an auction that has explicit steps and timelines. M&A advisors are usually hired to coordinate the process.

The typical steps in an auction process are:

- Drafting a list of potential buyers. This list usually includes strategic buyers (enterprises in the same or related fields) and financial buyers, like private equity firms.
- Contacting each potential buyer to determine its level of interest.
- Distributing a brief document to interested parties that broadly outlines a description of the business and the steps and timeline for bidding.
- Asking any parties that reconfirm their interest to sign a confidentiality agreement, before sending them a Confidential Information Memorandum (CIM). This document usually contains a more detailed description of the business and summarizes the markets it serves, its key strategies, assets, organization and other things, along with the opportunities and benefits for buyers and historical and projected financial information.

- Asking potential buyers to submit a non-binding expression of interest (often referred to as a *letter of intent*) that generally includes the buyer's proposed purchase price or range, any conditions, due diligence requirements, timelines and sources of financing. To improve their chances of getting to the next round of discussions, buyers often choose to set out a range of values rather than a single price in the original letter of intent. The seller may be attracted to the higher value, but the buyer still preserves a lower value that may prove to be more realistic after due diligence.
- Qualifying buyers and developing a short list. This step usually comes after representatives for the seller and each potential buyer have had some discussions and preliminary negotiations.
- Giving short-listed buyers access to more confidential information, usually housed in a virtual data room. Buyers are also invited to attend separate meetings hosted by management that include formal presentations and question and answer periods. Buyers are invited to submit questions and requests for more information. The seller may offer site visits and may provide a draft purchase and sale agreement. Short-listed buyers may be asked to confirm or refine their proposed purchase price and conditions.
- At this point, either a single buyer or a small group of buyers is invited to participate in several weeks of detailed due diligence. This process would involve site visits, meetings with functional leaders and providing more detailed confidential information. Buyers are usually asked to submit comments and suggested changes to the purchase and sale agreement at the end of due diligence.
- Following due diligence, one or more buyers are asked to confirm their proposed purchase price and other legal conditions. The parties then negotiate with the goal of signing a final purchase and sale agreement.

Advisory Firms

An investment bank or other advisory organization that has identified potential acquisition opportunities may approach buyer management looking for an engagement to evaluate (and potentially pursue) an acquisition, without a mandate from a seller. It is also common for companies to ask advisory firms to provide M&A ideas without formally hiring them. This information helps confirm the company's candidate list and may identify opportunities they have overlooked.

Key Questions About M&A Strategy Development

1. What are the forces driving change in the industry? How might it reshape?
2. If the company remains as is and does not pursue an M&A strategy, can it remain competitive in costs, quality and scale? If not, should there be an exit strategy?
3. Can M&A contribute to growth and positive returns? If the industry is restructuring, should the company be a buyer or a seller? What is the risk of not participating?
4. How will value be created in an M&A strategy? What are the associated risks? (For example, can savings be achieved in excess of competing bidders? Is there a track record of achieving revenue synergies? Is the strategic value real? How will it materialize? Does the company have the required capabilities?)
5. What are the acquisition rationale and search criteria? Are the boundaries for target size, performance and fit within the company's experience, skills and financial resources?
6. How does the corporate centre add value to the portfolio? Are the search criteria consistent with past success?
7. What is the scope of the search? What mandate do the advisors have? Is it aligned with the established criteria? How will the potential target data be accumulated and maintained?
8. If the enterprise did not own this particular business or asset, would the company buy it today? If not, should it be put up for sale?
9. Which companies can derive the greatest value from the assets for sale?
10. Are the acquisition targets within the corporation's risk tolerance?
11. How will the board fulfill its oversight role effectively and add value to the M&A strategy?



PHASE 2

Transaction Development

PHASE 2

Transaction Development

This phase approaches M&A transactions in four steps, starting with approaching the target and culminating in a board-approved signing of a purchase and sale agreement.

Each step includes several activities, depending on the size and complexity of the transaction. These will sometimes be dictated by or negotiated with the seller, and sometimes recommended by advisors. It is an iterative and progressive process that builds the relationship between buyer and seller and involves a decision to proceed or terminate at each step. If successful, the final result is a binding agreement and ultimately completing the transaction.

For any material transaction, boards should be involved in each phase of the transaction development process, including reviewing candidate analyses, deciding if an initial investment is appropriate, and reviewing and (in some cases) approving the key terms of a non-binding letter of intent, including the proposed purchase price. They should also have a good overall understanding of the proposed communication plan.

OVERVIEW

2.1 Approaching Targets and Beginning Discussions

	Management's Role*	Board's / Special Committee's Role
Engage advisors and establish a special board committee (if needed)	engage advisors, if appropriate, with board approval	establish a special M&A committee (if needed) and begin initial discussions with management and board-approved advisors
Prepare to contact targets	complete a detailed analysis of all publicly available information	review management's detailed pre-acquisition analysis
Develop transaction structure and financing	develop a proposed transaction structure and financing	review the proposed transaction structure and financing
Formulate a meeting strategy	formulate a strategy for initial meetings with priority targets	review the initial meeting strategy and offer introductions, if requested
Develop letters of intent	develop a non-binding letter of intent for targets	review key terms of any non-binding letters of intent
Negotiate exclusivity, confidentiality and standstill agreements	negotiate agreements that set out terms related to confidentiality, exclusivity and share purchase standstill	review exclusivity, confidentiality and share purchase standstill agreements

2.2 Due Diligence

	Management's Role*	Board's / Special Committee's Role
Develop a plan	develop a detailed due diligence plan	review due diligence plan
Carry out due diligence	complete preliminary and final due diligence	review due diligence results
Confirm acquisition rationale	confirm that the acquisition rationale are valid and identify any material differences	assess how valid the acquisition rationale are
Assess value creation	assess sources and amount of value creation	assess the value creation estimate
Identify any negative synergies	identify any negative synergies that could result from the acquisition	review negative synergies
Develop a preliminary implementation plan	develop a preliminary implementation plan	review the implementation plan

2.3 Valuing the Company and Structuring the Transaction

	Management's Role*	Board's / Special Committee's Role
Develop preliminary valuations	develop preliminary (standalone) valuation, control premium and incremental value estimates	review and assess preliminary and post-due diligence valuations
Update valuation models based on due diligence	update valuation models and revise assumptions based on due diligence findings	
Develop proposed consideration	develop proposed consideration (cash, stock or a combination of both)	review transaction consideration, structure and financing alternatives
Develop proposed transaction structure	develop a proposed structure for the transaction and the new entity	
Develop financing options	develop options for financing the transaction	

2.4 Finalizing the Transaction

	Management's Role*	Board's / Special Committee's Role
Finalize the purchase price and financing	negotiate final purchase and sale agreements, financing arrangements and other contracts, within the parameters previously reviewed with the board	review and approve key terms of the purchase and sale agreement, financing arrangements and other material agreements
Negotiate and sign a definitive purchase and sale agreement		
Finalize executive employment matters		
Seek and obtain all required approvals		
Close the financing and the deal		

*For many of the items listed above management should consider assistance from advisors.

2.1

Approaching Targets and Beginning Discussions

This section reviews

- Engaging advisors and establishing a special board committee (page 43)
 - Preparing to contact a target (page 43)
 - Developing a transaction structure and financing (page 45)
 - Formulating a meeting strategy (page 46)
 - Developing letters of intent (page 50)
 - Negotiating exclusivity, confidentiality and standstill agreements (page 50)
 - The seller's perspective (page 53)
-

Engaging Advisors and Establishing a Special Board Committee

Advisors are often selected by this stage or sooner. It is important to choose advisors who have relevant industry experience and are free to act on the buyer's behalf. In an industry active in M&A, the company should consider acting early to find advisors (consultants, investment bankers, lawyers and accountants) that do not have conflicts of interest. (You can read more about engaging advisors on page 27).

If a possible transaction is likely to be very large or complex, the board may want to establish a special committee to oversee the project, engage with advisors and management and report on progress. Seller boards often establish special committees if most or all of the company is being sold (see *Responding to Unsolicited Offers* on page 53).

Preparing to Contact a Target

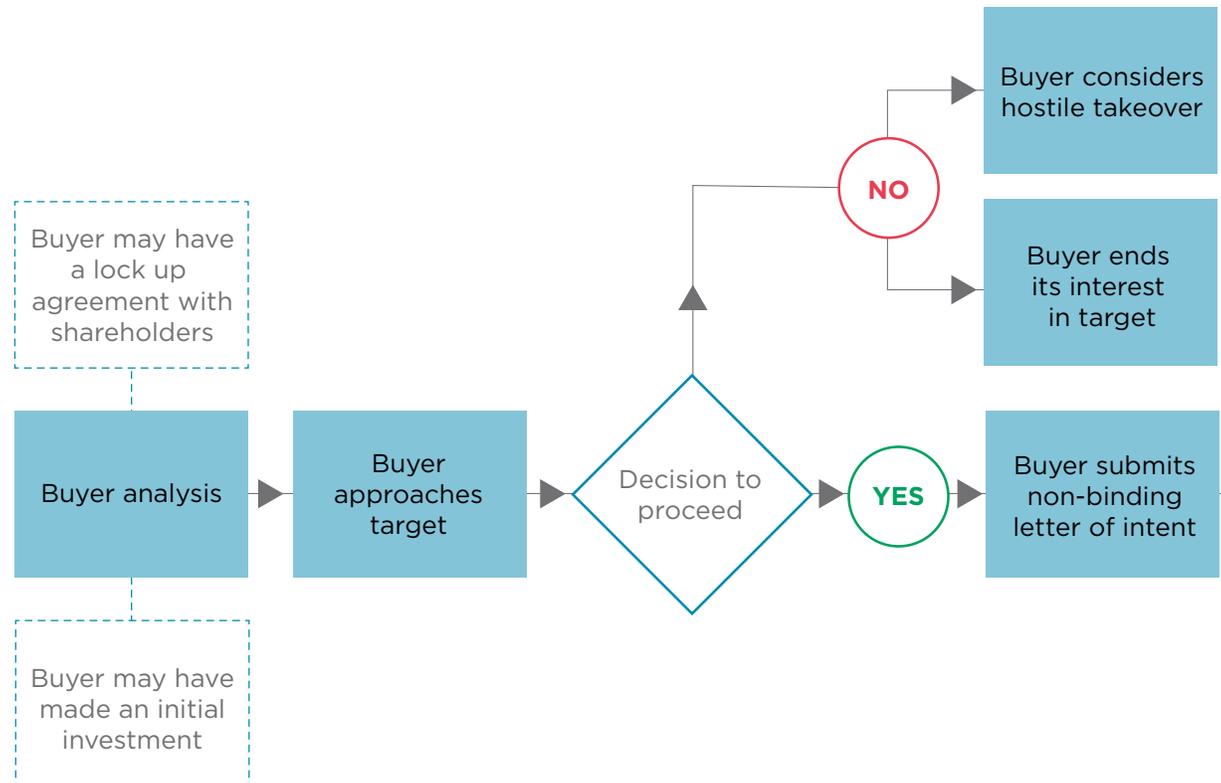
The stakes are much higher once discussions begin, because the company's strategy is at least partly revealed, and investors, customers and suppliers may also become aware that discussions are taking place.

This means that before the company approaches any target, it must be sure it has done the research necessary to understand the target, the industry and the acquisition opportunity well enough to be able to proceed with confidence. Directors with industry experience can be useful resources at this stage — they may have insight into the target's situation or may be able to offer an independent perspective.

All relevant information in the public domain should be gathered. The file for each public company target should include annual reports and other items included in recent continuous disclosure material available publicly on SEDAR or EDGAR, Dunn and Bradstreet credit reports, analyst reports, investor presentations, company fact books, product catalogues, press releases, print advertisements, published articles (on the industry and the company), executive speeches, and director and officer profiles.

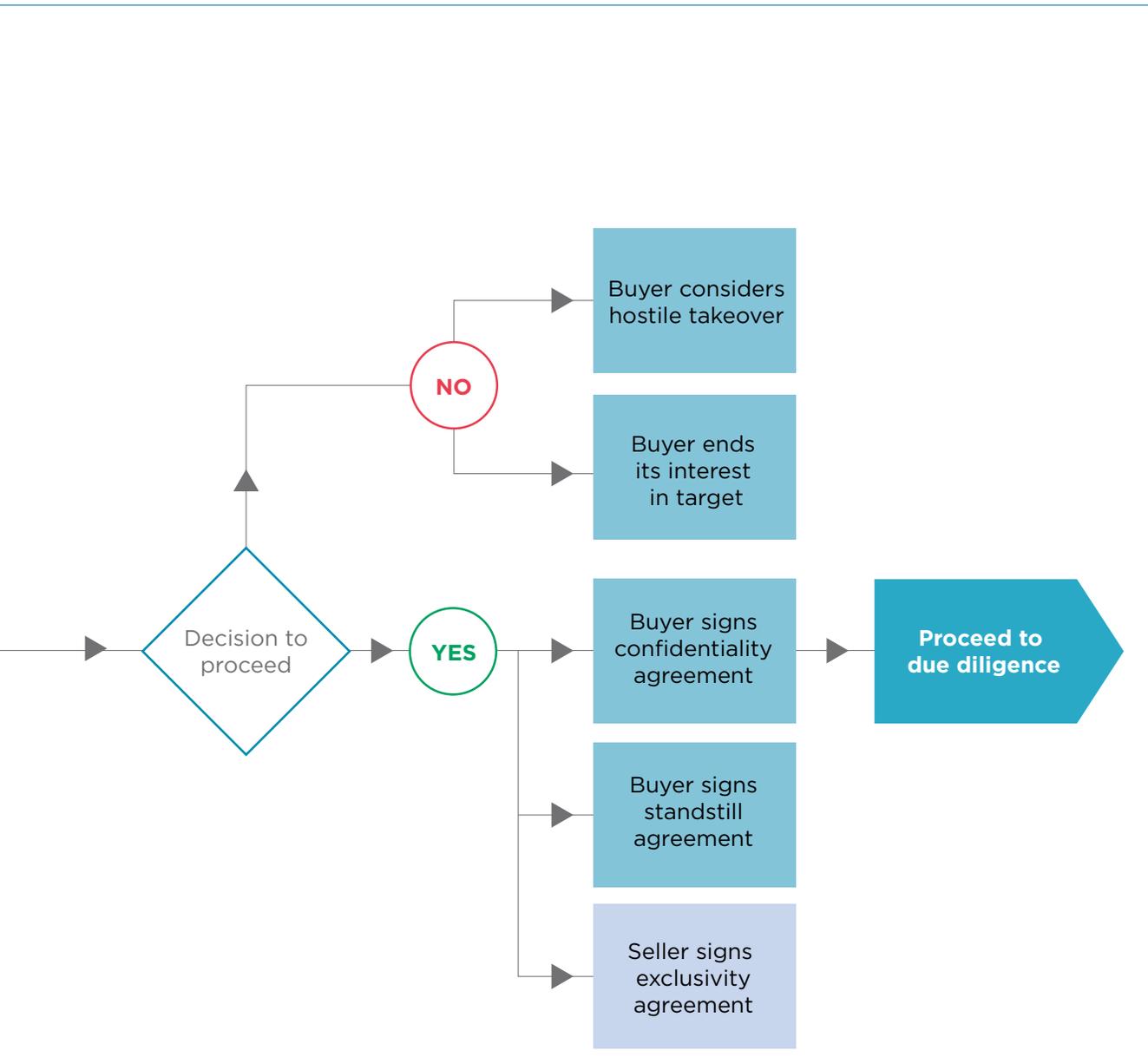
Directors should be satisfied that the company's detailed pre-approach analysis is complete and that the board's knowledge has been tapped.

The outcome of the M&A strategy development phase is a prioritized acquisition target list.



Most importantly, the data should be analysed and summarized to provide relevant insight into the industry, the target and the target's view of the industry. Some companies have the resources and expertise to do this analysis in-house. Others may need help from investment bankers or consultants.

The goal is to be able to present a compelling rationale for the business combination and a preliminary estimate of the benefits and value creation opportunity. This will help the buyer feel more confident about its choice, make a better case for entering into discussions and let the target know that the buyer is serious.



Developing a Transaction Structure and Financing

Buyers should also have a preliminary view of how the transaction would be structured and how it would be financed. These are more fully developed later in the process (see page 78), but the buyer should be able to describe a preliminary transaction framework and satisfy the seller that adequate financing is in place or available.

Formulating a Meeting Strategy

Choosing Who to Approach First

There are several ways to approach acquisition candidates. In a more structured process, the highest ranked target is approached first and other candidates are approached only if those higher on the list are not receptive to a transaction.

Another effective method is to canvas potential candidates broadly. This approach is more open ended, with discussions focusing on areas of mutual interest or opportunities to cooperate, and may lead to joint ventures, sales of specific assets or a complete acquisition.

The benefits of an open-ended approach are that it establishes a positive ongoing relationship between the executives involved and it helps the buyer gauge how receptive its targets may be to a possible transaction. It also leaves the door open, if conditions change and a target becomes receptive in the future.

About Approaching Competitors

If the target is a major competitor, there may be an issue with regulations or competition laws. If so, the buyer should discuss the issue with legal counsel to obtain an understanding of the rules to be followed before any confidential information is exchanged between competitors.

Even if a proposed transaction is likely to pass a competition review, it is important for directors to know how long a regulatory competition review is likely to take and what kind of review it would be, especially for companies operating in more than one jurisdiction. A lengthy competition review process (which usually becomes public) can adversely affect business for both parties by freezing competitive activities and creating uncertainty among customers, suppliers and employees. It can erode value and make it less likely that the transaction will be completed successfully.

Initial Investment and Lockup Agreements

It is sometimes a good idea to invest in a target company before approaching it, or after first contact but before standstill or other limiting agreements are put in place. Securities regulations allow investment in public companies up to certain thresholds without disclosing the investment or the buyer's future intentions (for example, in Canada a buyer can acquire just under 10% of a public company without having to disclose the investment and future intentions). The threshold in the U.S. is 5%.

Making a so-called *toehold investment* demonstrates that the buyer is serious, allows it to acquire part of the target's equity without paying a control premium, and makes it more difficult for other buyers to gain shareholder approval if they put forward competing bids. It also allows the buyer to profit from any subsequent sale if the buyer is not the successful bidder. Toehold investments should be discussed with legal counsel as there are a number of applicable rules.

Buyers can also use *lock-up agreements*—arrangements between the buyer and one or more large shareholders of the target company, who agree to support the transaction including voting in favour and tendering their stock in favour of a bid from the buyer. This effectively prevents these shareholders from considering competing offers, even at a higher value, although soft lock-ups that provide exits under certain conditions are also common. Investors will typically consider a lock-up or soft lock-up agreement when the buyer is the logical acquirer, there are considerable synergies between the companies (so the buyer can afford to pay a higher price), or when the seller does not want to run an auction process. Once again, the buyer should discuss the use of lock-up agreements with legal counsel as these agreements can create issues for the bidder if not properly executed.

Beginning Discussions

First contact with a target is very important because discussions could end there if it does not go well.

Usually, the buyer's CEO contacts the target's CEO or Board Chair. This communicates the importance and seriousness of the approach. But there are times when it makes sense for others to make the first approach—for example, if a buyer director has a longstanding relationship with a member of the target's board or if bad blood between the CEOs could jeopardize an opportunity presented by the buyer's CEO.

A consultant, investment bank or other third party can also be used to sell the idea of a business combination to a target. A third party may be seen as more objective and independent than the buyer's management team, if that's a concern. Also, it may take several meetings with the target's CEO or Board Chair and others to win agreement to proceed to joint discussions, so it may be more efficient to use a party who is more readily available for meetings and to respond to issues and questions.

If there is a major shareholder, there may be value in assessing the shareholder's interest in a transaction before speaking with the target's CEO or Board Chair.

What to Expect

The goal of first contact with the target is to gain agreement to have future discussions about a possible collaboration or business combination. This should lead to several meetings with a small group of executives from both parties and an exchange of non-confidential information.

At first meetings, it is typical for the buyer to describe the rationale and benefits of some form of transaction in broad terms. The target CEO is likely to be in 'listening mode' and may choose not to respond to an invitation for a follow-up meeting right away (CEOs of public companies are usually advised to be non-committal at this stage, and will normally say they need to discuss any overture with their board of directors before providing a response).

If there is mutual interest, both parties will want to explore the potential for value creation, including by accessing certain confidential information. To facilitate information sharing, it is customary and advisable to enter into one or more formal agreements, usually a confidentiality agreement and sometimes a non-binding letter of intent and a standstill agreement. (You can read more about these documents below). Since some confidential information is usually exchanged in these meetings, directors (or the special committee) should approve what confidential information may be shared at each stage of the process, especially if competitors are involved. Once discussions begin, many people may know about a possible M&A transaction, including executives on both sides of the transaction and their support staff and advisors. Because leaks can happen inadvertently, directors should be satisfied that the company is prepared if a proposed transaction becomes public. A communications plan should be ready that specifies who the spokesperson will be and what will be said. Each company should also impose a trading blackout prohibiting directors, officers and employees from trading in the company's stock and, in the case of those who know of the transaction, the stock of the other party.

If there is no interest in a friendly transaction, neither management nor the board should assume that this is the end of the conversation—it is common for acquisition targets that have rejected an initial approach to become receptive if business conditions or ownership circumstances change. If the potential for value creation with a disinterested target is real and significantly higher than the next best alternative, the buyer may consider a hostile approach. (You can read more about hostile takeovers on page 57.)

About Maintaining Confidentiality

Confidentiality in M&A generally applies in two areas: the M&A process itself and the exchange of material non-public information. Confidentiality is critical but difficult to maintain as a transaction progresses and more people become involved in the process.

Breaches of confidentiality can lead to legal liability, and also result in the termination of negotiations between the parties, or other potential buyers arriving on the scene.

Public Announcements

Unless there is a leak, potential transactions usually are not made public until a final purchase and sale agreement is signed. From the seller's perspective, keeping a possible sale confidential avoids concern and disruption among customers, employees, suppliers and other stakeholders. Buyers rarely announce their intention to acquire a business, and they are usually prevented from doing so by a confidentiality agreement. (The exception is during a hostile takeover bid.)

There are times when a company decides to publicly announce that it intends to put itself up for sale. Often the nomenclature is along the lines of 'evaluating strategic alternatives'. While this type of disclosure can be internally disruptive, it is often used when the business is in difficulty, a sale process is largely anticipated and the seller wants to have the broadest universe of potential buyers possible.

If one or both parties want to make an announcement before a final purchase and sale agreement is signed, they should make sure the content and timing of their press releases or other communications and their key messages are consistent. An external public relations firm should be considered if the company does not have team members with the right skills in-house. Disclosure requirements for M&A transactions, including the timing of announcements, can vary by jurisdiction, so legal advice is also necessary, to make sure the parties are complying with applicable laws.

Exchanging Material Information

When companies exchange confidential material information, it usually includes competitively sensitive data, like information related to the target's overall strategy and its products, sales, customers, costs, historical financial information and forecasts.

In addition, in an auction process, all M&A documents should be adequately controlled and access limited (by issuing numbered copies, for example). Information should be adequately protected (using code names and locked files, for example) and all parties should be reminded of unsafe practices, like reading documents on airplanes or discussing the transaction in restaurants or other public places.

Developing Letters of Intent

A non-binding letter of intent (LOI) outlines the key terms of a potential transaction, including a preliminary estimated purchase price or range, the proposed form of consideration, structure of the transaction, and key conditions and sources of financing.

Letters of intent are not legally binding, but they confirm the buyer is serious and willing to pay a fair price before the companies exchange confidential information. An initial letter is often refined later as the buyer gains access to more detailed information.

From a buyer's perspective, setting out a purchase price can be delicate. The price has to be high enough to pique the seller's interest, but not so high that it suggests the buyer is willing to overpay for the asset.

Letters of intent also help sellers qualify buyers in an auction process. It is common for a target company to request letters of intent early in the auction process, before providing detailed confidential information. (You can read more about auctions on page 34 and about valuation and consideration on page 55.)

You will find an example of a non-binding letter of intent in Appendix 2.

Negotiating Exclusivity, Confidentiality and Standstill Agreements

Once a letter of intent is in place, sellers usually want to set limits on how confidential information can be used and shared and restrict buyers from acquiring stock without the seller's consent. Buyers often seek some form of exclusivity arrangements to preclude the seller from seeking other offers.

Exclusivity Agreements

It is customary for buyers to want exclusivity early and equally common for sellers to resist exclusivity until much later—often when the final bidder is selected.

The buyer will ask for an exclusivity arrangement so it has a defined period to complete due diligence and submit a binding offer to the seller. During this period, the seller agrees not to approach or consider offers from other buyers.

This type of arrangement clearly benefits the buyer, since other potential bidders cannot receive information or submit offers, and it gives the buyer greater certainty that a transaction is possible before committing to the time and expense of due diligence. Buyers usually justify an exclusivity agreement by arguing that they have the greatest synergies with the target and can therefore pay the highest price. They will also argue that putting the company up for auction would be disruptive, creating uncertainty among customers, employees and vendors that could erode the value.

You will find an example of an exclusivity agreement in Appendix 3.

In Canada, boards of public companies are generally obligated to consider bona fide offers for all (or a major part of) the corporation, even in a non-binding form. That does not mean that boards must accept such offers, or even enter into further discussions or initiate an auction process. But in the face of a credible offer for a widely held public company, the board should consider the appropriate response. This could include continuing discussions with a single buyer or examining alternatives, including running an auction process. If the board decides to proceed with a single buyer without having conducted an auction, it is common and advisable to insert a provision in the purchase and sale agreement that allows the board to accept higher offers for a specified period after the purchase and sale agreement is signed (*a fiduciary out*—see page 93).

At a minimum, buyers should be precluded from approaching any employees they have interacted with during the M&A process for up to two years.

Confidentiality Agreements

Confidentiality agreements usually include provisions for both parties to keep material information and the negotiation process confidential.

They usually also include other restrictions on potential buyers, like limiting how the information shared can be used (only to evaluate a possible transaction) and agreeing not to hire the seller's executives and employees for a certain period of time.

Confidentiality agreements may also include restrictions on acquiring equity in the seller, known as a *standstill agreement* (see below).

You will find an example of a confidentiality agreement in Appendix 4.

Standstill Agreements

It is customary to ask potential buyers to enter into separate standstill agreements, or to add standstill provisions to confidentiality agreements. Standstill agreements restrict buyers from acquiring stock in a target company without the seller's consent. This precludes a buyer from gaining an advantage by acquiring a large amount of the target's stock (up to the limit allowed before public disclosure is required). There are a number of different formalities of standstill provisions, including some that "spring" (release) on the happening of certain events.

You will find an example of a standstill agreement in Appendix 5.

When a confidentiality agreement is signed, boards of public companies should make sure everyone involved in the potential transaction is reminded of the corporation's insider trading policy and instructed not to trade in the buyer or target company's securities. In some cases, this restriction could extend to competitor securities too.

The Seller's Perspective

The seller's actions in the transaction stage will depend on whether the sale is planned or unplanned.

Planned Sales

If a company plans to sell a division or the whole company, it usually goes through an auction process (see page 34). In an auction, the seller, with the help of advisors, drafts a long list of potential buyers, usually divided into those that might have a strategic interest (like competitors) and financial buyers (like private equity firms). There should be a communication plan in place to address any potential leaks and outline any stakeholder communications.

Care must be taken to avoid real or perceived conflicts of interest.

If it is likely that the buyer wants to retain the target CEO and other executives, there should be restrictions on their involvement in the sale process (for example, it would be advisable that the executive not be involved in discussions and negotiations with the buyers, other than in the normal course of responding to due diligence requests).

It is common for the target board to establish a separate "special" board committee to be the primary interface with buyers and to have the target company's advisors directly engaged by and reporting to the committee. The special committee is usually relatively small and comprised of independent directors with M&A experience who have the time available to devote to a time-consuming and fast moving process. The special committee will have a board-approved mandate that sets out its role and responsibilities.²

At an appropriate time (usually late in the sale process) the seller will allow the buyer to discuss continuing employment and terms of employment with any executives it wants to retain (see page 94).

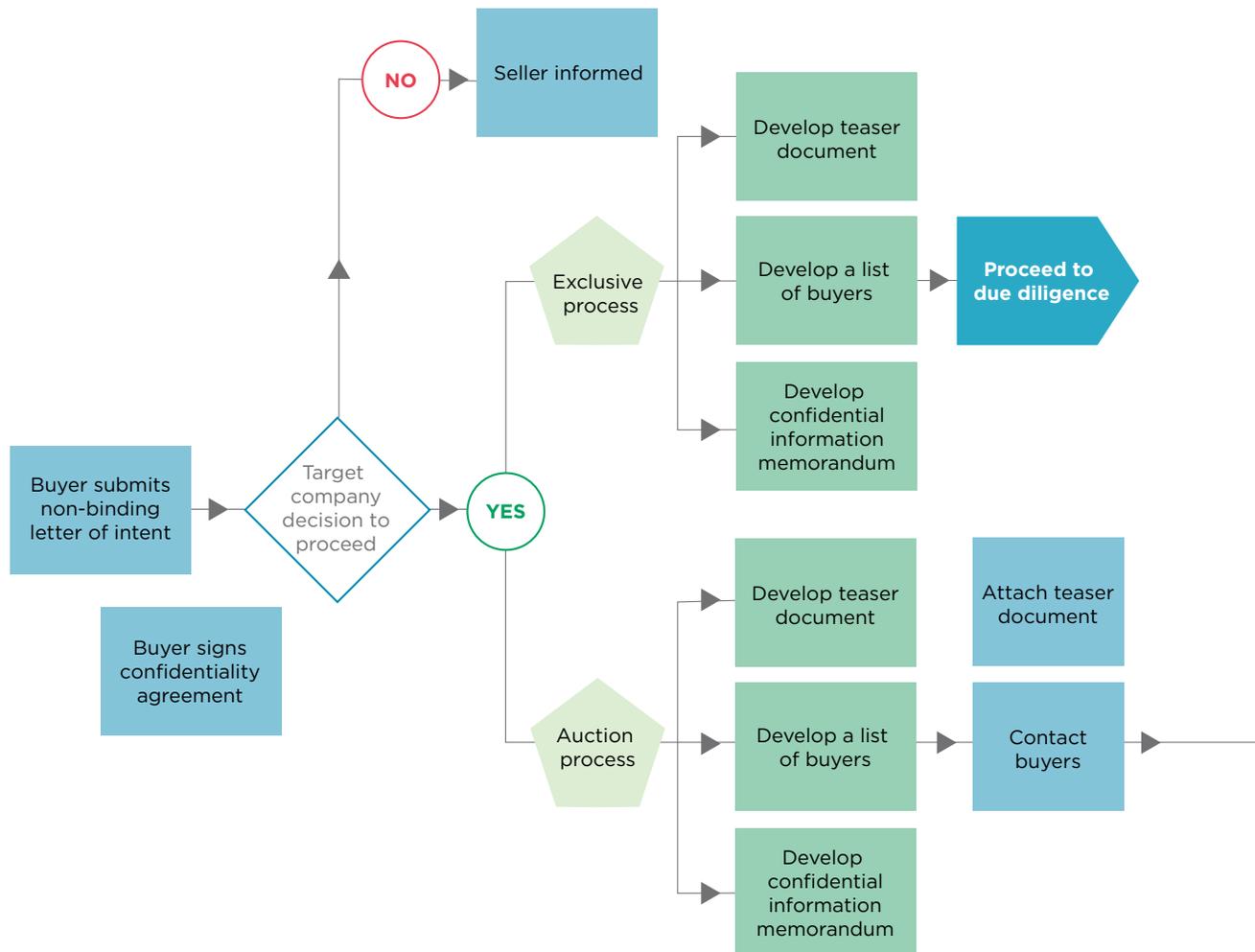
Responding to Unsolicited Offers

When a prospective buyer approaches a company with an unsolicited offer to acquire it, the preparation process is accelerated. The target's board has to decide whether it wants to enter into discussions with this buyer and under

A special committee of the board can be helpful for overseeing the sale process, or even participating in negotiations with buyers directly, since it can be available on short notice and can help the organization make decisions more quickly. For planned sales, it is a good idea to establish the special committee and determine its mandate ahead of time. Directors who are not on the committee can feel 'left out of the loop' however—particularly when terms of the sale are being negotiated—so it is best for M&A committees to report to the board frequently.

² For more information See William K Orr and Aaron J. Atkinson, 20 Questions Directors Should Ask about Special Committees, 2nd Ed. CPA Canada, 2012.

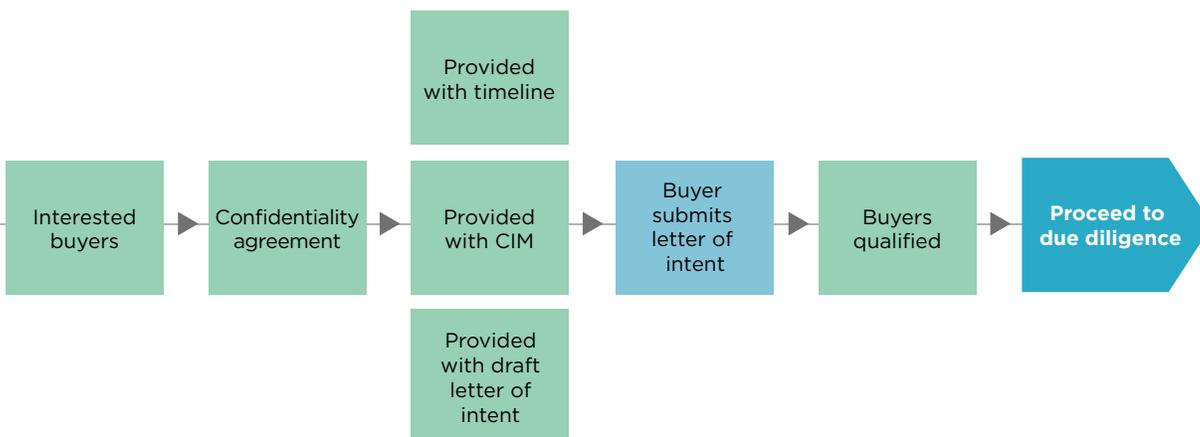
The Seller's Perspective (continued)



what conditions, including whether it wants to deal exclusively with the buyer or run an auction process. (You can read about the typical steps in an auction process on page 34.)

The most important considerations are:

- valuation
- structure
- likelihood of completing the transaction
- available alternatives.



Valuation

One of the most fundamental issues a board faces with an unsolicited offer is valuation: that the sale and related value is in the best interests of the corporation and its shareholders, taking into consideration conditions in the offer, the likelihood of closure and other alternatives.

The issue is further complicated when there is significant institutional shareholder involvement. Institutional shareholders will often support a transaction with a material control premium because of certainty of value, compared to the uncertainty of the enterprise's future performance and potential to create value.

The Seller's Perspective (continued)

Bids for an entire company are generally priced above the company's current market valuation. The difference is known as a *control premium*. Control premiums can vary based on many factors, including current market conditions and norms, the amount and timing of synergies available to the buyer, strengths and prospects for the seller's business and the company's current market capitalization. The expected control premium can also be higher if the company's market capitalization is depressed (because of overall market conditions, industry cycles or other factors) or if there are company-specific events or circumstances, like poor quarterly results that have put downward pressure on the company's stock price.

Structure

It is also important for the seller to assess the structure of the proposed transaction: is the consideration all cash or is some or all of it in the form of an exchange of shares? An all-cash offer is straightforward, since it gives shareholders certainty about valuation. An exchange of equity carries more risk because shareholders are converting an investment in the target company to an investment in the combined entity but that also allows target shareholders to participate in the potential value creation of the combined entity.

Shareholders will expect the target board to assess the strength and value creation opportunity of the combined entity, and any risk related to the combination. The target board should also consider the liquidity of the buyer's stock. If the typical trading volume and value of shares traded is relatively high relative to value for the acquisition, the target's shareholders will be able to sell the stock of the buyer that they receive on the open market without significantly depressing the price of the buyer's stock. Conversely, if there is relatively little liquidity in the buyer's stock, target shareholders may have to hold their shares for a long period of time, increasing risk.

Likelihood of Completion

Assessing whether a transaction would be likely to close involves understanding the conditions the buyer is proposing and external factors that might affect the transaction. For example, the transaction could be subject to the buyer securing financing (although it is a condition that is not often accepted), or there could be jurisdictional issues, like approvals required under anti-competition laws or onerous shareholder voting and approval requirements.

The target board should assess all obstacles in the way of completing the transaction to determine how likely it is to close and how long it may take. Independent advice is recommended.

When the approach to a public company target is unsolicited, the target board must normally consider the available alternatives and seek external advice from an M&A advisory firm and legal counsel.

Alternatives Available

Alternatives usually fall into two categories: choose not to sell or consider other potential buyers. Each alternative has no shortage of complications.

- Choose not to sell**—the standalone scenario involves comparing the buyer's offer with the target's longer-term prospects and potential for value creation if it remains independent. The target should examine opportunities to restructure its operations, like selling or spinning off underperforming assets, refinancing, or other options to unlock value. It must also examine the historical performance of its stock, which could be depressed for a variety of reasons. These situations can be very challenging for a target board, particularly when there is an all-cash offer with a substantial control premium, limited conditions, and a high probability of closure. When choosing a standalone strategy instead of accepting a credible premium offer, the board must be sufficiently confident that remaining independent is likely to generate superior shareholder return over a relatively short period (usually one to two years) and that it can convince the target's shareholders to adopt that view.
- Consider other buyers**—when faced with an unsolicited offer, it is common for targets to identify, qualify and encourage other potential buyers, to put tension in the process to achieve the highest value. The target needs to weigh the benefit of undertaking an auction process against the risks involved in exposing its confidential information to competitors and to leaks that could harm customer relationships and employee morale.

Target boards may also want to consider including a go-shop provision in a purchase and sale agreement that will allow

If the target board agrees to participate in unsolicited discussions initiated by a potential buyer, it should still consider alternatives. Even if a better buyer is not found, the presence of other potential buyers can affect the offer – and for public companies, there is little alternative. An attractive offer from one suitor obligates the board to at least consider other options, including the option to remain independent. That does not mean that the company has to be sold to the highest bidder, but directors need to run a proper process to determine what is in the best interests of the target.

In the face of a hostile takeover bid, target boards should move quickly but with prudence and objectivity. Obtaining expert advice from experienced M&A advisors and legal counsel is essential. The board must develop a proper process to consider all alternatives available to the target, including negotiating further with the hostile bidder, to determine the course of action that is in the best interests of the target.

The Seller's Perspective (continued)

the seller to actively seek and accept superior bids once the transaction has been announced. (You can read about go-shop provisions on page 93.)

Dealing with a Hostile Bid

While most acquisitions are friendly, there are times when a buyer decides to make a hostile takeover bid. This is almost always because the buyer's friendly offer has been rebuffed, usually because of price, conditions or both.

Widely-held, public company boards should periodically examine the company's takeover defences and identify advisors and potential white knights (individuals or companies the board might be willing to support or encourage if the company were threatened with a hostile takeover bid). The board should have a Takeover Bid Response Plan that includes a standing engagement with advisors, typical key information, and a data room.

A buyer's decision to proceed with a hostile takeover bid is usually predicated on the following conditions:

- the seller has rejected its friendly offer
- there are compelling reasons to acquire the target (most often, considerable synergies that would be relatively easy to achieve)
- there is no absolute requirement to retain the existing management
- the buyer has access to firm financing
- the buyer believes the target's shareholders are likely to accept the proposed selling price.

Before turning down a friendly offer, the target board must be satisfied that the proposed purchase price and related terms are not in the best interests of the target. Expert independent financial advice is normally obtained.

The target may have takeover defences in place. The most common is a *poison pill*, which is designed to make its stock prohibitively expensive or otherwise unattractive to the hostile buyer. In practice, the poison pill gives the board additional time to reach out to other bidders. As discussed above, alternatives to selling the target include proceeding with the current strategy (if it is arguably of higher value than sale) or restructuring and refinancing, possibly selling or spinning off specific assets or divisions. If there is no compelling alternative strategy, the board should quickly engage resources, identify other potential buyers and prepare a data room to be made available to other potential buyers.

Often, initially hostile bids end in a negotiated transaction, but at a higher price for several reasons including that the seller has provided access to confidential information, the increased certainty of closing, and that the buyer may not have tabled its highest offer initially.

Three Reasons Buyers Avoid Hostile Bids

Bidders who start out hostile successfully gain control about a third of the time. The rest of the time, companies are either able to mount a successful defence or are sold to other parties.

Most buyers try to avoid hostile bids for three main reasons:

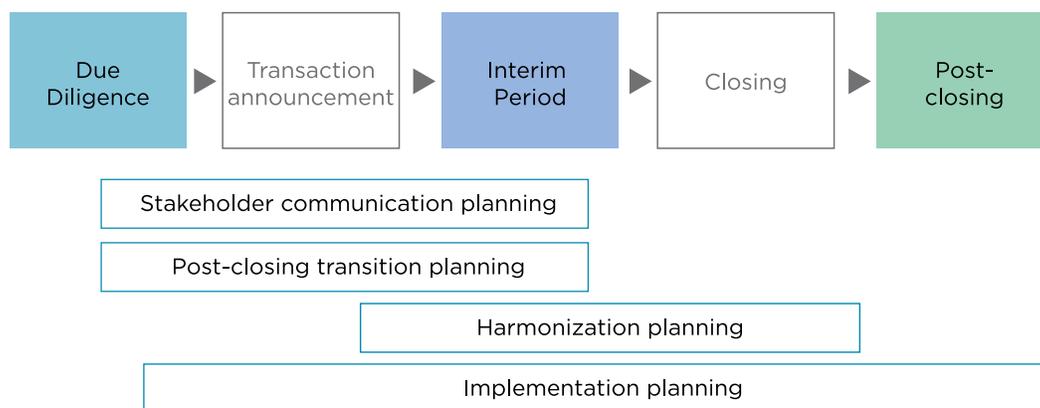
- **completion rates are poor**—the completion rate for takeover bids is relatively low. In the face of a hostile takeover approach, the target is viewed as 'in play' so other bidders are likely to appear – including white knights encouraged by the target's board
- **buying blind**—hostile buyers do not have access to non-public information about the target, so they have to buy the business without the benefit of important confidential information and without meeting with management or visiting target sites
- **target boards may influence shareholders to reject a hostile bid**—target boards almost always recommend that target shareholders reject hostile bids, and give specific reasons for rejecting them (usually that the amount offered is not adequate). On the positive side, an all-cash offer with a substantial control premium (see page 74) can be very attractive to shareholders and is likely to be accepted, unless there is a higher competing bid from a "white knight."

2.2 Due Diligence

This section reviews

- Preliminary due diligence (page 61)
 - Final due diligence (page 64)
 - Confirming the acquisition rationale and potential to create value (page 70)
 - The seller's perspective (page 71)
-

In the context of M&A, due diligence is the process of investigating, evaluating and verifying material facts presented or implied by the seller.



In a transaction negotiated with a single buyer, due diligence may be compressed into a single phase. In an auction process, there are usually two phases: preliminary and final due diligence.

The two-phased approach has several benefits for the seller. It:

- restricts access to competitively sensitive information
- reduces disruption and management time
- helps the seller qualify buyers by asking them to refine the terms of a non-binding letter of intent.

Buyers, however, always benefit from having access to as much information as possible early in the process, so the two-phased approach is not particularly beneficial to them, other than reducing the time and expense of more in-depth due diligence at an early stage.

The duration and complexity of due diligence may also differ depending on whether the entity being sold is a public corporation, a private company or a division of a public company. Continuous disclosure requirements of applicable securities laws can simplify the preliminary due diligence process for public companies, while private companies or divisions of public companies may not have the same information readily available, including (among other things) audited financial statements.

Preliminary Due Diligence

The purpose of preliminary due diligence is to confirm the acquisition rationale, preliminary valuation and potential to create value, using limited target company information provided under a confidentiality agreement. It also helps the buyer start to assess the business combination. In contrast, final due diligence involves detailed review and evaluation of every material aspect of the business, including strategy, financials, operations, and organizational, legal and other material areas.

The scope of preliminary due diligence will vary, but it usually involves reviewing the seller's confidential information memorandum, limited information in the seller's data room (usually a web-based or virtual room) and presentations and discussions with the target's senior management.

For larger transactions, it is common for the buyer board to receive presentations or a report from buyer management setting out the planned scope, timeline and resources for each phase of due diligence, including when external advisors will be engaged and their fees.

Alignment with Acquisition Rationale

Initial due diligence should focus on the company's acquisition rationale. For example, a key M&A goal may be to gain financial leverage and a competitive advantage by acquiring a competitor who will bring increased scale, expanded product lines and a broader customer base. Preliminary due diligence would then focus on:

- the potential increase in scale
- the uniqueness of and prospects for the target's current products and those under development
- whether the target's larger customers are complementary to or overlapping with the buyer's existing customers.

Value Creation Potential

Preliminary due diligence should also identify and confirm additional sources of value, using the four broad categories we described on page 17:

- **Cost synergies**—if the acquisition rationale involves gaining the benefit of scale, then preliminary due diligence should focus on that, particularly confirming the extent of cost reduction opportunities available. Buyers should look beyond obvious, transparent synergies for enough cost savings to justify a price premium.
- **Revenue synergies**—buyers should examine the potential for new revenue more carefully, including the value proposition the combined company could offer customers and the resources that would be needed to win new business. Revenue synergies tend to be more difficult to validate than cost synergies, however, particularly without the benefit of speaking directly to existing and potential customers (see *Customer Strategy* on page 67 for a discussion of this). Directors should be skeptical of any scenario that does not account for some customer attrition, especially if customers currently buy goods or services from both companies and have procurement policies that require sourcing from more than one vendor.
- **Strategic value**—as noted in the M&A strategy section, some of the highest-value strategies do not create value directly or immediately, but position the company for possible future steps that could create value. Buyers should explore and understand future scenarios, including probabilities and implications for creating value. Consider and account for scenarios that have the potential to limit or even destroy value.

- **Other sources of value**—buyers should assess other likely benefits of managing the target company differently (benefits from financial engineering, selling assets, restructuring the organization, or changing the company's approach to R&D, operations or marketing, for example) and challenges the buyer may face in achieving them.

About Due Diligence with Competitors

If the target is a competitor, there may be concerns about sharing data, especially about pricing and customers, in case the transaction does not occur.

In some cases, competition law will restrict sharing certain information until shareholders and regulators approve the transaction. In that case, sensitive information can be withheld or disguised (for example, by code-naming customers).

Alternatively, companies can use a clean room managed by a team of advisors who receive data from both companies and generate reports that include conclusions, but no competitively sensitive data (for example, both companies may submit detailed cost data but will receive only an estimate of cost synergies based on the clean room analysis). Both companies submit files (physical or electronic) to the clean room but neither company has access to the other's information.

What Boards Should Expect

Following preliminary due diligence, boards should expect management to:

- confirm that the acquisition rationale is valid, or identify the material issues or any change from the initial premise
- report on the sources and amount of any value creation opportunities, especially cost synergies and any net negative synergies
- identify the amount (if any) that the estimated valuation could be changed and why
- identify key issues, concerns or other items that would need to be confirmed in final due diligence
- recommend whether to proceed to final due diligence
- if the recommendation is to proceed, identify any change to the proposed purchase price (up or down).

Final Due Diligence

Final due diligence happens once the seller chooses one or two potential buyers for definitive discussions and negotiation. This is an extensive process, usually involving a detailed review and evaluation of every material aspect of the business, including strategy, financials, operations and organizational, legal and other material areas.

Final due diligence is an important step for confirming the acquisition rationale and valuation assessment, identifying risks and gaining a thorough understanding of the seller's business. It is only at this stage that the buyer has full access to all material information about the target.

Final due diligence should also confirm the validity and value of any expected synergies and help the buyer develop a post-acquisition integration plan. Once this step is complete, the seller will expect the buyer to finalize an offer price and other key terms and have approval to proceed.

Due diligence teams usually include staff and external advisors with knowledge and experience in each area of the business. Experienced and effective due diligence teams:

- use detailed checklists
- meet frequently (often at the end of each day) to share findings, especially those that could affect valuation, or that conflict with the rationale for acquiring the business, and identify items that need follow-up
- are also responsible for developing the post-closing integration plan.

What Buyer Boards Should Expect

Before final due diligence begins, directors should be satisfied that:

- the scope of final due diligence includes everything material to value and risk associated with the target company and the new combined business (see *Scope and Responsibilities* below)
- the employees and third parties involved are qualified and independent
- enough time will be allowed to review any important findings that could impact value and risk.

Buyers should request an exclusivity agreement at this point, if not sooner (see page 51 for a description and Appendix 3 for an example of an exclusivity agreement). Final due diligence is expensive, so buyer boards should be assured that the seller is committed to completing a transaction.

Scope and Responsibilities

You will find an example of a final due diligence checklist in Appendix 6.

The summary below outlines:

- key areas to focus on in due diligence
- how a review of each area can contribute to confirming the value of the target and related risks
- the kind of help the buyer may need to complete a review of each area.

Although most buyers have access to the right resources (in-house or external) to conduct financial, legal and other kinds of due diligence, critically important strategic, organizational and operational due diligence is often glossed over or executed poorly.

<p>Corporate organization and ownership Due diligence related to how the corporation is organized.</p> <p>Responsible:</p> <ul style="list-style-type: none"> • In-house or external legal team 	<p>Should be designed to understand:</p> <ul style="list-style-type: none"> • the seller's legal entities, articles of incorporation and by-laws • the nature and types of securities it has outstanding • all related rights or agreements. • It should also determine who the owners are and their relative shareholdings.
<p>Physical and intangible assets Due diligence on assets.</p> <p>Responsible:</p> <ul style="list-style-type: none"> • Legal team • Financial team • Operational and technical teams 	<p>Focuses on confirming all of the physical assets listed in the entity's most recent financial statements. This could involve:</p> <ul style="list-style-type: none"> • reviewing titles, security interest searches, deeds and leases • physical inspections or independent confirmation • reviewing appraisals and committed capital expenditures. <p>Diligence around intellectual property would include reviewing and confirming patents, copyrights and trademarks, and understanding the depth of operational and technical know-how and reviewing employment contracting practices.</p>
<p>Compliance and litigation Due diligence related to compliance and litigation matters.</p> <p>Responsible: :</p> <ul style="list-style-type: none"> • Legal teams responsible for compliance and litigation 	<p>Includes reviewing or examining:</p> <ul style="list-style-type: none"> • all licences, permits and related restrictions • current, pending and past matters involving regulatory bodies like securities commissions and environmental agencies • current, pending or threatened litigation • conducting appropriate searches.
<p>Environmental Due diligence related to environmental matters.</p> <p>Responsible:</p> <ul style="list-style-type: none"> • Legal and operational teams • External environmental specialists • Specialized legal advisors 	<p>Includes reviewing environmental matters for all sites, including:</p> <ul style="list-style-type: none"> • their current status • historical environmental studies, audits, reports, external assessments and litigation • site inspections.

<p>Contracts, licences and commitments</p> <p>Due diligence related to material contracts.</p> <p>Responsible:</p> <ul style="list-style-type: none"> • Legal team 	<p>Includes reviewing all material contracts, including:</p> <ul style="list-style-type: none"> • loan agreements • customer, vendor and distributor contracts • licences and related party agreements. <p>Counsel should pay particular attention to unrecorded potential liabilities or commitments arising from contractual indemnities, future performance requirements and guarantees, restrictive covenants, most favoured nations clauses, change of control clauses and warranties.</p>
<p>Liabilities</p> <p>Due diligence related to liabilities.</p> <p>Responsible:</p> <ul style="list-style-type: none"> • Finance and accounting teams • External audit • Legal team (as needed) 	<p>Involves:</p> <ul style="list-style-type: none"> • reviewing outstanding accounts payable • validating the amounts (and appropriateness of) accruals and provisions for pension and post-retirement benefits • determining whether any unrecorded liabilities are likely to be identified in other due diligence files.
<p>Financial (including taxation)</p> <p>Due diligence related to accounting, auditing and taxation.</p> <p>Responsible:</p> <ul style="list-style-type: none"> • Finance team • External audit and taxation specialists 	<p>Financial due diligence includes a detailed review of:</p> <ul style="list-style-type: none"> • the entity's audited financial statements (including an account-by-account review of any schedules) • its accounting policies • audit reports on its financial statements. <p>Taxation due diligence involves reviewing:</p> <ul style="list-style-type: none"> • tax returns and assessments • open audits • tax reserves. <p>The entity's internal control systems are assessed primarily by examining internal audit reports and work files and external audit reports.</p>
<p>Information and other systems</p> <p>Due diligence related to information systems.</p> <p>Responsible:</p> <ul style="list-style-type: none"> • In-house and external IT specialists 	<p>Involves:</p> <ul style="list-style-type: none"> • understanding hardware, software and network architectures • validating system performance • assessing whether the system is meeting the entity's overall requirements • reviewing plans to upgrade or renew legacy systems • reviewing potential integration issues.
<p>Strategic</p> <p>Due diligence related to the formulation and execution of strategy.</p> <p>Responsible:</p> <ul style="list-style-type: none"> • All functional disciplines • Strategy advisors 	<p>Strategic due diligence should be considered at both the investment and operating levels. Each asset should be assessed in terms of competitiveness, sufficiency, quality and cost.</p> <p>The target should be benchmarked against its competitors by analysing:</p> <ul style="list-style-type: none"> • absolute and relative market shares • performance • depth and quality of resources (assets and financial and human capital) • competitor strategies, advantages and gaps. <p>Business units</p> <p>Strategic due diligence at a business unit level involves examining how strategy is formulated and executed, how competitive the unit's resources are, and how well they are performing.</p>

Strategic
(continued)

The nature of markets served and targeted by the business unit can be understood by asking:

- How are they segmented?
- What is the size and trajectory?
- What is the basis of competition?
- What factors influence growth or contraction?
- How large is the market's profit pool?
- What are the barriers to entry?
- What are the six or seven key success factors that industry players must excel at to be successful?

Key functional areas

Strategic due diligence also includes reviewing key functional areas in depth, including:

- manufacturing and service delivery
- distribution
- sales and marketing
- product or service development
- general and administration functions.

The reviews should look at the current model of delivery and past and projected cost and effectiveness (as benchmarked against competitors). The longer-range forecasts buyers usually provide should be reviewed critically in light of any findings from strategic due diligence.

Other business or operations

If the target has multiple businesses or operations, there will be a strategy for allocating capital and other resources. The buyer should review future plans and how effective past decisions have been, including the criteria used to allocate resources.

Customer strategy

One of the best ways to determine the efficacy of a seller's strategy (including market acceptance, whether its products and services are competitive, and the depth and quality of its relationships with customers) is to conduct in-person customer interviews, selecting the key customer group.

Customer due diligence includes:

- concentration analysis
- historical and projected revenue and profitability by customer and share of wallet
- historical and projected new customer wins
- customer purchase criteria (in rank order of importance).

Former customers and competitor customers should be interviewed, as well as the target's current customers.

- **Current customer interviews**—help assess the rank order of purchase criteria, loyalty of the customer base, and product competitiveness and value proposition.
 - **Former customer interviews**—provide information about product or service deficiencies or lack of competitiveness. Insights can also be gained by speaking with competitor customers, to determine the reasons the seller's offerings have not been selected and to better understand the value proposition and differentiation of competitor products and services.
-

Strategic
(continued)

Understandably, sellers will resist buyers meeting with their customers.

This resistance can be overcome by scheduling customer interviews as the very last due diligence step, perhaps even after the definitive purchase and sale agreement has been negotiated and is ready for signing. Using a third party to conduct interviews under the guise of an industry-wide survey can also work effectively without customers becoming aware of an ongoing sale process.

Organizational

Due diligence related to the organization's structure, including employment terms and culture.

Responsible:

- Human resources
- Compensation
- Labour and cultural integration experts

Employment terms

Privacy laws may restrict the buyer's access to certain employee information. The buyer will need to work with the target to manage these issues.

Organizational due diligence involves a broad range of examination, including employment terms like:

- salaries, compensation plans and benefits
- employment contracts (including change of control provisions, accelerated equity vesting, labour contracts and management resources).

If the buyer wants to retain some or all of the target's senior management, each executive should be put through the buyer's standard interview process. This would likely include multiple interviews, testing tools and reference checking.

Cultural differences

Due diligence related to cultural differences between the buyer and seller organizations is often overlooked or minimized, but can be the primary reason a combined entity underperforms after the transaction closes. Using external advisors can be helpful, as they bring both expertise and objectivity.

It is almost axiomatic that the buyer's intent is not to blend cultures, but rather to align the seller's culture with its own. Due diligence should include developing an understanding of the seller's culture, and how it differs from the buyer's. Trying to align cultures is particularly complex when combining entrepreneurial and bureaucratic organizations, when two fierce competitors are merging, or when multi-national businesses are merging.

Imposing a bureaucratic culture on an entrepreneurial organization can be stifling and retaining top performers can be challenging. Conversely, attempting to instil an entrepreneurial culture into bureaucracy can be immensely frustrating and painful for both parties.

Similarly, merging intensely competitive organizations is particularly difficult, since each party typically believes their company is superior and revels in winning head to head competition.

Complexity in multi-national organizational mergers involves blending both nationalistic and company-specific mergers.

The scope of cultural due diligence should involve articulating:

- the fundamental cultures of each organization
 - the primary differences that pose the greatest obstacles to a successful merger
 - a preliminary plan (at minimum) for cultural integration after the merger.
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<p>Organizational (continued)</p>	<p>Buyer boards should not underestimate the importance, difficulty, time requirement and risk associated with cultural integration. Assertions that a significant cultural shift can be achieved within a short period without a radical change in management should be viewed with considerable skepticism.</p>
<p>Operational Due diligence related to how the business is run day-to-day.</p> <p>Responsible:</p> <ul style="list-style-type: none"> Operational and technical teams 	<p>Operational due diligence varies broadly depending on the nature of the enterprise, but critical components include understanding the depth and quality of the entity’s resources and its performance across key metrics, benchmarked against the competition.</p> <p>Since operational due diligence aims to confirm the soundness of the entire business system, it should also extend to parts of the operation that are external to the target, like suppliers, third party distribution channels and outsourced operations. Events like the 2013 collapse of a factory in Bangladesh that supplied Loblaw and others underscores the importance of extending environmental, liability and operations due diligence beyond the boundaries of the legal entity.</p>
<p>Synergies Due diligence related to expected M&A synergies.</p> <p>Responsible:</p> <ul style="list-style-type: none"> All due diligence teams 	<p>The due diligence process should be used to confirm and detail synergies, and to identify further opportunities to create value.</p> <p>This includes identifying potential incompatibilities and any risks related to achieving the synergies that are anticipated, such as what it will cost and how long it will take. Each due diligence file should examine, list and quantify the synergies it supports and the synergies it could put at risk.</p>
<p>Execution and integration Due diligence related to expected M&A synergies.</p> <p>Responsible:</p> <ul style="list-style-type: none"> All due diligence teams 	<p>At this stage, most organizations have a preliminary post-closing integration plan in place or under development.</p> <p>Each due diligence team should be tasked with developing a specific integration plan for each function. These plans might include things like rationalizing the organization, rationalizing facilities and products, reducing costs, making new investments, integrating systems or making broad changes in strategy, to leverage scale and drive further value.</p>
<p>Material differences and risks Due diligence related to material risks.</p> <p>Responsible:</p> <ul style="list-style-type: none"> All due diligence teams 	<p>A final objective of due diligence is to develop a comprehensive list of issues that may or may not have been disclosed that could affect current or future value—for example, unrecorded or contingent liabilities, the condition or valuation of assets, or unrealistic assumptions underpinning financial forecasts.</p> <p>This list will allow the buyer to reassess its proposed purchase price and justify any proposed reduction.</p>
<p>Experienced buyers often use the outcome of due diligence to materially lower the proposed purchase price. While this tactic can be somewhat confrontational, it can also be effective, especially when other bidders are no longer competing for the asset</p>	

Confirming the Acquisition Rationale and Potential to Create Value

Final due diligence should confirm that the benefits of the proposed combination are valid and can actually be achieved—in other words, how the transaction will result in a better company, worth more to its shareholders.

There are usually qualitative and quantitative components.

Qualitative Rationale

The qualitative rationale should relate to the buyer's M&A strategy. It should include a discussion of industry context and the buyer's competitive position, and outline how the transaction will advance the buyer's strategy.

It should also identify (and to the extent possible, quantify) the sources of value the transaction will create. For example, the transaction may improve certain key skills or the buyer's competitive position in selected markets. It may introduce product or channel synergies, lead to a lower-cost position, or provide access to new geographic markets. It may even reduce or eliminate certain risks.

Quantitative Rationale

The quantitative rationale should provide the investment analysis. Specifically, it should discuss how and when the anticipated benefits will translate into new revenue or reduced costs for the buyer and the investments required.

The costs involved in achieving the benefits of an M&A transaction are often ignored, and should include transaction costs, capital investments and the cost of resources needed to achieve the revenue and cost synergies, as well as the actual price of the transaction (usually an estimated range at this point).

It is important for the investment analysis to be incremental to the right base case. On one hand, the investment case will be inflated if revenue and cost improvements attributed to the benefits of the transaction include growth and efficiencies already planned and achievable without M&A. On the other hand, in restructuring or consolidating industries, the right base case may be future-disadvantaged against new and larger competitors, so it could include negative growth and margin erosion. Buyer directors should be satisfied, however, that a lower base case is justified by industry and competitive developments, and is not simply a convenient way to justify the transaction.

There should be an assessment of potential risks that could prevent the buyer from achieving the acquisition rationale, including economic consequences.

There are also likely to be risks associated with most parts of the acquisition rationale. For example, there may be regulatory risk if the transaction could be viewed as lessening competition or if the acquired asset is in another country or regulatory jurisdiction. The implications of those risks and ways to mitigate them should be part of the final due diligence process.

Finally, there is also risk associated with not proceeding with a transaction. In a consolidating industry, there may be a risk of not finding other suitable merger partners needed to remain competitive. The value of the target in a competitor's hands should also be considered.

What Buyer Boards Should Expect

At this stage, there should be at least an outline of the implementation plan, to demonstrate to the buyer's board that the acquisition rationale is actionable.

The plan should also provide a basis for considering required investments and a timeline for returns. Directors should be satisfied that the actions needed to achieve the anticipated benefits of a proposed transaction are clear, the risks have been considered, and the timelines for implementation are realistic.

The Seller's Perspective

For the seller, the due diligence process can be time-consuming and disruptive. The early stages usually involve developing a confidential information memorandum, a draft M&A process and timeline to distribute to potential buyers, draft letters of intent and confidentiality agreements. Outside advisors, including consultants, investment banks and accounting and legal firms can be very helpful in drafting these documents, reducing the burden on management.

Populating virtual data rooms and developing management presentations can also be laborious. Using a typical buyer due diligence checklist as a guideline to determine what materials to include can be very helpful. Senior management, under board or special committee supervision, should be involved in deciding how much competitively sensitive information should be provided to buyers, and at what stage in the process.

Sellers are advised to control and limit the due diligence process as much as possible. Buyers have a voracious interest in target company information that often exceeds what is required, especially for preliminary due diligence. These excessive demands for information can easily strain seller resources if management does not set limits.

Clearly defining what information will be made available and establishing and maintaining due diligence timelines makes the process efficient and manageable for all parties.

2.3

Valuing the Company and Structuring the Transaction

This section reviews

- Preliminary valuation (page 72)
 - Final valuation (page 76)
 - Consideration (page 77)
 - Structures (page 78)
 - Financing (page 82)
 - The seller's perspective (page 85)
 - Structuring the transaction (page 86)
-

Many aspects of this step are technical and fall into the realm of legal, tax and securities experts.

It is important, however, for directors to understand key structures and terminology, consider the risks inherent in the structure, price and consideration, and be satisfied that the ultimate structure and pricing are consistent with the acquisition criteria and will facilitate implementation.

Preliminary Valuation

In most M&A transactions, buyers table a preliminary offer price along with the non-binding letter of intent. The price is usually based on information in the public domain or, in the case of a private company, on limited information provided by the seller.

Sellers use the initial offer price to decide if the ultimate purchase price is likely to be high enough to consider selling, and as one of several criteria to qualify potential bidders.

Preliminary valuation of the target should be done in three separate steps:

1. determine the target's current standalone value
2. assess the value of the control premium
3. identify the incremental value to the buyer, based on its acquisition rationale.

These three methodologies provide the extreme limits of the price range. The target is not likely to sell for less than its standalone value and the buyer will not want to pay more than what it estimates the value to be after its acquisition rationale is factored in. If the value of the target to the buyer is higher than its standalone value plus an estimated control premium, a transaction may be possible.

1—Determine the target's standalone value

Public companies—the standalone valuation of a public company is usually based on comparing three approaches:

- **Trading value**—the value of the enterprise, based on its current market capitalization (calculated as the number of shares outstanding × current stock price + net debt). To address day-to-day price volatility, buyers typically use the target's weighted average stock price over a particular period of time (typically 30 to 90 days) and take daily trading volumes into consideration.
- **Comparator value**—a comparison of the enterprise with similar public companies, using ratios. For example, dividing the enterprise values of several comparable companies by their EBITDA (earnings before interest, tax, depreciation and amortization), then multiplying the target's EBITDA by the comparator ratios to establish a range of values. EBIT (earnings before interest and tax), EBITDA, revenue or other multiples may be used, depending on which are the best indicators of value for the industry.
- **Discounted cash flow value**—the net present value of the enterprise's future cash flows, using an appropriate weighted average cost of capital as the discount rate.

Each has its advantages and disadvantages. For example, while the discounted cash flow value is likely to be the purest estimate of value, it is subject to many assumptions and does not work well in all industries. The market-based approaches provide objectivity, but only if the comparators are relevant and unbiased.

Private companies—standalone value relies on comparators (and net present value, if the data is available). Multiples are usually based on historical (or *trailing*) performance, but forward-looking values can be used if the seller provides forecast information. For private technology companies that are pre-revenue, other valuation methodologies will be needed.

2— Assess the value of the control premium

The control premium is the difference between the target's trading value as a standalone entity and what a buyer is willing to pay to acquire a controlling interest in it. It is often determined by looking at recent sales of public and private companies, called *precedent transactions*.

Buyers can establish a range of values that might be expected if the business was sold *en bloc* by using multiples of the target's trailing and forecast EBIT, EBITDA or revenue compared to precedent transactions. The choice of comparators is important here too, including making sure the time period and market conditions of the precedent transactions are relevant.

Control premiums can vary widely for several reasons, including depressed stock prices, expected future performance and expected incremental values associated with a business combination.

3— Identify the incremental value to the buyer

It is best to use a discounted cash flow model to determine the value to the buyer, based on incremental cash flow from the transaction (standalone value + expected synergies - additional investment needed), discounted at the appropriate weighted average cost of capital. Considering a range of future cash flows and synergies will reduce the risk of these estimates. See the example below.

Intrinsic value of the target	\$5,100
Net present value of synergies	\$1,400
Value of the target to the buyer	\$6,500
<hr/>	
Market value of the target	\$4,900
Control premium	\$1,200
Total price	\$6,100
<hr/>	
Value creation for the buyer	\$400

Risks Related to Valuation

While the three valuation methodologies recommended here are common, boards should be aware of their pitfalls and other factors to consider.

- **Trading values can be misleading in cyclical businesses**—trading values can still be relevant in cyclical businesses (and are used in practice) but they may need to be adjusted to take into account cyclicality, industry trends or company-specific events or conditions. In cyclical businesses, wide ranges of trading are common. Buyers prefer to acquire companies in the down cycle, but sellers will be more interested in a transaction at the top of a cycle—in fact, a reasonable control premium may not be enough of an offset for a company at the bottom of a cycle, since staying independent and riding the upward cycle may create greater shareholder value. Highly volatile stocks can offset all or part of a reasonable control premium.
- **Determining an appropriate control premium is not always straight-forward**—it is important to review precedent transactions carefully to assess whether they are really relevant and comparable and whether there were unique circumstances that may have caused a control premium to be higher or lower than expected. Investment banks can offer very helpful advice.
- **EBITDA is not a proxy for cash flow**—by definition EBITDA excludes cash outflows associated with interest and cash income taxes. It also excludes the funds needed for working capital, capital expenditures and other investments.
- **Boards should take little comfort from comparator multiples**—especially when an acquisition opportunity is valued mainly using EBITDA multiples. The ultimate value of the business to the seller is its future cash flows, discounted at an appropriate discount rate.
- **Directors should question the assumptions used to estimate the terminal value**—when calculating the net present value of future cash flows, there are usually five to 10 years of estimates followed by a “steady state” year that is used to estimate the remaining value in perpetuity. This is what is known as the terminal value. The valuation as a whole can be highly skewed by assumptions about continuing growth, margins, capital expenditures and other things included in the terminal value calculation.
- **Buyers should complete preliminary valuations before initial discussions begin**—buyers need to be satisfied that there is enough room in the valuation envelope to be able to reach a deal. Target companies often believe they are worth more than they are, so it is helpful for the buyer to come armed with public valuation data to share. The buyer should also encourage the seller to obtain independent expert valuation advice.

- **Directors should understand how quickly the proposed transaction will increase earnings per share**—it is important for the buyer board to understand whether the proposed transaction will be immediately accretive or whether it will take time for the results of the combined entity to increase the buyer's earnings per share (if earnings per share will decrease under the combined entity scenario the transaction is dilutive).

Boards should be wary of acquisitions where the combined results only become accretive when most of the expected synergies are realized. This suggests the purchase price is too high and adds substantial risk to the transaction.

In valuation, sometimes the simplest approach is the most telling and useful. Simply asking: "When do we get our money back?" can cut through all the complexity and clutter in valuation methodologies.

Final Valuation

There are usually two competing forces influencing valuation as buyers work through the sale process, especially when there are significant synergies:

- competitive tension among bidders (created in part by the seller) can drive buyers to move to the higher end of their ranges, pushing the valuation up
- detailed due diligence inevitably identifies issues and risks that push the valuation down.

You can read about closing the gap between buyer and seller expectations on purchase price starting on page 90.

Companies should update their valuation models throughout the due diligence process to reflect new findings and changes in performance and market conditions that might affect the preliminary estimates.

It is also common for sellers to ask bidders to refine their offers after preliminary due diligence. This gives the seller some comfort that its expected value could be realized (if preliminary due diligence did not degrade the bidders' valuations) and to qualify a short-list of bidders.

A final offer price is ultimately negotiated between the buyer and seller, taking final due diligence findings and other terms of the purchase and sale agreement into consideration.

Fairness Opinions

Obtaining a fairness opinion on price is a good practice for both buyers and sellers. A fairness opinion is an estimate of value by a qualified and independent party. It typically values the target entity 'as is', but still provides assurance of the base value and can protect buyer and seller directors from liability. As well, directors are entitled to rely on professional advisors in discharging their duties as directors so fairness opinions offer liability protection to directors.

Buyer boards are the last line of defence on valuations and should be aware that management may be so enamoured with a potential transaction that it recommends a higher valuation, usually by raising risk-adjusted synergies or adopting top of the range multiples.

Buyer directors should take a disciplined and conservative approach that considers both the opportunity and its related risks.

Consideration

Consideration can be in the form of cash, stock or a combination of both.

From a buyer's perspective, cash has certain advantages. It gives the seller certainty, making the buyer's offer more attractive, and, if there are substantial synergies, it preserves their value for the buyer's shareholders. The primary disadvantage of cash for the buyer is the effect on its balance sheet—drawing down on cash balances, increasing debt or both. Major acquisitions can result in a highly levered balance sheet, which increases overall enterprise risk.

Sellers usually prefer cash transactions, but sometimes the highest offer includes stock as some or all of the consideration. Using stock has the obvious advantage of preserving the buyer's cash and debt position. It may be advisable for the buyer when:

- the target's multiple is lower than the buyer's multiple (generally providing immediate accretion)
- the buyer does not have enough debt capacity, or
- significant funds will be needed after closing (for example, to fund a major project or capital expenditures).

Stock-based transactions introduce added complexity for both the seller and the buyer. The seller has to complete its own due diligence on the buyer and the combined entity to be satisfied that the stock offered is sufficiently liquid and will retain the expected value after closing. For larger transactions, the equity market's view of the transaction will affect the share value of the

acquiring company at closing. For example, if markets view the transaction negatively, the seller would have to negotiate to discount the value of the shares and the buyer would need to issue more stock to compensate.

To give the seller greater certainty, a buyer may offer to guarantee a minimum share price or range at closing (called a strike price) and make up the difference in cash or additional shares, potentially increasing the price it will ultimately pay for the transaction. There are other ways to minimize risk of stock price fluctuations including the use of derivatives.

Structures

There are two broad structural components to consider in a transaction: the structure of the transaction itself and the structure of the combined business after the transaction.

Structuring the Transaction—Public Companies

There are three primary transaction structures for acquiring public companies in Canada: amalgamation, plan of arrangement and take-over bid. Each structure has advantages and disadvantages.

All three involve one corporation absorbing the other. The surviving corporation subsequently holds, directly or indirectly, all assets and liabilities of the other company.

- **Amalgamation**—in an amalgamation, the buyer usually forms a wholly-owned special purpose acquisition vehicle (SPV) with which the target is amalgamated. The amalgamation requires approval by the buyer, as the sole shareholder of the SPV, and by two-thirds (or 66 2/3%) of shares (called a supermajority) at a special target shareholder meeting. The transaction may also require approval by the buyer's shareholders if the buyer's publicly-listed shares are offered as consideration and the number of shares offered exceeds the threshold set by the relevant stock exchange. All of the target shares can then be exchanged for the purchase consideration and the buyer can proceed with implementation as soon as it receives regulatory approval.
- **Plan of arrangement**—a plan of arrangement is frequently similar to an amalgamation, except that the target also submits a detailed plan of arrangement to the court for approval. The court has broad power under the arrangement provisions of the business corporation statutes. Accordingly, plans of arrangement are used when there are special steps that are required for tax, regulatory or contractual reasons.

Plans of arrangement usually take longer to complete and are more expensive than amalgamations because of the court process.

- **Takeover bid**—a takeover bid is a direct offer to shareholders to acquire the target's shares. Once 100% of the shares have been acquired, the new owner can restructure the target as it wishes.

A buyer can acquire 100% of the target's shares in stages. If at least 90% of the shares are tendered (including shares that may already be held by the buyer), Canadian securities law compels the remaining shareholders to sell at the same price. If a supermajority of shares (usually 66 2/3%, sometimes more, as defined by the statutes of incorporation) are tendered to the buyer, the buyer can also force an amalgamation to acquire the remaining shares.

A takeover bid can be the fastest way to acquire a target because the bid is only required to remain outstanding for 35 days under current Canadian law.

Takeover bids can be used to transact a friendly acquisition (the takeover bid structure does not automatically imply that a bid is hostile), but a hostile bid can only proceed with this structure. Any regulatory approvals that apply must be received before the transaction can be closed.

About Cross-Border Transactions

Cross-border transactions require compliance with securities law in all jurisdictions. There may be legal obligations inherent in the transaction, or a risk of legal action by stakeholders. If the companies will integrate, or if the combination will have a greater share of market or greater supplier power, the risk of competition law challenges should also be assessed for each relevant jurisdiction.

Structuring the Transaction—Private Companies

Acquiring a private company (or smaller divisions of a public company) is generally simpler because there are only a few, known shareholders involved. Complications can arise if some of the shareholders do not want to sell.

Private company transactions are structured as asset purchases or share purchases. The buyer may also arrange for an *earn-out* (see below) to close a gap in negotiations about the purchase price.

- **Asset purchase**—the seller transfers the assets used in the business to the buyer, including physical assets (like plant and equipment) and intangible assets (like contracts, patents and trademarks). The seller retains the corporate entity to continue other business activities, or as a shell if all the assets are sold. Employees do not automatically transfer to the buyer, but are usually hired by the buyer. This creates an opportunity for the buyer to choose which employees it wants to hire and potentially leaves severance costs with the seller. By leaving the corporate entity behind, the buyer is also insulated from any unrecorded or contingent liabilities that arise after closing. There could be exceptions, however, and buyer directors should be satisfied that liabilities that could follow the assets have been identified and the risk assessed (collective bargaining contracts, for example, usually cannot be terminated when an asset is sold).

Asset transactions usually offer tax advantages to the buyer because the buyer may be able to write off some (or potentially all) of the value of the acquired assets over time. Generally, the buyer is entitled to allocate the purchase among the various assets. Depreciation on certain fixed assets can be claimed as a deduction for tax purposes.

An asset purchase can also have advantages for sellers. For example, the non-taxable gain on a sale of goodwill and certain other capital property can be distributed through Capital Dividend Accounts and withdrawn free of tax.

- **Share purchase**—sellers usually prefer a share purchase to an asset purchase transaction for two main reasons:
 - if there is a taxable gain on the transaction, selling shares may lower overall tax
 - a share purchase transfers to the buyer any liabilities that may emerge after closing. With this structure, buyers should expand and focus their due diligence on exposures for unrecorded and contingent or unknown liabilities to minimize this risk.

- **Amalgamation**—if a share transaction is desirable but some shareholders are unwilling to sell, as long as shareholders holding two-thirds of each class of shares wish to sell, the transaction can be carried out by way of an amalgamation “squeeze out”. The result will be the same (or close to the same) but it does involve additional complexity.
- **Earn-outs**—earn-outs are used to close a gap in negotiations about the purchase price. An earn-out usually requires the buyer to provide additional consideration if certain financial targets are met, usually over a relatively short period of time (typically one or two years). The obvious advantages are that it reduces the risk of overpaying if future performance is poor, and provides an incentive to the target’s management to stay and perform well. Financial targets are often in the form of earnings and cash flow but they can also be tied to revenue, or even customer and employee retention.

Earn-outs can be very effective for retaining key owner/managers as long as the financial targets involved can be easily measured. Earn-outs are only appropriate if the acquired entity will remain separate enough after closing to track its performance independently—the financial performance of a target that is fully integrated with the buyer, for example, likely will not be measurable. The degree of integration needed to satisfy the buyer’s acquisition rationale will determine whether or not earn-outs are feasible. If tracking the entity’s performance after closing will restrict integration, contingency payments may not be practical.

Structuring the New Combined Company

How the new company is structured has both legal and tax implications: the legal structure of the enterprise and its organization structure can affect implementation after closing, while the definition of division boundaries and transfer pricing between corporate entities can affect where profits are taken and taxed.

Legal Issues

Buyer directors should be satisfied that the legal structure of the enterprise and the proposed organization structure are aligned with the buyer’s strategy and will make it possible to implement cost and revenue synergies and other value-creating initiatives.

This may be more complicated in cross-border transactions. The target’s country may have different laws, its exposures may be different under foreign ownership, and the buyer may have to decide which legal standard to comply with (the parent company’s jurisdiction or the target’s company’s).

Legal issues that are particularly relevant to international transactions include:

- intellectual property (for example, standards and enforcement in some developing countries may be different than in Canada)
- consumer protection (standards for safety, contents transparency and other things vary widely around the world. The buyer may choose to comply with the local standards or a higher corporate standard).
- environmental protection standards (may vary by region and jurisdiction)
- labour and employment rights.

Tax Implications

How the new company is structured can affect which jurisdictions it is taxed in (for example, certain tax loss carry-forwards may be usable in the combined entity but only within a given jurisdiction). Corporate tax rates and terms of payment may vary across jurisdictions, so the structure of the combined company (in particular, the business unit structure and the transfer pricing between divisions) can determine where profit is taken and taxed. This is a complex and controversial topic, and major corporations are being challenged for defining corporate structures with the specific purpose of avoiding tax, so buyer directors should make sure tax advisors have been consulted about how best to appropriately minimize taxation.

Buyer directors should be satisfied that any structure proposed to optimize tax will not make it harder to achieve synergies expected from the acquisition. For example, although certain locations or organizational structures may be advantageous from a tax perspective, they may make it harder to achieve cost or revenue synergies and to successfully integrate the new business.

Buyer directors should be sure tax advisors have been consulted about tax optimization strategies. The risk and implications of unfavourable tax rulings, or of tax rule changes in each jurisdiction, should be identified and assessed. Buyer directors should also consider the responsibilities of the corporation to the communities where it operates and the potential negative impact on the buyer's brand and its stock.

Financing

Buyers should have a well-defined financing strategy at the outset, even before they approach possible targets.

If a proposed transaction can be financed using the buyer's current cash reserves, or using its stock as currency, the financing strategy is very simple. Ideally, buyers should raise additional capital in the form of new equity before any transaction. However, capital markets can resist issuing new equity to build

cash reserves to pursue a specific transaction (known as *building a war-chest*), preferring to support a new equity issue once a transaction is completed and made public. There are also other ways to structure a transaction to provide investors with some protection on the use to which the proceeds of an equity financing will be put, such as the use of instalment receipts which are a technique that withholds the cash from the issuer until certain conditions have been satisfied, such as the completion of a qualifying acquisition.

Financing becomes more complex when the buyer needs additional debt to finance the transaction. The seller will want to understand how a transaction will be financed at a very early stage of discussions.

Most buyers will already have debt capacity under their current credit arrangements, or will increase their debt capacity when they decide to pursue a transaction. If not, they may be able to give the seller indicative term sheets that outline their lender's willingness to finance the transaction within certain parameters.

For practical reasons, it may be difficult (and not advisable) to put new long-term debt in place in anticipation of a transaction. The buyer will not know exactly how much debt will be required until the key terms and structure of a transaction are known. There is also no guarantee that the transaction will be completed and, if long-term debt is arranged too soon, the seller's balance sheet could be encumbered with unnecessary debt. Most importantly, lenders will have difficulty establishing appropriate terms (including loan covenants) until they can adequately assess the condition of and prospects for the combined entity.

These barriers may drive buyers to use short-term credit facilities or bridge loans to finance the transaction initially. These are very flexible and can usually be put in place quickly with attractive interest rates. The downside is that they are short-term in nature. While it is possible to roll credit facilities over continuously as they come due, there is always a risk that the lender will choose not to renew the facility because market conditions or lending policies have changed, or the buyer's financial condition has weakened.

There should be a clear plan to refinance the combined company's balance sheet after closing, replacing any short-term debt with equity, long-term debt or a combination of both.

What the Buyer's Board Should Expect

The buyer's board should understand how an acquisition will be financed, and refinanced after closing if necessary. It should be aware of the state of capital markets, how the equity and debt markets might respond to the proposed transaction, and whether the capital market would be receptive to a new equity or debt issue by the combined company.

Many acquisitions that create value in the long run are assessed negatively by the equity market when they are first announced. Buyer directors should not be dissuaded by a negative market assessment as long as they are satisfied with the acquisition rationale and the implementation plan for long-term value creation, and that any proposed financing arrangements can withstand a temporary drop in share price.

Buyers should obtain expert advice on debt and equity markets, including typical bank credit facilities. Financial advisors can model short and long-term debt facilities, including expected covenants and other terms, to help the board understand the degree of leverage and whether the combined entity will be able to meet its financial obligations when they come due. To avoid the appearance of a conflict, buyer boards may consider hiring different financial advisors for this work, because advisory fees related to the transaction are usually contingent on closing although it is common that only a single financial advisor is engaged to do both. Legal counsel should be consulted about how to compensate financial advisors so as to preserve the protection the board receives from relying on their expert advice.

Other Stakeholders

Selling a company can affect many stakeholders in addition to shareholders—employees, bondholders, communities, and even the general public. Other stakeholders can and should be considered. In Canada, the Supreme Court of Canada's 2007 decision regarding the proposed sale of BCE confirms the obligation of the directors to consider the interests of all stakeholders (the company's bondholders, in BCE's case).

Considering the interests of all stakeholders is also consistent with the directors' duties to act in the best interests of the corporation. The interests of other constituencies should be considered in the long-term interest of the corporation. Ignoring the interests of other stakeholder groups can ultimately negatively impact the value of the business.

The Seller's Perspective

Valuation

The seller should understand the same three valuations methodologies as the buyer: the standalone value of the entity, the value of an appropriate control premium, and the price a buyer should be able to pay, based on estimated synergies.

In fact, the seller should assess these values for each buyer (it will be different for each because of the synergies estimated for each potential transaction) and be able to rank buyers by their ability to pay, in addition to their likely willingness to pay. Professional financial advice can be very helpful.

The seller's board should remember that it is under no obligation to sell the business, and remaining independent or making acquisitions of its own may be a better option than the current offer, once risk is taken into account. That is not to say the board is free to dismiss credible offers without full consideration. Corporate law and securities regulations govern the obligations and actions of boards of public companies when they are presented with unsolicited offers. Directors should seek legal advice about the alternatives that can be considered and their legal obligations. (You can read about the legal obligations of boards of public companies on page 51.)

Consideration

All-cash transactions are the easiest type for sellers to assess and can serve as a basis of comparison for more complex considerations. If an all-cash offer price is better than any alternative offers and the value of the target's standalone strategy, its shareholders have been offered an acceptable control premium and the transaction likely to close, then directors should be satisfied that it is the best price that can be negotiated.

If an offer includes stock in the buyer, the seller must assess the buyer's acquisition rationale and overall strategy. Sellers should be cautious about accepting the buyer's stock as currency and should negotiate terms that minimize the potential impact of declining stock prices on their shareholders. (You can read about strike prices on page 78.)

Structuring the Transaction

From the seller's perspective, it wants its shareholders to receive the proceeds as quickly as possible with the fewest strings attached. For public companies, takeover bids are usually the best path to achieve that outcome. Asset sales tend to be the most complex and time consuming, but in certain circumstances can be tax advantaged.

Sellers usually prefer share transactions when selling a private company, because the proceeds of a sale are treated more favourably for income tax purposes and because it insulates the seller from any unrecorded or contingent liabilities that may arise after closing. (As long as the value is attractive on an after-tax basis, buyers should not be overly concerned about an asset purchase.)

In private transactions, the selling shareholders will normally have to give indemnities that could ultimately reduce the purchase price retained by the selling shareholders, and frequently part of the sale proceeds are withheld in escrow for a period of time for possible claims against those indemnities.

Earn-outs (page 81) can be lucrative and advantageous for the seller (especially owner/managers) if they are willing to stay for the earn-out period. Being hands-on and having a positive impact on cultural integration and other post-closing activities can help ensure the combined entity succeeds and is more likely to achieve the financial performance targets tied to such arrangements.

About Spin-offs

When parts of a company are being sold, it may be necessary to create a new legal structure. A *spin-off* is the most common of these structures.

In a spin-off, a separate legal entity with its own shares is created for a particular business operation and assets and liabilities related to the business are identified and moved over. Shares of the spin-off are then distributed to the parent company's shareholders pro-rata, or the company can remain a wholly-owned subsidiary of the parent.

Creating a spin-off can sometimes be accomplished tax-free, but the rules are complicated. In Canada, a court-approved plan of arrangement (called a *butterfly reorganisation*) can distribute the assets and liabilities of one company into two. There are restrictions both before and after reorganisation, including restrictions on change of control transactions. Tax advice must be obtained.

Spin-offs are separate operations that can be run independently. They can often expose the market to value that was hidden or underdeveloped when the business was part of the parent company (for example, several Canadian retailers have spun off their real estate assets into real estate investment trusts, or REITs. These trusts have more value as pure plays in commercial real estate, with access to certain tax advantages as investment trusts).

It is important, however, that each resulting entity has the assets and resources to succeed. Parent companies sometimes separate a troubled operation for sale or use spin-offs to isolate pension, environmental or other liabilities. Directors of the spin-off should be satisfied that the liabilities assigned to a spin-off are appropriate, have been independently valued and that the risks are well understood.

2.4

Finalizing the Transaction

This section reviews

- Negotiating and signing a final purchase and sale agreement (page 88)
 - Finalizing executive employment (page 94)
 - Approvals (page 95)
 - Finalizing financing and closing the transaction (page 96)
-

Finalizing the transaction is a critical step that includes negotiating a final purchase price and key terms of the purchase and sale agreement, making decisions about executive employment, and securing shareholder approvals and, in some cases, regulatory approvals.

Negotiating and Signing a Final Purchase and Sale Agreement

Negotiating teams for purchase and sale agreements usually include senior executives from both parties, outside counsel and investment bankers or other financial advisors, although the players can vary depending on the size, nature and complexity of the transaction. For larger transactions, the chief executive officer should be involved, especially for negotiating key terms. If a public

company is being sold and there is a possible conflict of interest with senior executives, it may be appropriate to have members of the special committee of the board directly involved instead.

Occasionally, after final due diligence, the seller may ask the buyer to update the letter of intent or submit a term sheet that sets out the key proposed terms of the purchase and sale agreement.

A better solution is to move directly to negotiating a definitive purchase and sale agreement.

Discussions about a final purchase and sale agreement often begin while the buyer is finishing final due diligence. Who drafts the purchase and sale agreement depends on the relative negotiating leverage of the parties and the nature of the transaction, since the party that creates the first draft inevitably builds in a bias in their favour. In auctions, the seller typically drafts the first version, in part to make it easier to compare competing bids. In a negotiated transaction, it is almost always the buyer who drafts the documents.

Key Terms of Purchase and Sale Agreements

Boards should understand which clauses of the purchase and sale agreement are normally subject to negotiation and which are standard or less important.

The following discussion will focus only on the key terms boards should understand before approving a transaction.

It may not be practical or advisable for directors to review every detail of a purchase and sale agreement before they authorize management to sign it. It is, however, useful and recommended for legal counsel to review the key terms of the transaction with the board, especially the provisions that were most heavily negotiated.

Final Purchase Price

The final purchase price is usually negotiated after final due diligence is finished. Sellers prefer to finalize a purchase price before negotiating other parts of the purchase and sale agreement. But if the buyer believes that other key terms are likely to be contentious, it may choose to defer price negotiations until all issues are on the table.

Buyers may attempt to use their final due diligence findings to seek a price adjustment, based on things like differences in asset values, unrecorded or contingent liabilities, higher than expected risk related to achieving forecasted results, or changes in market conditions or the competitive environment.

Occasionally, sellers may try to raise the purchase price, usually when there are competing final round bidders and the seller requests each buyer's 'best and final offer'.

In final purchase price discussions, experienced buyers and sellers enter negotiations with similar information—the value of the standalone business, a narrow range of value for the control premium, and the estimated value to the buyer, taking expected synergies into account. Final negotiations often revolve around determining how the value of the synergies should be allocated between the parties. The buyer will argue that it should keep the full value of the synergies, since it brings the plan and the ability to realize the benefits. Sellers will argue that the synergies only exist if they are willing to agree to the transaction.

Purchase Price

This section states the purchase price and nature of consideration (cash, stock or a combination of the two).

For a private company transaction, the section will contain provisions for purchase price adjustments (usually for changes in working capital or debt level), holdback or escrow amounts and earn-outs. If the buyer is acquiring a public company, however, it is not possible for the buyer to recover funds paid to the wide-spread shareholders, so purchase price adjustment mechanisms, escrows, holdbacks and contingent payments will not be included.

Experienced buyers often use due diligence to materially lower their proposed purchase price. While this tactic (called grinding) can be confrontational and may polarize the target, it can also be effective, especially when no one else is competing for the asset. Buyers tend to get reputations for this kind of conduct so the seller board would be well advised to seek to understand the reputation of its potential buyers in advance of the negotiations.

Covenants

Covenants determine the actions that are allowed (or not allowed) during the period between signing of the purchase and sale agreement and closing the transaction (known as the “interim period”). They also form the basis for closing conditions and indemnification. If one party breaches a covenant, the other party will be able to claim indemnification or may be able to terminate the transaction.

Common interim period covenants include the seller not incurring any further indebtedness, issuing new shares, or declaring or paying any dividends, not disposing of any assets or making any acquisitions, and not making capital expenditures above a certain amount.

In private transactions, there may be post-closing covenants, such as the selling shareholders agreeing not to compete with the buyer for a certain period of time.

Representations and Warranties

Representations and warranties include statements and assurances a seller (or selling shareholders) makes about the business. The buyer also makes representations and warranties. If the buyer is paying some or all of the purchase price with its own stock, the nature and scope of its representations and warranties will be quite similar to the representations and warranties given by the seller.

Each party is entitled to rely on the representations and warranties of the other party. If they turn out to be untrue or inaccurate at signing and closing, the other party may be able to delay closing or terminate the transaction (breaches of representations and warranties form the basis for indemnification claims).

Sellers typically make statements about the condition of the business being sold related to things like share title, the accuracy of its financial statements, the existence and condition of physical property, and the existence (or non-existence) of environmental claims and liabilities. Buyer representations tend to be simpler. The most important is the buyer’s statement that it has adequate financing to complete the transaction.

Negotiations about representations and warranties are not typically about the statements themselves, but about qualifying materiality and knowledge.

Sellers will often seek to exclude liability for small discrepancies using a material adverse change or material adverse effect clause (also known as a *MAC* clause). A material adverse effect clause gives the seller a way to qualify certain representations and warranties so that immaterial breaches are ignored. Under a *MAC* clause, a buyer may also terminate the transaction or renegotiate terms if an unforeseen material adverse business or economic change occurs between the time they execute the acquisition agreement and close the transaction. The terms of the *MAC* clause are frequently heavily negotiated.

Sellers may also want to include a knowledge qualifier that limits the truth and accuracy of its statements to what certain senior management personnel understand to be true and accurate, rather than absolute truth and accuracy.

A key issue for private company transactions is how long representations and warranties will survive after the transaction closes. Some survival periods (the period during which the buyer can initiate a claim against a seller for a representation or warranty that was untrue on closing) only last six to 18 months, while others are indefinite or evergreen.

Closing Conditions

Common closing conditions include obtaining necessary shareholder and regulatory approvals.

In circumstances where there is an interim period between signing and closing, buyers will generally try to include a “bring down” clause, to avoid closing if the seller’s representations and warranties are not true on closing. Sellers typically negotiate to have the buyer’s condition limited to representations and warranties that are materially untrue and to changes that are materially adverse.

Indemnification

Indemnification is a remedy that can be used after closing if the other party breaches a covenant or representation made in the purchase and sale agreement. Indemnification claims are usually subject to a negotiated cap or a deductible structure that either covers all claims above a certain threshold or pays all claims once a certain threshold has been exceeded. Certain breaches may have no limitation on recovery (for example, things like authority to complete a transaction or title to shares).

Indemnification is relevant to private company transaction. Indemnification obligations are not part of public company M&A transactions, in part for practical reasons (the difficulty in chasing after numerous shareholders) and in part because of market practice.

Termination

Termination clauses describe the conditions under which a seller or buyer has the right to terminate the transaction. Termination rights are invoked when one or more of the conditions to the transaction are not (and cannot be) fulfilled.

Common reasons for termination include failing to obtain regulatory approvals, failing to satisfy closing conditions, breaching a no-shop clause, or if the seller has a fiduciary duty to accept a better offer from another buyer (see no-shop and fiduciary-out provisions below).

Go-shops, No-shops and Fiduciary-outs

A *go-shop* provision allows a seller to seek competing offers for a short period of time (typically one or two months) after it has received a firm unsolicited purchase offer in cases where no auction or other market check was undertaken by the seller's board. Go-shop agreements normally give the initial bidder the opportunity to match any better offer the seller receives, and may pay the initial bidder a termination fee if the target company is purchased by another firm.

Buyers, however, typically seek to obtain no-shop provisions that prevent the seller from actively seeking other bidders between signing a purchase and sale agreement and closing the transaction. The concept is that it is reasonable to protect the substantial investment the buyer has made in locating the target company, performing due diligence and negotiating and drafting the agreements. No shops are typically used in structures where an auction or other market check has been conducted by the seller's board.

Fiduciary-out provisions balance no-shop provisions. Under this provision, if the seller receives an unsolicited, bona fide, written acquisition proposal, the board can take action (including terminating the purchase and sale agreement with the initial buyer) if it determines, in good faith and to comply with its fiduciary obligations under applicable law, that it can do so. This provision typically includes a requirement to notify the buyer about any unsolicited offer, so that the buyer will have an opportunity to match the bid.

Fiduciary-outs insulate the seller's directors from liability for breach of their fiduciary duty of care to shareholders by agreeing not to consider other offers, while assuring the buyer that the seller will not actively shop the target for sale.

Break Fees

Many purchase and sale agreements include a break fee (sometimes called a *termination fee*) the seller pays the buyer if it terminates the transaction to accept a better offer and in certain other circumstances. The fee is typically in the range of 3% to 4% of the equity value of the transaction, and designed to cover the cost of planning, negotiations, due diligence and legal or financial advisory services the buyer incurred in pursuing the deal.

Break fees signal the seller's commitment to completing the transaction and discourage it from unilaterally terminating the deal. Sometimes a large break fee can discourage other bidders from launching superior bids after a transaction is announced because it is the successor bidder who will normally end up paying the break fee out of the assets of the seller it acquires.

Continuation of Director and Officer Insurance

Sellers frequently require director and officer insurance to remain in force for several years after the transaction is complete to protect the seller's officers and directors from future claims relating to prior periods. The best way to do this is for the seller directors to buy a run off or tail directors and officers insurance policy under the target's policy. This tail policy will protect them under the terms of the target's then-existing directors and officers insurance policy for the tail period in respect of any actions or omissions that occurred on or prior to closing. The length of the tail period is variable (based on the premium paid) but can last for many years.

Finalizing Executive Employment

Buyers often want to keep some of the seller's top executives and may make it a condition of closing the transaction.

If the executive is interested in staying with the business, he or she will want to have an in-depth discussion with the buyer to better understand the role, reporting structure and compensation arrangements. Although the executive has a fiduciary responsibility to the seller up to closing (and after closing, if there is a dispute) the prospect of continuing employment can create the appearance of a conflict.

Sellers should resist authorizing discussions between the buyer and its executives until a purchase and sale agreement is finalized. It may also be useful to have the seller's legal counsel or a special committee member present for any discussions.

Approvals

The seller's shareholders must normally approve M&A transactions. Depending on the size and structure of the transaction, the buyer's shareholders may also need to approve it.

Many transactions need regulatory approval under competition laws, foreign investment rules or industry specific rules (such as broadcasting and telecommunications rules). Some regulators will give an advanced ruling, which can speed closing. If the advanced ruling requires material remedies, however, it may affect synergies, valuations and pricing.

Buyer directors should be satisfied that potential regulatory challenges have been considered in advance, that remedies (whether offered by the buyer or imposed by the regulator) will not materially alter value (or that the pricing has been adjusted accordingly), and that the process with regulators has been open and everything possible has been done to expedite approval.

Legal advisors will help the company through this process. The task can be made easier if the buyer examines the regulatory issues realistically and resolves as many as possible before applying for approval. For example, competition in rural markets is often reduced when banks or retailers merge. Rather than wait to be told the obvious by the regulator and then find remedies, it is usually faster to identify the markets that will be affected and offer remedies as part of the application (for example, selling certain retail locations).

Preparing For and Dealing with Delayed Closings

When regulatory approvals are needed, there is often a significant risk that the transaction will not close on time or may not be approved at all. Boards and management should work together to develop contingency plans for different outcomes (for example, if there are likely to be concerns about competition, the seller could consider selling certain assets or explore other remedies).

If a lot of time passes between reaching a final agreement and closing the deal, the door may also be open to other bidders (for example, a competition review in France delayed the proposed INCO-Falconbridge merger for several months. This left the door open to other bids that ultimately succeeded). If better alternatives come forward, directors on both sides of a transaction must continue to consider what is best for their company and its shareholders. A large break fee (see page 94) can be a deterrent for other bidders, however, unless they believe the benefits of a proposed transaction justify having to pay the fee.

Finalizing Financing and Closing the Transaction

The purchase and sale agreement will contain a requirement that financing be put in place so the transaction can close and buyers should advance their financing discussions during final due diligence.

It is not practical to have final loan documents available at that point, but it is reasonable to expect a lender commitment under terms set out in a negotiated term sheet.

During the interim period, the buyer should arrange for the lender to visit the site and have access to the seller's diligence documents, so that final loan documents can be ready for signing well before closing.

There is usually merit in having a contingency plan in case the transaction does not close or for leaks during the M&A process. For buyers, this is mainly a communication plan. For sellers, the communication plan may be more extensive, since stakeholders were expecting and planning for a change of control.

Selected key questions about transaction development for the Buyer

Initial Discussions

How many potential acquisition targets have we approached? Relative to our acquisition criteria, how does this target rank?

What are the consequences if we do not do this deal?

For the purchase price range to be included in the letter of intent, what price do we need to submit to ensure we are selected to move to the next phase? How does that compare to what we think this business might be worth to us?

Are there other potential buyers that could achieve greater synergies from this transaction?

If asked by an analyst or investor if we are considering acquiring this target, how would we respond?

If no synergies were achieved, how dilutive would the transaction be?

Can we avoid the seller going to auction if we table a pre-emptive price? If so, how high would the price have to be?

Have we considered making an initial investment below the disclosure threshold? What are the reasons for and against a toe-hold investment?

Due Diligence

What were the major findings coming out of due diligence that were negative or concerning?

In considering the synergies of the transaction, what are the primary risks to achieving them?

How did we get comfortable that the synergies are real and achievable?

In completing customer surveys as part of strategic due diligence, what was the rank order of customer purchase criteria? How do the combined company's products and services stack up against these criteria, compared to competitors?

If you were the CEO of one of our competitors, what would you do if we made this acquisition?

If we had more time to complete due diligence, what additional work would be done?

How aggressive are the target's forecasts? How much should they be discounted?

If this transaction was to turn out badly, is the viability of the entire company at risk?

What kinds of contingent liabilities were uncovered in due diligence?

How should the cultural integration risks related to this transaction be characterized, given the differences in cultures involved?

What are the material contracts affected by change of control including customer and employment contracts and what are the implications?

Valuation

When do we get our money back?

Over the past two years, what has been the range of market capitalization?

How do the valuation multiples of the two companies compare?

Looking at precedent transactions, what range of control premiums would be appropriate? How does the value of the business compare with what it is worth to us, with a control premium applied?

What is the internal rate of return on this transaction? How does it compare with our weighted average cost of capital and our incremental cost of capital?

Are we going to have to share the value of the synergies we expect with the seller to reach agreement on price?

Have we received an independent fairness opinion that supports the transaction valuation?

Structure

Which structure are we planning to use to effect the transaction? Why?

Who are the target's major shareholders? Are they likely to support the transaction with a reasonable control premium?

To what extent have we examined other structures to minimize tax?

Consideration

Is it possible to use stock as part or all of the consideration?

How does our stock performance compare with the target's over the past two years?

How much of each party's stock is held by common shareholders?

Financing

How much debt will we take on at what interest rate and other fees?

How long will it take to pay down debt arising from this transaction out of our free cash flow?

Given the state of capital markets, how comfortable are we that we can refinance the business after the transaction is completed?

How much room above the purchase price do we have in our credit facilities?

Are the lenders willing to commit to acceptable terms in the form of a term sheet?

How levered will we be after closing?

Assuming we refinance the transaction after closing, will we generate sufficient free cash flow to repay the debt in full, or will we have to roll some debt over when it comes due?

Purchase and sale agreement

Which clauses in the purchase and sale agreement were the most heavily negotiated?

Describe the conditions and our ability to terminate the deal.

What are the major risks associated with not closing the transaction?

How was the break fee determined? How does it compare with precedent transactions?

How much time will there be between signing and closing? Is another bidder likely to appear after the transaction is announced?

Other

Are there directors on the target's board we should consider for our board?



PHASE 3

Post-closing Activities

PHASE 3

Post-closing Activities

Most directors understand the importance of post-closing implementation to acquisition success, but they may not have the means to provide effective oversight at this stage.

Board oversight of post-closing implementation is critical for a successful transaction.

The three steps in this section outline the key tasks and issues that can arise at this stage, to give directors a better understanding of the level of planning needed leading up to and after closing, including preliminary planning in advance of closing and more detailed plans developed later with the new, combined management team. Good planning, with appropriate accountabilities, metrics and milestones that can be reported and tracked at the board level are essential to proper board monitoring.

Harmonizing systems, policies and processes, integrating cultures and monitoring progress against integration plans and targets are all key to realizing value creation potential. This section also describes how to learn from each transaction to build competitive M&A skills.

This section does not discuss divestiture considerations. While the seller's management usually plays a role in implementation, the seller's directors will have either joined the buyer's board or are no longer involved.

OVERVIEW

3.1 Planning by Buyer

	Management's role	Board's role
Develop a communication plan	develop a detailed, multi-phase internal and external stakeholder communication plan	review and approve plans
Develop a transition plan	develop a post-closing transition plan	
Develop a harmonization plan	develop a plan to harmonize systems, policies and processes	
Develop an implementation plan	develop individual plans and timelines for projects related to the acquisition rationale and synergies	

3.2 Implementation

	Management's role	Board's role
Execute project plans	oversee implementation projects and report to the board regularly	review status reports
Integrate culture		
Manage implementation		
Monitor and evaluate progress		

3.3 Learning from Experience

	Management's role	Board's role
Complete a post-mortem	detailed post-acquisition review, including lessons learned from each phase of the transaction	review post-acquisition audit report and lessons learned

3.1 Planning

This section reviews

- Stakeholder communication planning (page 105)
 - Transition planning (page 110)
 - Integration (page 111)
 - Implementation planning (page 111)
-

An effective implementation plan, complete with assigned responsibilities, metrics and milestones, is key to the board's oversight of a successful M&A transaction.

This section discusses four kinds of planning. Although each should have its own objectives and timelines, there is likely to be some overlap between them.

Stakeholder Communication Planning

The importance of communications, from when a transaction is first announced and throughout the implementation period, should not be underestimated. Business combinations create uncertainty and can destabilize many stakeholder groups if they are not addressed proactively.

Communications Plan

Directors should look for an integrated two-part communication plan:

- **part 1**—when the transaction is announced
- **part 2**—after closing and during implementation.

When the transaction is

announced—public companies are required to issue a public announcement when they sign a purchase and sale agreement for a material transaction, usually in the form of a press release. Because the news will be of

interest to all stakeholders, a broad, integrated communications plan will be necessary. The objective is to communicate the details of the transaction well, to help stakeholders understand the reasons for the acquisition, and to ease any concerns.

Before announcing a transaction, directors should review the final press release, the communication plan and key messaging to each stakeholder group.

The buyer's stakeholders will want to know:

- the main reasons for acquiring the new company
- how the new company fits the buyer's strategy and acquisition rationale
- the expected benefits for each constituency
- how the stakeholders' concerns will be addressed
- immediate and longer-term implementation plans
- timing and conditions for closing
- the likelihood of success of the transaction
- implementation timing.

The seller's stakeholders will want to know:

- the reasons for entering into a business combination
- the value
- why they should support the transaction.

While the messaging should be positive, sellers should be careful not to make statements that could be unhelpful if the transaction does not close.

After closing and during

implementation— for significant public company M&A transactions, a day-by-day communication plan is needed for the first two to three weeks following closing. It should be developed and refined between the announcement and closing date. Communicating frequently is needed throughout this phase.

Management should update the board on the outcome of the initial communication program and any key issues that arose, through a written communication or conference call.

Audiences and Key Messages

Defining the key constituents and primary messaging for each is an important first step.

Key stakeholders for the announcement usually include investors, customers, employees, vendors, regulators and possibly community leaders. Key stakeholders during implementation are investors, customers, employees and vendors.

When the Transaction Is Announced**Communicating with Investors**

For obvious reasons, both parties should announce the transaction at the same time. This can be done through a joint press release or separate releases from each party. Either way, the message must be consistent.

For larger transactions, the parties could host a joint investor conference call (the buyer will generally take the lead). Separate but coordinated conference calls can also be effective.

The buyer's shareholders will want to know:

- the acquisition rationale
- quantified (and unqualified) benefits that will drive shareholder value
- when the buyer expects to realize these benefits
- the degree of share dilution, if any
- when the buyer expects the transaction to become accretive and related amounts
- whether consideration for the transaction will be cash, stock or a combination of both
- current and planned financing and how it will impact the buyer's balance sheet
- conditions and timing for closure, including the form of the combination and whether shareholder approval will be required.

After Closing and During Implementation

Key investor groups should include current shareholders, sell-side analysts and investors whose investment style and mandate suggest a potential interest in the combined company.

One-on-one visits by the chief executive officer and chief financial officer are ideal. (Be careful not to disclose material non-public information.)

These sessions should set expectations about:

- the fundamental acquisition rationale
- the timeline for implementation
- expected benefits.

The seller's shareholders will want to know:

- the economics of the transaction (especially the control premium)
- planned timing to closure and conditions to close
- why they should support and approve the transaction.

If the transaction includes an exchange of shares, the seller's shareholders will become investors in the buyer, so they will also want to know the same things as the buyer's shareholders.

Communicating with Customers

Customer retention is critical in nearly all business combinations, so reaching out to customers should be a very high priority.

Customers will usually be concerned about potential supply disruptions, any changes in key relationships and lessening of competition.

If customers feel uncertain, their first reaction is usually to reduce risk by reaching out for alternative sources of supply, so direct communication should be a high priority.

In conjunction with issuing press releases, there should be a separate written communication sent to all customers, followed by phone calls and in-person visits for all key accounts, especially those most at risk of leaving.

Both buyers and sellers will want to retain their customers by emphasizing the benefits of the transaction and allaying any concerns, but the seller should be aware that if the transaction does not close and the benefits are not delivered, it may have negative repercussions.

Sometimes it is helpful to have the buyer communicate with the seller's customers, but it needs to be handled with extreme care

If a competition review is likely, another important reason for reaching out to customers is to gain their support for the transaction. Regulators are likely to be more attuned to customer concerns over lessening competition than to objections raised by competitors, so allaying those concerns and winning customer support should be a high priority.

Communicating with Employees

Buyers and sellers should err on the side of over-communicating (but not over committing) with employees, if only to keep them in the loop about progress towards closing, the status of integration planning and the timing for future communications.

Messaging to customers should be consistent with the initial calls after the announcement.

It is best to hold face-to-face meetings with key customers, ideally with the chief executive officer or other executive present.

Presentations and leave-behind materials are also helpful.

Key themes might include:

- the importance of the customer
- a description of the combined entity and how its capabilities have expanded
- how the customer's needs will be better fulfilled by the company's products, services and capabilities, and how the combined company plans to add greater value to the customer's business
- any changes in day-to-day relationships and interfaces
- key senior level contacts, if there are issues or concerns.

Best practices for employee communications include almost daily communication in the early days, from the CEO and others, using face-to-face, print and digital communication and social media.

Although employees will have more than a passing interest in understanding the acquisition rationale and benefits, their primary focus will be on understanding what it means for them. While cost reductions will be appealing to investors, they inevitably mean layoffs, usually in the seller's organization.

Employees will want to know about:

- plans for realigning the combined organization
- reporting relationships
- changes in compensation or benefits
- how they will fit into the combined entity.

The period between announcing the transaction and closing is usually fraught with uncertainty for employees. While high-level organizational plans are developed throughout the sale process, the details are often worked out during the period from announcement to closing, and since the new owners have not yet written the cheque and taken the keys, communication about specific plans tends to be sparse until after closing.

It is both customary and advisable for the buyer to reach out to key seller employees to provide assurances that they will have a continuing role.

The delivery should be forthright and positive.

The goals for this communication are to build confidence, reduce uncertainty, promote alignment and begin messaging related to cultural integration.

Key messages should include:

- defining the organization, reporting structure and accountabilities and how they align with the broader corporate strategy of the integrated company
- identifying when employees will be informed of their roles and reporting relationships
- defining short-term goals for the transition period
- clarifying and promoting opportunities for the combined entity and for personal development
- a broad outline and timeline for implementing plans after the short transition period.

When planning is sufficiently advanced on staffing requirements and redundancies, it is useful to introduce layoffs as quickly as possible. Where staff will be asked to remain with the organization through the transition period, some form of retention plan may be useful.

Communicating with Vendors

The supply base should not be ignored after a transaction is announced.

They will want to know about:

- changes to procurement policies
- whether they will be kept as a supplier after closing
- new contacts or other relationship changes.

It may not be practical to give suppliers definitive answers when the transaction is first announced, but reassuring long-standing vendors that the company intends to continue its relationship with them can be helpful, especially if the transaction may involve operational changes and site closures.

After closing, procurement and operational staff should meet with vendors.

They will want to know:

- how they fit with the new entity's procurement plans
- how the company's need for their products and services may have changed
- expectations around quality, delivery and price
- relationship or interface changes.

Communicating with Regulators

When regulatory approvals are needed, a well-orchestrated communication plan should be in motion even before the announcement if possible (as in the case of an advance ruling) or immediately after the public announcement.

Required filings should be fully vetted and ready for submission. Personal visits should be well planned and key messaging aligned.

Regulators are not immune to comments and articles in the press and to the reaction of investors and customers. A fully integrated communication plan can have a significant impact on smoothing the way for approvals.

Transition Planning

The goal in transition is to get to a functioning, combined organization as quickly as possible. Planning should begin during due diligence and be refined between the announcement and closing dates, using the combined resources of the blended organization.

For larger transactions, the board should review the key elements of the transition plan and the timeline for completing other plans.

The transition plan should be short, implemented quickly after closing, and include: defining a structure and staffing for the new, interim organization and launching the second phase of the communications plan (see the table above).

It is useful to separate transition planning from implementing the major initiatives that drive value. Not treating these as separate activities can lead to:

- **blending stabilization tasks and implementing major initiatives too quickly**—resulting in a weak implementation, failure to capture the full value of the transaction and a poorly aligned organization
- **waiting too long to stabilize the organization**—taking too long to unveil a final design structure because the company is trying to “get it right the first time” can leave employees and customers in the lurch.

Structure and Staffing

People need to know as quickly as possible what their role in the combined entity will be, what their accountabilities will be and who they will be reporting to. The best people always have other options and each day of uncertainty increases the risk that they may leave.

Best practice is to define the top-level structure of the combined organization before closing, and have a process for defining the levels below that very quickly after closing. Within the first day or two after closing, each employee should be told when their level and position will be defined. This does not need to be the final structure for the organization, but it needs to be functional and implemented quickly, and it should eliminate any obvious redundancies.

Integration

There are three goals of harmonization planning:

- preserve system continuity after closing
- harmonize key policies and practices
- identify broader changes the company will need to make later.

Harmonization planning is mainly a management activity, but it is useful for directors to understand the goals, accountabilities and timeline for this work so they can track progress later.

When the plan is to quickly integrate the seller's business into the buyer's business, it is important to identify and address any temporary bridges that may be needed between each organization's systems and any important differences in their policies and practices. An obvious example is accounting systems. The buyer will need to consolidate financial information, conform accounting policies and practices, and identify any additional information requirements.

Much of this work can be scoped and planned during due diligence and then examined in more detail between announcement and closing. Best practices include setting up a harmonization steering committee with sub-committees for each functional area, established and populated by staff from both organizations. If the seller permits, some of this work can begin between announcement and closing.

Implementation Planning

Throughout the entire M&A process, the strategic rationale has been at the forefront. It formed the basis for the initial approach, weighed heavily in valuation and was the primary focus of attention in due diligence. Once the initial transition and harmonization work is done, the buyer needs to drive opportunities to create value and map out specific, executable plans to realize the full benefits of the transaction as quickly as possible.

Because implementation may take longer than planned and fall short of expectations, the goal is to create a list of executable initiatives with defined deliverables, timelines, milestones and accountabilities. These plans should be reportable and reviewed with the board regularly until implementation is finished and the benefits are realized.

The process should start with reviewing the acquisition rationale and breaking the list down into specific initiatives. A senior executive should manage the process. It may also be useful to form a steering committee to oversee activity and monitor progress. Task teams should be set up for each initiative, and should be accountable for execution.

Implementation plans for each initiative should include:

- scope
- objectives (quantitative and qualitative)
- analysis (including risk assessment)
- conclusions and recommendations
- key actions, timelines and accountabilities
- post-completion metrics.

Reportable milestones include things like headcount reductions and new products introduced to each company's sales force from the other. Transaction-specific metrics might include indicators like customer retention and revenue from new products or new channels. The goal is to track and report on the progress and effectiveness of the transaction, not just the performance of the combined company.

Effective implementation planning broadens understanding of the strategy across the organization, makes the execution plans more practical, and kick-starts the process of integrating the people and cultures of the two organizations.

3.2 Implementation

This section reviews

- Unlocking the value (page 114)
 - Other sources of value (page 117)
 - Integrating organizations and cultures (page 118)
 - Managing implementation (page 120)
 - Monitoring the transaction (page 121)
-

The M&A transaction itself is really only half the battle. While the market may recognize some of the potential value created by combining the two entities and reflect that in the buyer's stock price right away, no new value can be created until the post-closing execution begins.

Post-merger implementation is particularly important for companies that have built their strategy around M&A and plan to make a series of acquisitions. While every acquisition is different, companies that successfully execute a series of transactions must have an effective and repeatable approach to implementation—not only to succeed in each transaction, but to ensure a sustainable competitive advantage in the M&A market.

Director oversight of post-merger implementation activities should focus on:

- **assigning capable leaders to key project roles**
- **aligning implementation plans with the acquisition rationale**
- **integrating people and organization cultures**
- **realizing and measuring value creation.**

Unlocking the Value

The value that can be generated during implementation can be categorized using the four types of value creation discussed in phase one: cost synergies, revenue growth, strategic value, and other sources of value (page 17). Most transactions will create at least some opportunities in each area, and larger transactions will offer multiple opportunities to capture value.

Cost Synergies

For transactions designed to address the needs of a buyer in an industry that is consolidating, gaining economies of scale through cost synergies is usually an essential part of both the acquisition rationale and the buyer's overall strategy.

Opportunities to reduce costs generally focus on the cost of physical assets, people, systems, and purchased goods and services. These are often interrelated.

Rationalizing assets—rationalizing operations takes time and can require a substantial investment. For example, if two manufacturers with five plants each find that eight plants will provide enough capacity after they merge, they will likely need to upgrade and equip at least some of the remaining plants. It will also take time and investment to close the other two (plant closures are complex projects, with no shortage of issues). These initiatives need to be well planned and adequately funded.

Reducing staff—staff reductions usually make up a large part of the benefit of consolidating operations, and there may also be opportunities to eliminate redundant staff positions in corporate and back-office functions. Some of these reductions will have happened during the transition phase, but a more thorough re-engineering initiative may be needed to select best practices, processes, systems and outsourcing arrangements between the merging firms. Again, investments may be required to accomplish this.

Integrating systems—almost all businesses have critical systems that must keep functioning to support their operations. The most effective systems integration strategies leverage the systems of both companies, choosing the best system for each function and integrating the data of both companies. However, some integration failures have been tracked to well-intended but hopelessly slow attempts to build the best new systems. Directors should thoroughly review and carefully monitor systems integration plans and execution.

Integrating supply chains—purchased goods and services often represent as much as half of the expense base, or even more. While sometimes overlooked in post-closing cost reduction programs, consolidated specifications and increased buying power can represent significant opportunities to improve economies of scale throughout the supply chain.

One concern about cost reduction programs is that they can be taken too far and affect customer service, product quality and employee morale. Directors should be mindful of the company's strategic rationale, supporting aggressive cost reduction where it makes sense but avoiding cuts that could interfere with achieving revenue synergies or other sources of value. Some acquired

assets and resources that may seem redundant in the short-term could be valuable in the context of the company's future M&A strategy (for example, fully optimizing distribution and sales channels may not be wise if the company is considering future acquisitions that would add new products or additional manufacturing capacity). A strategic approach calls for identifying assets acquired in each transaction that could be valuable in the future.

Directors should be satisfied that the cost reduction program is aligned with the company's overall strategy and that it is ambitious, well-managed and adequately resourced. Key initiatives should include metrics and milestones, and should become a regular part of board reporting until the planned benefits are achieved.

Revenue Growth

Acquisitions based on revenue growth are more difficult to track for several reasons:

- achieving higher sales usually involves a high degree of integration
- revenue often declines at first, especially if the buyer's and seller's customer bases overlap
- implementing a revenue growth strategy takes time, particularly if new product development is part of the acquisition rationale.

It is very important to have clarity about how revenue growth will be achieved—for example, by better leveraging current product offerings and resources, introducing new products, or entering new markets. It is best to establish specific initiatives for revenue growth, with assigned accountabilities and timelines. Otherwise, revenue related to the acquisition will be indistinguishable from revenue from ongoing operations, leaving directors wondering how successful the acquisition actually was.

Marketing and brand development can transcend individual transactions. A company leading an industry consolidation strategy will have a clear understanding of brand positioning that it will consider in choosing targets to acquire. The parent's brand positioning will evolve as each acquisition adds new brands, capabilities and customers. An example is Google's evolution from a search engine to a multi-faceted technology enterprise.

Companies acquiring for revenue growth should also be aware that buyers commonly fail to retain the entrepreneurial talent of the companies they acquire—the very talent that made the company an attractive target in the first place. Again, thinking beyond the transaction is important. The people that drove the growth of the seller are strategic

assets for the buyer. Deploying these individuals in a way that inspires them and leverages their talent will often mean identifying a career development path outside the seller's business. Their value to the transaction versus their potential value to the combined entity needs to be weighed carefully—most entrepreneurial leaders leave.

Directors should be satisfied that post-merger revenue retention and development plans are developed in the context of the buyer's overall strategy and desired market positioning. Performance against the revenue growth targets set out in the M&A transaction proposal should be part of regular board reporting after closing.

Strategic Value

Strategic value from an acquisition is realized over time, partly through actions taken during the post-merger implementation period and partly through longer-term actions that need to be incorporated in the buyer's strategic plans.

If strategic value from the transaction is genuine, the greatest implementation risk is that the strategic opportunities the merger made possible will be ignored or forgotten. Directors should be satisfied that decisions made during the post-merger implementation period and in later strategic planning take those opportunities into account.

Other Sources of Value

Other sources of value related to new ownership generally fall into two categories: a new management approach or financial engineering.

New management approach—many private equity firms derive value from identifying underperforming companies and inserting new leadership or acquiring positions on their boards to drive change in how the company is managed. Directors of companies that take on turnaround challenges should carefully scrutinize whether the company has the in-house skills and capacity needed to drive change in this way. Directors should track progress with care and encourage management to use external resources if progress is slow or goes off track.

Financial engineering—using financial measures to preserve or create economic value is most critical when there will be little or no integration, when the acquired company is unstable, or when leverage is high.

Larger acquisitions have the potential to threaten the viability of the buyer, particularly if they are heavily financed by debt. Directors should be satisfied that damage can be contained if implementation fails.

If the acquired company is unstable or there will be little or no integration, buyers will usually be investors or private equity firms. While the associated benefits can be valuable (unused tax losses, pension fund surpluses, or capital restructuring) they do not usually drive the buyer's M&A strategy (except investors or private equity firms).

A high degree of leverage, however, can be relevant to any M&A strategy. The financial structure of a company is highly relevant to its ability to acquire other companies. The ability to borrow, the value of the company's stock, and its cash reserves determine its capacity for the next acquisition. Accordingly, serial acquirers always consider the target debt-to-equity ratio, the ongoing value of the buyer's stock as currency, and cash reserves in their financing strategy.

These things are not independent of each other—for example, too much debt or cash can depress stock value, while higher dividends will raise stock value but drain cash reserves. For this reason, financing and post-merger financial engineering is done with a view to achieving an optimal balance of debt, share price, and cash reserves.

It is Important to Take the Long View

Although the strategic risk related to acquisitions is high, buyers that can successfully execute M&A strategies are rewarded with higher share prices and create a virtuous cycle—each successful transaction that creates shareholder value will enhance share price in the long run

and gain equity market support for the next transaction. Shares of companies that successfully acquire tend to outperform their industries, resulting in a further competitive advantage with each successful transaction.

However, it typically takes two years or more for investors to recognize the true value of any particular transaction as the results of post-merger actions become apparent. Capital markets almost always react quickly and strongly to transactions when they are announced and then correct much later (valuations at closing and at the one year mark, for example, are often significantly different).

Unfortunately, the tendency of markets to react to transaction announcements quickly with a strong buy or sell signal can cause companies to focus on short-term returns instead of long-term results.

Directors need to take the long view, encouraging transactions and post-closing actions that will create the most value rather than attempting to second-guess how equity markets might react to any given transaction.

Integrating Organizations and Cultures

Organizational issues often dominate post-merger agendas, but not necessarily in productive ways. Organizational solutions should be designed to realize the benefits of the transaction and advance the development of the enterprise, not just to integrate whatever can be integrated.

Issues of culture, in particular, must be addressed carefully and deliberately—failure to deal with cultural integration well is often cited as a key reason mergers fail. Cultural integration is frequently not managed because it is seen as undefined. But most of what makes up corporate culture is defined by the organization's values, work practices and leadership.

For acquisitions that involve preserving the seller's independence (including its management), it is wise to add a senior executive from the buyer's team to the seller's organization. The right executive can provide "eyes and ears" and have a significant impact on the resolution of issues related to transitioning to new management and integrating cultures.

Values

Collective values are largely determined by the values of the people who make up an organization, by what is understood about corporate values, and by what is reinforced or motivated. If a merging organization defines its desired collective values, it can select people for key positions whose values are consistent with that target and they can reinforce and motivate the desired behaviours.

Work Practices

Work practices represent “the way things get done around here”—formal and informal work practices that are largely determined by business processes, decision processes, and less formal, but definable, norms and standards. If properly implemented, process re-engineering is likely to have a direct impact on culture. Leadership can play a significant role by demonstrating the expected norms and standards.

Leadership

Leadership is both a major component of culture and a primary agent of change, so it is critical to post-merger integration. The new culture will be clearly and significantly influenced by the leaders that are selected at all levels and by how the company’s hierarchy and accountability are defined.

If a company cannot define the culture it wants, it is unlikely that it will properly manage this important aspect of integration. If it can define the culture it wants in terms of values, work practices, and leadership, then the process can be managed and progress toward that objective can be part of reporting to the board.

Directors should be satisfied that the desired post-merger culture is defined, that it is aligned with the overall strategy and that culture change is being managed, not left to chance. Integrating culture can be particularly difficult when competitors are merging, however, and significant cultural shifts can rarely be achieved without changes in management.

Managing Implementation

A major M&A transaction is the beginning of a large, complex project. Implementation leaders must translate the acquisition rationale into post-merger priorities and plans, define and lead key implementation teams, and institute regular tracking and reporting. A few aspects important to board oversight are highlighted here: pace, completeness, and measurement and reporting.

Directors should be satisfied that new management is actively engaged in transition and implementation planning, since they can materially impact the pace of implementation.

Pace

The period between announcing a merger and achieving a stable organization should be considered a separate transition phase and should be completed as quickly as practical. Implementing key changes as soon as possible is important, but the emphasis should be on doing the right things. Leaders should focus on the acquisition rationale and the organizational and cultural changes needed to support it, including ensuring that both are consistent with the longer-term strategy of the combined enterprise. Other opportunities for improvement can wait.

Completeness

To make sure as many benefits are realized as possible, the post-merger implementation plan must be comprehensive—many companies implement less than half of the opportunities outlined in the M&A transaction proposal. Every element of the acquisition rationale should have both an owner and a plan.

Measurement and Reporting

Unlike the transition phase (which should be as short as possible) the post-merger implementation phase may need to extend over six to 12 months or more.

Directors should be satisfied that the organization has achieved the results it expected from the transaction, or understands why it did not.

Sound project management uses clear schedules, reporting milestones, metrics that track progress and measurement of actual impact versus goals, but these practices are not common in post-merger management.

While relevant milestones and metrics will vary by industry and other transaction specifics, directors should expect management to use standard project management tools to manage their post-merger implementation projects.

Select milestone reports should go to the board, and directors should be satisfied that the process will yield either the expected results or lessons learned that will be applied to the next transaction proposal.

Monitoring the Transaction

The board needs to monitor two aspects of every M&A transaction:

- whether results were achieved (and value realized) from the transaction
- what lessons were learned that can be applied to the next transaction.

Oversight and Reporting to the Board

The degree of board involvement in implementing a transaction will depend on the transaction's size, complexity and impact. For very small, tuck-in type acquisitions, the board may simply be informed of the plan and notified when closing occurs. For material transactions, directors would need to be more involved and have greater oversight responsibilities, especially if the company does not often make acquisitions.

In either case, there should be regular (usually quarterly) reporting to the board for at least a year after a transaction is completed.

The reporting may vary with the nature of the transaction, but the board should generally expect to see:

- metrics related to the acquisition rationale (what types of value creation opportunities were expected from the transaction—for example, cost reduction, revenue growth, etc., and when were they to be achieved)
- status reports on each major implementation initiative (including progress against milestones, reasons for variances and corrective actions, if any)
- negative synergies (what was discovered after closing that is a cause of concern or impacting profitability or cash flow)
- stakeholder impact
- customer retention and new customer acquisition
- involuntary employee turnover (especially critical skills and top performers)
- investor commentary (analyst reports, stock charts and reports from meetings with shareholders).

Implementation completion audits are a good practice and should be reported to the board. These audits include a brief report on each item and source of value identified in the transaction proposal (whether it was completed, results and lessons learned). Best practice is to have such audits undertaken by an independent advisor.

3.3

Learning from Experience

This section reviews

- Lessons about M&A strategy development (page 123)
 - Lessons about developing M&A transactions (page 124)
 - Lessons about post-transaction planning and implementation (page 125)
-

This final step in the framework considers what companies can learn from examining their M&A successes and challenges.

It highlights some of the key skills and competencies needed to be competitive in M&A and how directors can be satisfied that the company is learning from each transaction and building better skills and capabilities for the next one.

Lessons about M&A Strategy Development

Strategy Formulation

Disappointments in post-merger implementation can sometimes be attributed to a change in context. For example, planned cost savings or revenue growth may prove impossible because of changes in competition or market dynamics.

The board is ultimately responsible for company strategy, including M&A strategy. Directors should aim to learn from post-merger tracking and audits to play a more effective oversight role in future strategy development.

Such surprises may point to weaknesses in strategy development or due diligence. Companies should not underestimate the importance of setting strategy in the context of where analysts and other experts believe the industry is heading, rather than planning solely based on current market conditions and assumptions. While the future can never be predicted with certainty, companies will improve their planning skills by considering alternative scenarios for future market environments and competitive actions.

Sources of Value and Risk

Post-merger implementation assessment can reveal which sources of expected value were not real and expose risks that had not been considered. For example, the transaction proposal may have included revenue growth from cross-selling, when the buyer had no experience in cross-selling, or required turning the target's performance around, when the buyer had no experience in managing turnarounds. Or it may have been an international transaction, and the buyer had no experience in the seller's country or insufficient knowledge of its corporate culture.

These kinds of implementation issues often point to an M&A strategy that needs to be better aligned with the skills required to implement. The buyer either needs to acquire the right skills or change its M&A strategy.

Candidate Search and Screening

Disappointments in target selection usually mean that the search universe was too narrow, the criteria were not aligned with strategy, or the screening methodology was not robust. Leading acquirers are all proactive in their searches, and do not limit themselves to obvious transaction opportunities or opportunities presented by others. Their corporate development function carries out a broad scan for opportunities and their leadership is skilled at nurturing relationships, even with merger partners that may seem unwilling at first.

Lessons about Developing M&A Transactions

Approach and Initial Discussions

Buyer's remorse is common during post-merger implementation. A common cause is regret that a target the buyer would have preferred was not available, so the buyer settled for a weaker company or one with less valuable synergies. The situation becomes worse when the preferred target is acquired by another buyer, sometimes creating a formidable competitor.

This points to weakness in the value proposed to the target or in developing a relationship with the target. The buyer may not have been able to interest the target because it was not adequately prepared, used the wrong advisors, or the chemistry simply was not right. The best acquirers are skilled at relationship development and develop reputations as preferred buyers.

Directors should seek to understand disappointments and performance shortfalls that can be attributed to how the transaction was developed. For every transaction, directors should be satisfied that the target chosen is the right one, that management is clear about how value will be created, that the transaction structure is aligned with the required post-merger actions, and that there has been adequate due diligence on the post-merger plans and value potential, as well as on the entity.

Preliminary Due Diligence

In a competitive M&A environment, the market essentially determines the price required to complete a transaction. The most attractive targets are also appealing to others, especially in consolidating industries. As a result, the competitive market will force higher premiums that are commensurate with the higher quality of a particular company's assets, a compelling growth trajectory, or greater potential to create value. A differentiating skill for buyers is knowing what they can afford to pay. That requires knowing enough about the future of the target company and its industry, the value that can be created in a given transaction, and alternatives to that transaction.

This knowledge and ability to assess transactions accurately can provide competitive advantage in two ways: knowing the value that can be created can prevent buyers from paying more than they can recover from a transaction, while having certainty about the value potential of a transaction may allow the buyer to pay more than its competitors can justify paying (if the buyer is truly the company that can derive the most value, then it can safely pay more than others can).

Transaction and Enterprise Structure

It is often during post-merger implementation that management discovers the new enterprise structure is impeding value creation. For example, the new entity may have to be kept somewhat separate to monitor performance incentives or retention bonuses tied to the original target, there may be covenants to lenders related to the target as originally defined or structured, or financing for the transaction may be insufficient to fund some of the investments needed to achieve the desired synergies.

Lessons learned from these issues apply to structuring the transaction and the combined enterprise. Post-merger planning should start early to address the new structure and to improve the investment thesis and help sell the transaction to investors.

Final Diligence and Approvals

Starting post-merger planning during due diligence is a recommended practice that can differentiate an acquirer. The traditional due diligence exercise is a confirmation that what the company is buying is what they thought it was. If post-merger planning is also incorporated, the potential synergies and plan metrics and milestones can also be audited during due diligence, not just the target entity as-is.

The lesson here, too, is to start post-merger planning early.

Lessons About Post-Transaction Planning and Implementation

Effective post-transaction implementation builds on the M&A strategy and transaction development competencies described above.

In addition, some of the most important competencies for competitive M&A programs relate directly to post-transaction implementation. Learning in post-transaction implementation helps build competitive M&A programs—companies that implement well have better insight into how they can create real value in the next transaction, which can affect target selection and negotiation, and can support paying the price required to win because of the greater confidence in implementation and performance outcomes. Effective and timely post-transaction execution also supports the stock price, which in turn puts the company back in the market ahead of others.

However, superior post-transaction implementation skills are difficult to acquire and there are three main stumbling blocks to successful post-transaction implementation:

- the difficulty of staying focused on the fundamental reasons for the acquisition
- the challenge of culture integration
- the size, scope and complexity of post-transaction projects.

It is a multi-dimensional challenge that's becoming increasingly difficult as success in M&A is beginning to depend increasingly on strategic synergies (the hardest kind to achieve) and on integrating large, complex international organizations and cultures.

Staying Focused on the Acquisition Rationale

Although most transactions have a stated rationale, many fail to implement it. Post-transaction audits show that half or more of the actions planned are typically forgotten or ignored. By necessity, only a small number of executives and advisors know the details of the sources of transaction synergies before the transaction is announced. After it is announced, the great ideas of those few individuals in leadership roles are often not sufficiently understood or accepted by the many individuals who have to implement them, especially if they are not communicated well. The post-transaction environment is confusing at best, and can sometimes even be hostile.

Because buyers sometimes have difficulty staying focused on the acquisition rationale, directors who are faced with approving transactions based on the stated acquisition logic and planned actions need to be satisfied that the buyer has the skills needed to implement a transaction.

For cost reduction—competitive capabilities may include researching benchmarks and codifying processes, so that the post-transaction exercise is not delayed by unproductive (or even counterproductive) effort, debate and uncertainty.

For revenue synergies—differentiating skills include segmentation and cross-selling capabilities. Effective segmentation defines which customers have the greatest growth potential, which key customers need to be incented to stay, and which customers can be lost without serious consequences. Many companies that fail to cross-sell in their current product portfolios still undertake acquisitions that depend on cross-selling. Their cross-selling skills need to be developed and demonstrated for M&A transactions on that basis to be successful.

For financial engineering—the mechanics of financial engineering are important to any buyer, but most companies do not need to develop core competence in this area. These skills are only required in the finance department or among the buyer’s advisors, and they apply to a specific and narrow set of integration benefits. While the associated benefits can be of substantial value, only a company in the business of M&A (like a private equity company) needs to build this skill as a core competence.

Managing Cultural Integration

While all agree on its importance, few know how to properly assess or integrate corporate cultures. The ability to manage culture integration faster or more effectively than others can therefore provide a competitive advantage in M&A.

Because failure to integrate cultures represents a missed opportunity for shareholders, buyer directors should be satisfied that culture issues are actively managed, not simply perceived as barriers to doing a transaction or a neglected area of risk in an approved transaction.

In each transaction, the cultural outcome should be defined and planned, usually based on one of three scenarios: the combined entity takes on the culture of one of the merging companies (usually the buyer), the cultures remain independent of one another, or a new culture is formed that is different from both of the previous cultures. Each case requires different post-transaction actions and different skills.

In [The Core Competence of the Corporation](#), C. K. Prahalad and Gary Hamel characterize core competence as advantage derived from “...collective learnings...across organization boundaries...which are enhanced as they are applied and shared.” Given the need for M&A in today’s restructuring industries, and the persistently high failure rates from M&A transactions, the message is clear: M&A needs to be a core competence and superior M&A skills can provide an important basis of competitive advantage.

Overseeing Post-Transaction Implementation Activities

Project management challenges associated with large M&A transactions are often underestimated. Companies commit their 'best and brightest' and hire expensive advisors to develop transactions, but then leave the detailed planning and implementation to hastily assembled integration task forces, who must often work on integration issues part-time while maintaining some or all of their usual duties.

The best acquirers assign skilled integration leadership, carefully structure the key teams, provide adequate resources (including external resources, when needed), set clear post-merger priorities, and institute process and performance tracking. Many managers will be doing this for the first time, so skilled post-transaction project management requires codified tools and processes, capable resources, and training, support and coaching for the managers involved in each transaction.

Key Questions About Post-Closing Implementation

What was each stakeholder group's reaction to the announced business combination? What were the most negative reactions and biggest issues raised?

What percentage of the target's employees will be redundant under the new structure? What is the buyer's messaging to those who will be asked to continue?

Are there any major systems issues that have to be addressed quickly to preserve continuity after closing?

What issues have emerged since closing that the buyer did not anticipate?

If the buyer adds up the goals of all the cost reduction initiatives underway, how would they compare with the original acquisition rationale?

How have competitors reacted to the transaction since closing?

What is the plan for regular reporting to the board on implementation? What key metrics and milestones will be used?



Appendices

Appendix 1— Sample Acquisition Screening Criteria

The acquisition criteria should be set in advance of considering any particular acquisition opportunity.

The criteria should reflect the M&A strategy—the organic gap that needs to be filled and the characteristics of the ideal acquisition candidate.

Other considerations include:

- capacity to fund and structure an attractive transaction
- complexity of post-merger integration
- execution skills of the buyer.

The Criteria Can Be Set by Answering the Following Questions:

What part of the company's strategy does it want to use M&A to advance? (Does it want to use M&A to expand its product line, gain manufacturing capacity, enter new geographic markets, diversify or simply to grow?)

How will the company create value in acquisitions? (Does it seek to turnaround underperforming companies, to consolidate like companies to reduce costs, or to achieve revenue synergies additive to the revenue of the buyer and target? i.e., how will $2 + 2 = 5, 6$ or 10 ?)

How much (and what kind of) risk is the company prepared to assume related to acquisitions?

What is the company's financial capacity and what cash restrictions should be placed on any one transaction?

If the M&A strategy is being used to enter new product markets, geographic regions or sectors, what skills must the targets bring? Are management quality and retention key to successful outcomes?

How will shareholders view a transaction? Is long-term value creation enough to win their support or do acquisitions also need to be accretive?

Does the company have the skills it needs to execute on the objectives set out in the M&A strategy? What limitations do the company's experience and proven skills place on the nature of the company to be acquired? Does the company need to choose targets that fill its skill gaps?

Does management have the capacity to conduct an extensive post-merger implementation project? What are the risks to the business of taking on a post-merger implementation project?

Illustrative Acquisition Criteria and Scoring

ABC is a mid-size automotive parts manufacturing company building broader capacity in North America to serve the increasingly global market for original automotive equipment.

Criteria		Does not meet	Poor	Weak	Acceptable	Strong	Meets perfectly
Industry	Automotive parts						
Key product lines	Suspension systems						
Market position	Top two (by size) in its geographic market						
Geographic location	Mexico						
Customer concentration	No customer representing more than 20% of revenue						
Size	Revenue of \$300 million						
Financial performance and returns	Solid history of profitability and growth <ul style="list-style-type: none"> • net earnings of at least \$15 million • gross margins of at least 25% • returns on capital not less than 15% 						
Management	High quality, experienced management team. Can run the business independently.						
Assets	Newer equipment in good condition. Leased or owned buildings with potential for expansion.						
Capabilities	<ul style="list-style-type: none"> • deep understanding of complex suspension systems • high quality, low cost manufacturing • deep customer relationships 						
Ownership	Private (management would like to have a meaningful ownership position)						

Criteria	Does not meet	Poor	Weak	Acceptable	Strong	Meets perfectly
Valuation and returns	<ul style="list-style-type: none"> • multiple of 7.0 × net earnings • absolute value: \$150 million • expected 20% annual return after synergies 					
Integration complexity	Limited					

Appendix 2a—Sample Non-binding Letter of Intent For a Private Company

ABC Company Letterhead

Strictly Private & Confidential

Dear • :

This letter confirms our mutual intentions with respect to a potential transaction described herein between ABC Company (the *Buyer*) and XYZ Corporation (the *Seller*), collectively the parties.

1. Terms

The principal terms of the proposed transaction shall be substantially as follows:

2. Assets to be acquired

The Buyer requires substantially all of the assets, tangible and intangible, owned by the Seller that are used in or necessary for the conduct of its business, including without limitation, the working capital, fixed assets, any and all customer lists and related goodwill associated therewith, all intellectual property, all free and clear of any security interest mortgages or other encumbrances.

3. Consideration

The aggregate consideration for the assets and business to be purchased would be \$ •; provided, however, that the working capital (current assets less current liabilities) of the business to be purchased equal to \$ •as shown on the closing date balance sheet prepared in accordance with generally accepted accounting principles.

4. Due diligence

Promptly following the execution of this letter of intent, you will allow the Buyer to complete customary due diligence including the examination of your financial, accounting and business records and agreements, contracts, minute books, books, records and other documents as well as site visits to the principal locations. All confidential non-public information obtained by the Buyer as a result thereof will be maintained in confidence subject

to the terms of a Confidentiality Agreement executed by the parties dated _____, 20•. The parties will cooperate to complete the due diligence expeditiously.

5. Definitive purchase agreement
All the terms and conditions of the proposed transaction would be stated in a definitive purchase and sale agreement (“Purchase and Sale Agreement”) to be negotiated in good faith and agreed and executed by the parties. The Purchase and Sale Agreement will contain such representations, warranties, covenants, conditions, indemnities and other terms as would customarily be associated with a transaction of the type and nature described above and will be subject in all respects to the mutual approval of the parties.
6. Conduct in ordinary course
In addition to the conditions discussed herein and any other to be contained in the Purchase and Sale Agreement, consummation of the acquisition would be subject to conducting the Seller’s business in the ordinary course during the period between the date hereof and the date of closing, there having been no material adverse change in the business, financial condition or prospects.
7. Continuation of employment
Simultaneously with the execution of the Purchase and Sale Agreement we would offer employment to substantially all of the Seller’s employees and would expect the management of the Seller to use its reasonable best efforts to assist us to employ these individuals.
8. Expediency
The Parties will use reasonable efforts to complete the Purchase and Sale Agreement on or before next date and to close the transaction as promptly as practicable thereafter.
9. Expenses
The Buyer and Seller shall be responsible for their respective expenses incident to this letter of intent, the Purchase and Sale agreement and the transactions contemplated herein.

10. Public announcements

The parties will not make any announcement of the proposed transaction contemplated by this letter of intent prior to the execution of the Purchase and Sale Agreement without prior written approval of the other which approval will not be unreasonably withheld or delayed. The foregoing shall not be restricted in any respect the Buyer's ability to communicate information concerning this letter of intent and the transactions contemplated herein to its respective officers, directors, employees, and professional advisors subject to the conditions of the Confidentiality Agreement. The Confidentiality Agreement is hereby ratified and confirmed as a separate agreement between the parties thereto.

11. Closing conditions

The terms of the Purchase and Sale Agreement will provide for certain conditions for the sole benefit of the parties, as applicable, including, without limitation, acceptable financing arrangements; all regulatory/third party contractual approvals; satisfactory results of legal/business due diligence: satisfactory arrangements with key suppliers and customers; the absence of any material changes relating to the business and satisfactory arrangements with remaining employees of the Corporation.

12. Non-binding nature

This isoprietary document and is to be treated as highly confidential; the contents of this Letter of Intent are not to be discussed with or revealed to any person without the prior written consent of all of the parties. While the foregoing provisions of this Letter of Intent may contain essential parts of a definitive Purchase and Sale Agreement, each party understands and agrees that the foregoing is a non-binding proposal only and, except to the extent provided below in this paragraph, is not intended as a legally binding agreement by any party to enter into any of the transactions or arrangements contemplated above. By signing this Letter of Intent, each party confirms that the terms of this Letter of Intent are acceptable in principle to such party and that the parties wish to proceed expeditiously to negotiate, execute and deliver the purchase agreement in order to give full legal effect to the provisions set forth in this Letter of Intent. Except as provided below in this paragraph, neither party shall have any legal obligation with respect to the transactions contemplated above unless and until the purchase agreement is executed and delivered and then only to the extent provided for therein. Notwithstanding the foregoing, each party understands that the obligations set forth in this Letter of Intent relating to matters of confidentiality, shall, in each case, survive the execution and

delivery of this Letter of Intent and shall be legally binding on the parties hereto regardless of whether the purchase agreement is executed and delivered as contemplated herein.

13. Governing law

This letter shall be governed by the laws of Ontario.

If the above terms and conditions are acceptable to you, kindly confirm same where indicated below not later than 5:00 p.m. (Toronto time) on •, 20• so that we may continue with our business and legal due diligence investigations.

We are looking forward to working with you and your professional advisors to complete the Proposed Transaction.

Yours truly,

Each of the undersigned confirm, acknowledge and accept each of the provisions of this Letter of Intent as of this ____ day of •, 20•.

Name and title ABC Company

Name and title XYZ Corporation

Appendix 2b—Sample Non-binding Letter of Intent For a Public Company

ABC Company letterhead

Dear • :

Further to our recent telephone conversation regarding XYZ Company (“the Company”), we are pleased to provide the Board of Directors of the Company (the “Directors”) with our proposal of an all cash offer pursuant to which a new company (“Newco”) would be formed by ABC Company (“ABC”) to acquire 100% of the common shares of the Company (excluding shares already held by us) for \$x.00 per share, representing a total transaction value of \$y million (the “Transaction Value”). We have devoted substantial time, resources and energy to studying the Company. We believe our offer provides an extremely compelling combination of attractive and certain value for shareholders.

We are highly confident that ABC can fund the full amount of the consideration and all related transaction fees and expenses. We are seeking financing from [insert lender names] (the “Lenders”).

We have endeavoured to provide the strongest possible proposal to the Company and its shareholders, including:

- **All Cash Offer.** Our proposal is for Newco to acquire all of the outstanding shares of the Company for 100% cash consideration.
- **Attractive Long-Term Solution for all Stakeholders.** Under our proposal, the Company can avail itself of the benefits of a private operating environment without the distraction of the public markets and the emphasis on short-term financial results.
- **Highest Certainty and Speed of Completion.** Our proposal offers a high level of certainty of regulatory approval. Newco will be a Canadian buyer not subject to Investment Canada review and we do not believe that there are any Competition Act issues or issues under the antitrust laws of the United States that would impede the transaction. This will lead to a rapid regulatory approval, delivering cash proceeds to the shareholders as promptly as possible. Our proposal provides higher certainty than alternatives that have been suggested in the press.

- **No Financing Condition after Due Diligence.** Following completion of the requisite due diligence discussed below, financing requirements will be fully committed at the time of the execution of a definitive transaction agreement, which agreement will not contain a financing condition.
- **Maintain Process Flexibility to Maximize Value.** ABC and the Lenders will require a 6 week due diligence period which commences on the date hereof and ends at 5:00 p.m. (EST) on [insert date] (the “Diligence Period”). We are available to commence our due diligence immediately and believe such diligence would be conducted during the negotiation of definitive agreements. During the Diligence Period, the Company shall be permitted to shop the Company and the proposal to other third parties. ABC shall deliver an initial draft of the Definitive Agreement no later than 10 days from the date hereof. If the initial draft has not been delivered by such time, the Diligence Period shall terminate on the 11th day following the date hereof.

In order to advance our proposal, and for good and valuable consideration, you and we have agreed as follows:

1. During the Diligence Period the parties will negotiate in good faith with a view to entering into a definitive agreement (the “Definitive Agreement”) pursuant to which ABC will acquire the Company for the Transaction Value (the “Transaction”).
2. The parties will, as promptly as practicable, negotiate in good faith a confidentiality agreement regarding access to confidential information to be provided to us and our representatives (including the Lenders and equity participants in the Transaction), and the Company shall provide access to such confidential information as soon as possible following execution of the confidentiality agreement.
3. Nothing herein shall be construed as constraining the Company’s ability to have discussions with any other person about any transaction, including an Alternative Transaction prior to the execution of the Definitive Agreement. In this letter, the term “Alternative Transaction” shall mean any bona fide proposal or offer made by any person or group for (i) an arrangement, amalgamation, merger, reorganization, share exchange, business combination, recapitalization, dissolution, liquidation or similar transaction involving the Company which would result in any person or group beneficially owning more than 25% of the outstanding equity interests of the Company or any successor or parent company thereto, (ii) the acquisition by any person or group (including by any asset acquisition, joint venture or

- similar transaction) of assets (including equity securities of any subsidiary of the Company) representing more than 10% of the assets, revenues or net income of the Company and its subsidiaries, on a consolidated basis, other than transactions disclosed to ABC in writing on or before the date hereof, (iii) any acquisition (including by way of take-over bid or exchange offer) by any person or group that if consummated would result in any person or group beneficially owning more than 25% of the voting power of the outstanding shares or (iv) any combination of the foregoing, in each case of (i) through (iii) whether in a single transaction or a series of transactions.
4. During the Diligence Period, the Company shall cause the business of the Company to be conducted in the ordinary course and shall use commercially reasonable efforts to preserve in all material respects its business organization and maintain in all material respects existing relations with governmental entities, customers, suppliers and creditors, provided that if required in order to satisfy their fiduciary duties, the board of directors of the Company may take any action which they reasonably believe is necessary to preserve the value of the Company, and provided that the Company may take any action that it has disclosed to ABC in writing on or before the date hereof or that it has, on or before the date hereof, publicly disclosed it is, or will be, undertaking.
 5. If,
 - (a) During the Diligence Period the Company shall enter into any letter of intent or definitive agreement providing for an Alternative Transaction;
 - (b) During the Diligence Period the Company ceases to negotiate with the ABC in good faith with a view to entering into the Definitive Agreement by the end of the Diligence Period;
 - (c) During the 3 month period following the end of the Diligence Period, the Company shall enter into any agreement providing for an Alternative Transaction with a person with whom discussions regarding an Alternative Transaction were held before or during the Diligence Period;
or
 - (d) During the Diligence Period, an Alternative Transaction other than as contemplated in clause 5(a), (b) or (c) is publicly proposed or publicly announced by a third person and such Alternative Transaction with such person is consummated within 6 months following the end of the Diligence Period;

- then the Company shall pay ABC a fee of \$x for each issued and outstanding Company share, in the case of (a) immediately upon entering into such agreement, in the case of (b) immediately upon such cessation, and in the case of (c) or (d), upon consummation of the Alternative Transaction; provided, however, that no such fee shall be payable if the ABC shall have reduced the price offered below \$x per share without the approval of the board of directors of the Company.
6. If during the Diligence Period, the Company proposes to enter into an agreement relating to an Alternative Transaction, it shall not do so unless it has first provided 48 hours' written notice to ABC of such fact.
 7. In the event that the Diligence Period terminates and no Definitive Agreement is entered into between us because the Company ceases negotiations with the ABC (which the Company can do at any time), other than in circumstances where the ABC shall have reduced the price offered below \$x per share without the approval of the board of directors of the Company, you agree to reimburse us our reasonable and documented out-of-pocket expenses incurred in connection with our consideration of the Transaction, such reimbursement to include the reasonable and documented expenses of our legal, accounting and financial advisors; provided that the maximum amount of expenses subject to reimbursement hereunder shall not exceed \$z million. Any amounts paid in respect of expense reimbursement hereunder are creditable against any fee payable under paragraph 5.
 8. Until the date that is 6 months following the end of the Diligence Period, ABC agrees to vote all common shares of the Company that it owns, including shares acquired after the date hereof (a) if the Company's board of directors has recommended or approved the Transaction (i) in favour of the Transaction and (ii) against any Alternative Transaction or any action that is reasonably likely to impede, interfere with, delay, postpone, or adversely affect in any material respect the Transaction, and (b) if the Company's board of directors has recommend or approved an all cash Alternative Transaction in respect of which the Company has complied with Section 6 and which the board of directors has concluded is a Superior Proposal, (i) in favour of the Superior Proposal, and (ii) against any other Alternative Transaction or any action that is reasonably likely to impede, interfere with, delay, postpone, or adversely affect in any material respect such Superior Proposal. In the event that the Transaction is structured as a take-over bid or the Company's board of directors recommends a take-over that is a Superior Proposal, in respect of which the Company has complied with Section 6, ABC agrees to tender its common shares of the

Company into such Superior Proposal (and not withdraw its shares prior to the expiry of the take-over bid) until the date that is 6 months following the end of the Diligence Period. ABC represents that it has, and during such 6 month period will have, the ability to vote and dispose of all such shares in accordance with its obligations pursuant to this paragraph.

9. "Superior Proposal" means a bona fide written Acquisition Transaction made by an arm's length third party (i) that is reasonably capable of being completed without undue delay, taking into account all financial, legal, regulatory and other aspects of such proposal and the person making such proposal; (ii) that is not subject to any due diligence or access condition; (iii) that is not subject to any financing condition and in respect of which, where applicable, financing commitment letters reasonably satisfactory to the Company have been furnished to the Company; (iv) that did not result from a breach of any non-solicitation agreement between the parties contained in the Definitive Agreement, and that the board of directors of the Company determines, in its good faith judgment, after receiving the advice of its outside legal and financial advisors and after taking into account all the terms and conditions of the Acquisition Transaction, including all legal, financial, regulatory and other aspects of such Acquisition Transaction and the person proposing such Acquisition Transaction would, if consummated in accordance with its terms (but not assuming away any risk of non-completion) result in a transaction more favourable, from a financial point of view, to the shareholders of the Company than those contemplated by this Agreement or a Definitive Agreement between the parties.
10. Until the end of the Diligence Period, ABC agrees that it shall not, without the prior written consent of the Company, sell, transfer, assign, pledge, or otherwise dispose of, or enter into any agreement or understanding relating to the sale, transfer, assignment, voting (other than as provided herein) or other disposition of any common shares of the Company that it holds on the date hereof, or any shares acquired during the Diligence Period.
11. We agree to coordinate public disclosure of this letter agreement and our Proposal. Each party acknowledges that the other party has disclosure obligations under securities laws which will require the other party to publicly disclose this proposal in a filing with the provincial securities commission and/or the U.S. Securities and Exchange Commission and to comply with these requirements, each party will be filing this letter agreement with the applicable securities commission on or about [insert date].

12. This letter agreement shall be governed by the laws of the Province of Ontario.
13. It is understood that this letter does not create a binding obligation on our part or yours to enter into a definitive agreement with respect to a Transaction and that a binding obligation on: (a) our part to acquire the Company will result only upon our determination that we are satisfied with all aspects of the due diligence we carry out during the Diligence Period and the execution of the Definitive Agreement on terms and conditions that are acceptable to us, and (b) the Company's part will result only upon the execution of the Definitive Agreement on terms and conditions that are acceptable to the Company and upon the Company's board of directors authorizing the entering into and delivery of the Definitive Agreement. However, it is agreed that the provisions of paragraphs 1 through 13 shall create binding obligations between us, which shall survive the termination of the Diligence Period.

We are enthusiastic about the future prospects of the Company and look forward to advancing our proposal. Please acknowledge your agreement with the foregoing by signing the counterpart of this letter.

Yours very truly,

Appendix 3—Sample Exclusivity Agreement

ABC Letterhead

[date]

XYZ Corporation

Subject: Exclusivity agreement

Ladies and Gentlemen:

In connection with the discussions between ABC Company and/or its subsidiaries and/or its direct and/or indirect shareholders (collectively *the Company*), and XYZ Corporation (*XYZ*), regarding the possibility of XYZ acquiring assets of the Company (*the Potential Transaction*), agree as follows:

From the date hereof until the earlier of:

- (i) •., Toronto time, on •, 20•,
- (ii) the date on which a definitive agreement with respect to the Transaction is entered into (*the Exclusivity Period*) and
- (iii) he date on which XYZ determines not to proceed with the Transaction, at which time XYZ will promptly notify the Company of such decision,

the Company shall not, either directly or indirectly through its officers, directors, advisors or other representatives, without the prior written approval of XYZ,

- (a) solicit, initiate or encourage the submission of proposals or offers relating to,
- (b) respond to any submissions, proposals or offers relating to (other than to communicate that the Company is not interested in considering such submissions, proposals or offers at such time),
- (c) engage in any negotiations or discussions with any person relating to, or
- (d) furnish any confidential information that might be useful to any person in considering,

any acquisition, however structured, recapitalization or similar transaction involving all or any substantial portion of the Company business, securities or assets (an *Alternative Transaction*), other than with XYZ. The Company shall

promptly provide to XYZ notice of the receipt of any submissions, proposals, offers or inquiries concerning a possible Alternative Transaction made during the Exclusivity Period.

This Agreement does not constitute an agreement or understanding between the parties to enter into the Transaction or any other transaction.

Please execute and return one copy of this Agreement, which will constitute the parties' agreement with respect to the subject matter hereof.

Yours truly,

ABC Corporation

By: _____

Name: _____

Title: _____

Agreed to, confirmed and accepted as of the date first above written:

XYZ Corporation

By: _____

Name: _____

Title: _____

Appendix 4—Sample Confidentiality Agreement

XYZ Letterhead

[date]

ABC Company

Subject: Confidentiality Agreement

Ladies and Gentlemen:

In connection with the discussions between ABC Company and/or its subsidiaries and/or its direct and/or indirect shareholders (collectively Company), and XYZ Corporation. (XYZ), regarding the possibility of XYZ acquiring assets of the Company (the Potential Transaction), Company and/or its Representatives (as defined below) may disclose, furnish or reveal to XYZ and/or its Representatives, either orally, in writing or otherwise, or give XYZ and its Representatives access to, certain information and documentation about the financial condition, taxes, accounting, business, operations, assets, liabilities, prospects, legal structure, value and/or structure, marketing practices and techniques, business strategies and capabilities, business plans, and relationships with customers, suppliers, principals, employees, financing sources, hedging counterparties, contracting counterparties and others, and any information that is a trade secret within the meaning of applicable trade secret law, of Company (the Information). As a condition to, and in consideration of, Company's willingness to participate in those discussions and to permit the disclosure of Information to XYZ and/or its Representatives, Company requires XYZ's agreement to the terms and conditions of this letter agreement (this Agreement).

1. As used in this Agreement, the term Evaluation Material shall include all Information, whether (a) prepared by Company, its Representatives or otherwise or gathered by inspection, (b) in written, oral, electronic or other form, (c) identified as "confidential" or otherwise, (d) prepared prior to, on or after the date of this Agreement, that is furnished to XYZ or any of its Representatives by or on behalf of Company, regardless of the manner or medium in which such Evaluation Material is furnished, including all information and documentation which Company is obligated to treat as confidential pursuant to any course of dealing or any agreement to which Company is a party, and other documentation and materials prepared by

- XYZ or any of its Representatives, containing or based in whole or in part on any Information furnished by Company or its Representatives. Evaluation Material also shall include (i) the fact that the parties are considering the Potential Transaction, (ii) any discussions, negotiations and investigations regarding the terms, conditions or other facts with respect to the Potential Transaction, including the status thereof and the existence and terms of this Agreement, and (iii) that Evaluation Material has been made available to XYZ. Evaluation Material does not include information that XYZ can demonstrate: (x) is or becomes generally available to the public other than as a result of disclosure, directly or indirectly, by XYZ or its Representatives in violation of this Agreement, or (y) becomes available to XYZ on a non-confidential basis from a source other than Company or its Representatives provided that such source is not known by XYZ or its Representatives (after due inquiry) to be bound by a confidentiality agreement with or other obligation of secrecy to Company or another party.
2. XYZ shall use, and shall cause its Representatives to use, the Evaluation Material solely for the purpose of evaluating and, if applicable, pursuing the Potential Transaction (the “Permitted Purpose”) and for no other purpose. XYZ shall not, and shall cause its Representatives not to, directly or indirectly, at any time whether or not Company and XYZ enter into a Potential Transaction, disclose any Evaluation Material to any person or entity (other than the Company) in any manner, or permit or assist any person or entity (other than Company) to use any Evaluation Material, except that XYZ may disclose Evaluation Material to its Representatives who need to know such information for the sole purpose of assisting, and solely to the extent necessary to permit such Representatives to assist, XYZ in the Permitted Purpose; provided that XYZ shall require each such Representative to be bound by the terms of this Agreement to the same extent as if they were parties to this Agreement, and XYZ shall be liable to Company for any action or omission prohibited under this Agreement by any of its Representatives.

“Representatives” of any person shall mean its affiliates and the directors, officers, employees, controlling persons, representatives, agents and advisors of such person and its affiliates (including financial advisors, counsel and accountants) and XYZ Investors. An “affiliate” of any person shall mean any other person that directly or indirectly through one or more intermediaries, controls, is controlled by, or is under common control with, the first person. For purposes of this definition, “control” of a person means the possession of power to direct or cause the direction of management and policies of such person, whether through ownership of voting securities, by contract or otherwise. The term “person” as used in this Agreement will be

- interpreted broadly to include the media (electronic, print or otherwise), the Internet, any governmental representative or authority or any corporation, company, limited liability company, enterprise, association, partnership, group or other entity or individual. Without limiting the generality of the foregoing, XYZ agrees that neither it nor any of its Representatives shall directly or indirectly discuss with or offer to any third person any position (debt, equity, co-investor, joint venture partner or otherwise) or potential position in any Potential Transaction or any other form of direct or indirect participation in any Potential Transaction by such third party without the prior written consent of Company.
3. In the event that XYZ or any of its Representatives is legally required (by oral questions, interrogatories, requests for information, subpoena, civil investigative demand, or similar process) to disclose any Evaluation Material, it is agreed that, to the extent not legally prohibited, XYZ will give Company prompt written notice of such requirement so that Company may seek an appropriate protective order or other remedy, and/or waive compliance with certain provisions of this Agreement, and XYZ will cooperate with Company to obtain such protective order. In the event that such protective order or other remedy is not obtained or Company waives compliance with the relevant provisions of this Agreement, XYZ will furnish only that portion of the Evaluation Material that is legally required to be disclosed and use its best efforts to obtain assurances that confidential treatment will be accorded to such Evaluation Material.
 4. At any time upon request by Company the XYZ shall return to Company or destroy within five (5) days after such request all documents, materials and other items containing Evaluation Material without retaining any copies, extracts or other reproductions in whole or in part of such material, and shall provide a certification in form and substance reasonably satisfactory to Company, signed by an officer of XYZ, as to the completeness of the return of such materials. Upon such request, XYZ also shall destroy, and shall cause its Representatives to destroy, all documents, materials and other items created by XYZ or such Representatives embodying the Evaluation Material in whatever format, and shall provide a similar certification to Company as to the completeness of the destruction of such materials. These obligations shall not apply to any computer records held in archive or back-up systems by the XYZ or its Representatives and which cannot be destroyed without incurring unreasonable effort. Any Confidential Information held in such systems shall continue to be held subject to the terms of this Agreement. Compliance with this paragraph shall not relieve XYZ of its other obligations under this Agreement.

5. For the two year period following the date of this Agreement, none of XYZ, its affiliates or any of their respective directors, officers, employees or controlling persons shall directly or indirectly solicit for hire or engagement, or hire or engage, any individual who is now or was during the six months prior to such proposed solicitation, hire, or engagement, engaged or employed by Company; provided, however, that XYZ may make general solicitations through public advertisements in the ordinary course of business and consistent with past practice and employ persons in connection with such general solicitations.
6. Except for those representations and warranties that may be made in a definitive agreement between Company and XYZ concerning a Potential Transaction (if and when executed), XYZ acknowledges and agrees that neither Company nor any of its Representatives (i) has made any representation or warranty, express or implied, as to the accuracy or completeness of the Evaluation Material or (ii) shall have any liability whatsoever to XYZ or its Representatives relating to or resulting from the use of the Evaluation Material or any errors therein or omissions therefrom. Neither the Company nor its representatives shall be under any duty or obligation to update any Evaluation Material. Neither this Agreement nor disclosure of any Evaluation Material to XYZ or its Representatives shall be deemed by implication or otherwise to vest in XYZ or its Representatives rights in or to the Evaluation Material, other than the right to use such Evaluation Material solely for the Permitted Purpose.
7. For the two year period following the date of this Agreement, XYZ agrees not to initiate or maintain contact, directly or indirectly, with any officer, director, or employee of Company or any of its financing sources suppliers, customers or other persons with whom the Company has material contractual dealings regarding the business, operations or prospects of Company, other than in the course of the XYZ's normal business. XYZ agrees that all contacts or communications by XYZ or its Representatives with Company regarding the subject matter of this Agreement, including as to any Evaluation Material or request for Evaluation Material or with respect to any Potential Transaction, shall be made only in accordance with written instructions provided by Company or its Representatives.
8. XYZ acknowledges that the covenants contained in this Agreement are fundamental for the protection of Company's legitimate business and proprietary interests and that in the event of any violation by XYZ of any such covenants, Company's remedies at law would be inadequate. In the event of any violation or attempted violation of this Agreement, Company

- shall be entitled to specific performance and injunctive relief or other equitable remedy for any such violation without any showing of irreparable harm or damage, and XYZ hereby waives, and shall cause its Representatives to waive, any requirement for the securing or posting of any bond or other security in connection with any such remedy. XYZ also agrees to indemnify and hold harmless Company against and to pay to any loss or expense incurred by Company by reason of or arising out of any breach by XYZ of the obligations in this Agreement, including, any costs, expenses or other liabilities incurred by Company in connection with the enforcement of any of its rights or the obligations hereunder. Such remedies shall not be deemed to be the exclusive remedies for any breach of this Agreement but will be in addition to all other remedies available at law or in equity to Company. Any trade secrets included in the Evaluation Material will also be entitled to all of the protections and benefits under applicable trade secret law. XYZ hereby waives, and shall use all best efforts to cause its Representatives to waive, any requirement that Company submit proof of the economic value of any trade secret or post a bond or other security.
9. XYZ understands that (i) Company and its Representatives shall conduct the process for the Potential Transaction as they in their sole discretion shall determine (including entering into definitive agreements without prior notice to XYZ or any other person, and discontinuing discussions or negotiations with XYZ or any other party at any time for any reason or no reason), (ii) any procedures relating to such a Potential Transaction may be changed at any time without notice to XYZ, (iii) Company shall have the right to reject or accept any potential buyer, proposal or offer, for any reason whatsoever, in its sole discretion, and (iv) neither XYZ nor any of its Representatives shall have any claims whatsoever against Company or its Representatives arising out of or relating to the Potential Transaction (other than those against the parties to a definitive agreement with XYZ in accordance with the terms thereof). XYZ and Company acknowledge and agree that this Agreement is entered into with the express understanding that neither Company nor XYZ is obligated to enter into or to commence or continue any discussions or negotiations pertaining to the entry into any Potential Transaction, and that no such obligation shall arise unless and until a definitive agreement relating to a Potential Transaction is executed and delivered by the parties.

10. This Agreement shall be governed by and construed in accordance with the substantive laws of the Ontario. If for any reason any court of competent jurisdiction determines it is impossible to so construe any provision of this Agreement and holds that provision to be invalid, all other provisions of this Agreement shall remain in full force and effect. This Agreement was negotiated by sophisticated parties at arms' length, and neither party hereto shall be construed as the drafting party against which the Agreement could be construed. XYZ hereby irrevocably and unconditionally consents to submit to the exclusive jurisdiction of the courts of Ontario for any actions, suits or proceedings arising out of or relating to this Agreement and the transactions contemplated hereby (and XYZ agrees not to commence any action, suit or proceeding relating thereto except in such courts, and further agrees that service of any process, summons, notice or document by U.S. registered mail or by express courier such as Federal Express to XYZ's address set forth above shall be effective service of process for any action, suit or proceeding brought against XYZ in any such court). XYZ hereby irrevocably and unconditionally waives any objection to the laying of venue of any action, suit or proceeding arising out of this Agreement or the transactions contemplated hereby in the courts of Ontario, and hereby further irrevocably and unconditionally waives and agrees not to plead or claim in any such court that any such action, suit or proceeding brought in any such court has been brought in an inconvenient forum. To the extent that XYZ or any of its affiliates may in any jurisdiction claim for itself or its assets immunity from suit, execution, attachment (whether in aid of execution, before judgment or otherwise) or other legal process and to the extent that in any such jurisdiction there may be attributed to itself or its assets the immunity (whether or not claimed), XYZ and its affiliates as the case may be hereby waive such immunity to the full extent permitted by the laws of such jurisdiction.
11. Except as otherwise provided herein, the restrictions and covenants set forth herein shall terminate and be of no further force or effect upon the two year anniversary of this Agreement; provided, however, that with respect to Evaluation Material which constitutes a trade secret under applicable law, XYZ's obligations pursuant to this Agreement shall survive so long as the Evaluation Material remains a trade secret.

12. This Agreement shall not be assignable by XYZ without the consent of Company and any attempted assignment without such consent shall be null and void. The Company may assign its rights under this Agreement to any entity. This Agreement shall be binding upon, inure to the benefit of, and be enforceable by and against the successors and assigns of each party to this Agreement.
13. The provisions of this Agreement shall be binding upon any person or entity currently or at any future time controlling, controlled by or under common control with XYZ, and XYZ shall be liable to Company for any action or omission prohibited hereunder by any such person or entity.
14. Neither the failure nor any delay by Company in exercising any right, power or privilege under this Agreement will operate as a waiver thereof, nor shall any single or partial exercise thereof preclude any other or further exercise thereof or the exercise of any right, power or privilege hereunder. The rights, remedies, powers and privileges herein provided are cumulative and not exclusive of any rights, remedies, powers and privileges provided by law. If any provision of this Agreement is found to violate any statute, regulation, rule, order or decree of any governmental authority, court, agency or exchange, such invalidity shall not be deemed to affect any other provision hereof or the validity of the remainder of this agreement, and such invalid provision shall be deemed deleted from this Agreement to the minimum extent necessary to cure such violation.
15. Any amendment or modification of the terms and conditions set forth herein or any waiver of such terms and conditions must be agreed to in a writing signed by Company and XYZ. This Agreement may be executed in counterparts, each of which will be deemed an original, but all of which together will constitute one and the same agreement. Signatures to this Agreement transmitted by facsimile transmission, by electronic mail in “portable document format” (“.pdf”) form, or by any other electronic means intended to preserve the original graphic and pictorial appearance of a document, will have the same effect as physical delivery of the paper document bearing the original signature.
16. This Agreement contains the entire agreement and supersedes all prior agreements and understandings, both written and oral, between the parties with respect to the subject matter hereof and thereof. Whenever used in this Agreement, “including” or any derivation thereof shall be deemed to be followed by the phrase “without limitation”.

Please execute and return one copy of this Agreement, which will constitute the parties' agreement with respect to the subject matter hereof.

Yours truly,

XYZ Corporation

By: _____

Name: _____

Title: _____

Agreed to, confirmed and accepted as of the date first above written:

ABC Company

By: _____

Name: _____

Title: _____

Appendix 5—Sample Standstill Provision

As a condition to any further discussions between ABC Company (ABC or Company) and XYZ Corporation (XYZ) with respect to the Potential Transaction, and to the provision of any Evaluation Material to XYZ, XYZ agrees that, until two years from the date of this Agreement, none of XYZ, its affiliates or any of their respective directors, officers, employees or controlling persons shall, without the prior written request of Company, directly or indirectly, alone or jointly or in concert with any other person (including by providing financing to any other person), effect or seek, offer or propose, negotiate or agree (whether publicly or otherwise) to:

- (a) purchase, transfer or otherwise acquire any securities of the Company;
- (b) enter into any merger, arrangement, amalgamation or other business combination involving the Company; or
- (c) participate in any recapitalization, restructuring, liquidation, dissolution, or other extraordinary transaction with respect to the Company or any of its affiliates
- (d) the acquisition of any assets of or managed by or interest in assets of or managed by Company or any of its affiliates (including any rights or options to acquire or with respect to any such assets and, without limiting the generality of the foregoing, any rights of any counterparty to any hedge, derivative or similar arrangement to which Company is subject) (including from a person other than Company);
- (e) the acquisition of any liabilities or obligations (existing or contingent), or the right to acquire such liabilities or obligations, of the Company or any of its affiliates;
- (f) the commencement of any tender, exchange or other offer for any securities of Company or any of its affiliates;
- (g) the participation in any “solicitation” of “proxies” or consents to vote or otherwise with respect to any voting securities of Company or any of its affiliates;
- (h) the making of any public announcement with respect to any proposal for or offer of any extraordinary transaction involving Company or any of its securities or assets (or those of its affiliates);

- (i) any other action, to seek to control or influence the management, Board of Directors or policies of Company or any of its affiliates;
- (j) the formation, joining or in any way participating in a group with respect to Company;
- (k) to advise, assist or encourage, act as a financing source for, or otherwise invest in any other person to assist them in undertaking any of the foregoing; or
- (l) any action which could require Company to make a public announcement as to any of the foregoing.

XYZ further agrees during such two-year period not to:

- (i) request, directly or indirectly, that Company
 - (1) amend or waive any provision of this paragraph (including this sentence), or
 - (2) otherwise consent to any action inconsistent with any provision of this paragraph (including this sentence); or
- (ii) take any initiative with respect to Company or any of its affiliates or securities which would reasonably be expected to require Company or any such affiliate to make a public announcement regarding
 - (1) such initiative,
 - (2) any of the activities referred to in this paragraph, or
 - (3) the possibility of a transaction involving XYZ or its affiliates.

Appendix 6—Due Diligence Checklist

Company Organization

1. Review the corporate structure of all legal entities including ownership of each entity. Include diagrams or charts. Provide a list of the officers and directors for each entity.
2. Review articles or certificate of incorporation.
3. Review current by-laws.
4. Review the list of all jurisdictions in which the company is qualified to do business and the list of all other jurisdictions in which the company owns or leases real property or maintains an office and a description of business.
5. Review all minutes for board of directors, board committee and shareholder meetings for the last five years, including all written actions or consents in lieu of meetings.

Ownership and Control

1. Review the capital structure, including all outstanding capital stock, convertible securities, options, warrants and similar instruments.
2. Review the list of securityholders of the company (including warrant holders), setting forth class and number of securities held.
3. Review the list holders of stock options, restricted and deferred share units, stock appreciation rights, phantom stock rights, plans, or other commitments to issue securities, the date of grant, the number of shares entitled to be purchased, vesting schedules, exercise price and fair market value on the date of grant, and any other associated stock option, performance, or incentive plans.
4. Review the schedule of repurchases of capital stock or other securities.
5. Review copies of any voting agreements, stockholder agreements, proxies, transfer restriction agreements, rights of first offer or refusal, preemptive rights, registration agreements or other agreements regarding the ownership or control of the company.
6. Review any restrictions on the company's ability to make dividend payments to its shareholders.

Historical Financial Information

1. Review the audited financial statements for three years, including auditor's reports.
2. Review the most recent unaudited statements, with comparable statements for the prior year.
3. Review the most recent consolidated and divisional financial statements, reports and analyses, including comparisons with plans and prior periods used for managerial purposes.
4. Review all auditor's letters and replies for the past five years.
5. Review the most recent credit reports.
6. Review all recent analyst reports.

Strategy

1. Review the most recent strategic plan.
2. Obtain recent data on the size of the markets the business serves, its trajectory, influencing factors and barriers to entry.
3. Understand the business drivers or key success factors for the enterprise.
4. Understand the competitive strengths of business and the embedded competitive vulnerabilities.
5. Through direct discussions with key customers, understand (in rank order of importance) customer criteria for purchasing the company's products or services and how this maps against the company's customer value proposition.
6. Through direct discussions with key customers, understand whether and how this business serves its customers better than anyone else.
7. Through direct discussions with key customers, understand if the company's customers would recommend its products or services to other potential customers.
8. Understand how the company's performance and capabilities compare with its competitors, against the key drivers in the industry.
9. Understand if the company has a business model that can consistently produce earnings and positive cash flow, even in poor economic periods.
10. Assess whether the company's overall strategy (if executed effectively) would result in increased shareholder value.
11. Assess how closely the company's strategy maps against your acquisition criteria.
12. Assess strategic risk (the efficacy of the company's strategy and its ability to execute).

Projections

1. Review the most recent short and long term business plans, budgets and projections.
2. Analyse and assess the validity of the underlying assumptions, related risks and probability of success.

Assets

1. Review the schedule of all bank accounts and the most recent reconciliations.
2. Review the schedule of aged accounts receivable, including an analysis of doubtful accounts and any write-offs of uncollectible accounts in the past five years.
3. Review the schedule of inventory, including an analysis of obsolete inventory, turnover, method of costing, physical inventory process and timing, and write-down of the value of any inventory over the past five years.
4. Review the schedule of fixed assets, historical cost, locations and accumulated depreciation. Review depreciation rates for each asset class.
5. Review the schedule of all equipment leases.
6. Review the schedule of sales and purchases of major capital equipment during past five years.
7. Review copies of all real estate leases, deeds, mortgages, title policies, surveys, zoning approvals, variances or use permits.

Intellectual Property

1. Review the schedule of domestic and foreign patents and patent applications, including opinions.
2. Review the schedule of trademark and trade names, including opinions.
3. Review the schedule of copyrights, including opinions.
4. Review the description of important technical know-how.
5. Review the description of methods used to protect trade secrets and know-how.
6. Review the schedule and copies of all consulting agreements, agreements regarding inventions, and licences or assignments of intellectual property to or from the company.
7. Review the patent clearance documents.
8. Review copies of all documents, information or other materials pertaining to the application or registration of intellectual property.
9. Review all agreements involving licensing, assigning or granting any security interest or other right or ownership interest in any intellectual property rights to a third party.

10. Review copies of any licence agreements, including (but not limited to) computer software and other agreements, including research and development agreements.
11. Review copies of any royalty agreements (whether the company pays or receives the royalty).
12. Review copies of the company's agreements with employees about confidentiality and assigning intellectual property.
13. Review a summary of any claims (or threatened claims) by or against the company related to intellectual property.

Liabilities

1. Review a schedule of aged accounts payable.
2. Review a schedule of accrued liabilities.
3. Review a schedule and copies of equipment and office leases.
4. Review a schedule of any contingent liabilities not disclosed or described in financial statements.

Significant Contracts and Commitments

1. Review all contracts related to any reorganization proposed or completed in the past five years, or any acquisition, merger, or purchase or sale of substantial assets (including all agreements related to the sale, proposed acquisition or disposition of any and all divisions, subsidiaries or businesses) of or with respect to the company.
2. Review all joint venture and partnership agreements.
3. Review all material agreements encumbering real or personal property, including mortgages, pledges, security agreements or financing.
4. Review all guarantees or similar commitments.
5. Review all indemnification contracts or arrangements insuring or indemnifying any director, officer, employee or agent against any liability incurred in such capacity.
6. Review any correspondence or documentation for the last five years related to any defaults or potential defaults under financing agreements.
7. Review all contracts involving cooperation with other companies.
8. Review all contracts related to other material business relationships, including service, operation or maintenance contracts, customer contracts, contracts for the purchase of fixed assets, and any franchise, distributor or agency contracts.
9. Review any circumstances where the company may be required to repurchase or repossess assets or properties previously sold.
10. Review data processing or other information technology agreements and licences.

11. Review any contract by which any broker or finder is entitled to a fee for facilitating the proposed transaction, or any other transactions properties or assets.
12. Review management, service or support agreements, or any power of attorney with respect to any material assets.
13. Review any agreements or arrangements relating to any other transactions between the company and any director, officer, stockholder or affiliate.
14. Review the list of any other material agreements continuing over a period of more than six months that can't be terminated by the company with 30 days' notice.
15. Review all supply agreements.
16. Review all contracts related to marketing and advertising.
17. Review all construction agreements and performance guarantees.
18. Review all secrecy, confidentiality and nondisclosure agreements.
19. Review all agreements related to the development or acquisition of technology.
20. Review all agreements outside the ordinary course of business.
21. Review all warranties offered by the company with respect to its product or services.

Financing

1. Review the schedule of short- and long-term debt, inter-company debt, sale lease-backs and contingent obligations currently outstanding (including amounts, maturities, balances due, interest rates and prepayment terms), together with copies of all correspondence between the company and its lenders in past 12 months, and compliance reports prepared by the company or its auditors.
2. Review all agreements evidencing borrowings (including loan and credit agreements, mortgages, deeds of trust, letters of credit, indentures, promissory notes and other evidences of indebtedness) and any amendments, renewals, notices or waivers.
3. Review all financing agreements with (or for) suppliers and customers.
4. Review the schedule of interest rate or foreign currency swaps, caps, options, forwards or other derivative instruments or arrangements currently outstanding.
5. Review all standby letters of credit, performance bonds, performance guarantees and similar credit support obligations.
6. Review all outstanding commitment letters or other correspondence related to proposed financing or borrowings.

Litigation

1. Review all pending, threatened or completed litigation, claims, suits and proceedings.
2. Review all insurance policies providing coverage that would apply to pending or threatened litigation.
3. Review all documents related to any injunctions, consent decrees, or settlements the company is a party to.
4. Review all unsatisfied judgments.
5. Review all reports from attorneys, appraisers or others in the past five years about unsafe, questionable or illegal matters or practices.
6. Review a schedule of all significant work performed by outside law firms, by project.
7. Review a schedule of all laws, regulations, rules, ordinances, injunctions, franchises or court orders the company isn't in compliance with or has received notices of violation about.
8. Review all consent decrees, judgments, other decrees or orders, settlement agreements and other agreements the company is a party to or bound by that requires or prohibits any future activities.
9. Review all reports, notices or correspondence related to any violation or infringement by the company of government regulations, including any regulations related to occupational safety and health or transporting dangerous goods.
10. Review copies of letters from lawyers to accountants about litigation and other legal proceedings, including all attorney audit letters for the last five years.
11. Review all reports filed with government agencies, including all securities law filings.
12. Review all reports of any regulatory body that has audited or reviewed the company.
13. Review all information about any bankruptcy, receivership or similar proceedings with respect to the company or its officers or directors.
14. Review all material licences, permits, registrations, government approvals and clearances (obtained, pending or otherwise) that are required to conduct the company's business.
15. Review all laws, regulations, rules, ordinances, injunctions, franchises or court orders the company or its operations are subject to, and the status of the company's compliance with each of them.
16. Review all material government agency inquiries, citations, notices of violation, fines or penalties (if any), whether written or oral, and including any threatened formal or informal actions or inquiries.

Insurance

1. Review all general liability, personal and real property, business interruption, product liability, errors and omissions, key-man, directors and officers, worker's compensation, and other insurance.
2. Review the company's insurance claim history for past three years.
3. Review all areas the company self-insures and the methods of self-insurance used.

Environmental

1. Review all environmental audits (if any) for each property leased by the company.
2. Review a listing of hazardous substances used in the company's operations.
3. Review a description of the company's hazardous substance disposal methods.
4. Review all environmental permits and licences.
5. Review all environmental litigation or investigations or regulatory proceedings.
6. Review any contingent environmental liabilities or continuing indemnification obligations.
7. Review all local or foreign environmental laws and regulations (including, without limitation, permits, permit applications, notices of violation, compliance orders and agreements, pollution control capital expenditure reports, and information related to the presence of USTs, PCBs or asbestos).
8. Examine all internal company reports concerning environmental matters related to current or former company properties or properties it owned or operated in the past.
9. Examine copies of all other environmental studies and surveys, including any Phase I or Phase II reports.
10. Examine copies of all notices, formal and informal complaints, correspondence, suits or similar documents sent to, received by or served upon the company by any protective or regulatory environmental agency.
11. Review a description of any past or ongoing remediation efforts.
12. Obtain a list of all environmental permits and permit applications, together with copies of related correspondence and consideration of transferability.
13. Obtain a description of the condition of neighbouring areas, such as landfills, and common drainage of waste treatment areas.
14. Obtain copies of all waste manifests related to real estate the company has environmental responsibility for.

15. Obtain a list of former company properties and properties formerly owned or operated by the company, including evidence of chain of title for at least the last fifty years, together with a history of the property's use during that period.

Taxes

1. Review all domestic and foreign income tax returns and all sales, property, franchise, payroll, excise, withholding and capital tax for the last five years.
2. Review all sales tax returns for the last five years.
3. Review all audit and revenue agency reports.
4. Review all tax settlement documents for the last five years.
5. Review all employment tax filings for three years.
6. Review all excise tax filings for three years.
7. Review all tax liens.
8. Review all pending tax matters, including (but not limited to) audits, extensions of time, waivers of statutes of limitations, and deficiency/assessments, and the status of any outstanding tax audits, including a list of all audit adjustments proposed by any taxing authority.
9. Examine copies of all communications and agreements between the company and any taxing authority in the past five years.
10. Review all special tax rulings or agreements arranged with taxing authorities.
11. Examine any preferred tax status or tax benefit which may be adversely affected by the proposed acquisition and any related transactions, including a summary of any tax attribute carry-forwards available.
12. Review all open tax years and indicate whether any taxing authority has indicated that a claim may be asserted with respect to them.
13. Review audit and revenue agents reports for the last five years.
14. Review all correspondence about any audit or investigation inquiries.
15. Examine settlement documents and correspondence for the last five years.
16. Review agreements waiving statute of limitations or extending time for filing tax returns.
17. Review material tax opinions.
18. Identify evidence that all payroll, withholding, sales, use, franchise and real and personal property taxes are paid.
19. Identify evidence that the company has paid all transfer taxes related to the sale of personal or real property (if applicable) for the last five years.
20. Examine tax sharing, tax allocation or related inter-company transfer agreements and any taxing authority correspondence or assessments related to them.

Products or Service Lines

1. Review all existing products or services, and all products or services under development.
2. Review all correspondence and reports related to any regulatory approvals (or rejections) of any of the company's products or services.
3. Review all material complaints or warranty claims.
4. Review the results of all tests, evaluations, studies, surveys and other data about existing products or services and products or services under development.

Customer Information

1. Review a complete customer list.
2. Review a schedule of the company's ten largest customers (by sales and margins), the amount sold annually to each, and a description of discounts, promotional allowances, payment terms and rebates for each for the last three years.
3. Review all supply or service agreements.
4. Review the company's credit policy.
5. Review all surveys and market research reports relevant to the company's products or services.
6. Review current advertising programs, marketing plans and budgets, and printed marketing materials.
7. Provide a detailed breakdown of customer attrition data for the past five years.

Operations

1. Review current operations and performance for each major location, including all key operational metrics.
2. Understand their practical capacity, given current organizational, human resource and facility constraints.
3. Understand the status of relationships with major suppliers and vendors, including a description of any supplier quality issues.
4. Obtain a listing of relationships with major service and installation organizations.
5. Obtain a schedule of the company's ten largest suppliers and vendors, setting forth annual amounts purchased.
6. Understand the major production materials required.

Organization

1. Review a staff organization chart, listing all employees (including titles and grade levels). List any open positions to be filled in the next six months.
2. Review a list of senior employees (including positions, current salaries, salaries and bonuses paid in last three years, and years of service).
3. Review resumes of all key employees.
4. Use comprehensive interviews, testing and other means to assess the qualifications, capabilities and fit of all key management employees.
5. Review all officers and directors and other key employees who have recently resigned or been terminated, and all compensation paid during the last five fiscal years to the same (including base salary, bonuses, benefits, perquisites and length of service).
6. Review copies of any management and service agreements, collective bargaining agreements, employment agreements, deferred compensation agreements or arrangements, severance agreements or arrangements, consulting agreements and change of control agreements, including a description of any oral agreements.
7. Obtain a list of all temporary employees of either company and copies of contracts or agreements related to such employees.
8. Obtain a list of any officers, directors and employees involved in criminal proceedings or significant civil litigation.
9. Obtain a schedule of all loans to any officer, director, employee, or shareholder and copies of all related documents.
10. Analyse voluntary and involuntary employee turnover statistics.

Culture

1. Assess the company's culture across multiple dimensions (see questions 2 to 14 below) through interviews, employee surveys and other means, and assess cultural similarities and differences between the acquirer and the company.
2. Understand the company's fundamental strategic direction and determine how it's internally described and discussed.
3. Understand the key business drivers or key success factors and how progress and success are measured and communicated.
4. Understand how the company is organized and the nature of reporting relationships, interfaces and relationships between line and staff organizations.
5. Understand formal and informal work practices, including levels of formality and flexibility.
6. Understand where the company fits on the continuum of entrepreneurial to bureaucratic cultures.

7. Understand the company's performance orientation (does it promote, endorse and reward high collective and individual performance?)
8. Understand how customer-centric the company is (how much time do executives spend with customers? How prevalent are discussions about customer service and satisfaction?)
9. Understand the leadership model, including how decisions are made and communicated and what behaviours are encouraged or discouraged.
10. Understand supervisory practices (how do employees and immediate supervisors interact, what are the levels of authority and accountability, and how is performance measured and communicated?)
11. Understand how technology is used.
12. Understand the physical environment and workplace settings (for example, open workspaces versus private offices, types of buildings, furniture, grounds, etc.)
13. Understand employee perceptions, expectations and values (what do employees think is important? How would they describe what it's like to work for the company?)
14. Understand other cultural indicators, such as dress code, work hours, sponsored activities and town hall practices.

Employee Compensation and Benefits

1. Review all employee benefits and holiday, vacation, and sick leave policies.
2. Analyse all benefit packages available to employees, including length of time before receiving benefits.
3. Review all stock option and stock purchase plans and a schedule of grants under them.
4. Review base salary, incentive compensation arrangements and benefits for key employees.
5. Obtain a schedule of all loans to any officer, director, employee, or shareholder and copies of all related documents.
6. Understand total employee costs.
7. Understand trends in the major categories of benefits over the last three years.
8. Review any administrative service agreements (or other agreements with benefit plan administrators) related to any benefit plans.
9. Review all severance policies.

Labour Matters

1. Review all collective bargaining agreements.
2. Obtain a description of any labour disputes, requests for arbitration or grievance procedures currently pending or settled in the last three years.
3. Obtain a description of the company's worker's compensation claim history.
4. Review a description of any labour union organizing activity in the last five years.
5. Review all material labour disputes, strikes or work stoppages in the last five years.
6. Review all alleged wrongful termination, harassment, and discrimination claims (including whistleblower alerts) in the past three years.

Pensions and Post-retirement Benefits

1. Review the key terms of all pension plans.
2. Examine financial statements and plan evaluations for the last plan year.
3. Review the most recent actuarial evaluation reports, including underlying assumptions, plan surpluses or deficits and future funding requirements.
4. Understand cost-benefit information for the most recent plan year, including administrative costs, employer and employee contributions and benefit distributions.
5. Review post-retirement plans, liabilities and obligations.

Information Technology

1. Understand the company's technology infrastructure (including servers, networks and data centers), capacity and degree of obsolescence.
2. Understand the applications used to run the company's business and support important internal departments and functions.
3. Identify who is responsible for software and hardware asset management and describe how these assets are managed.
4. Review all key desktop software deployments.
5. Determine what metrics are tracked for internal systems and infrastructure, including stability, ongoing support costs and user satisfaction.
6. Review copies of all IT policies and procedures (development processes, physical and electronic security, back up and recovery, data privacy, trade secret policies, acceptable use policies, regulatory compliance, export control, internal controls, etc.).
7. Understand the structure of the IT organization, including capabilities and costs.
8. Obtain a copy of the company's data privacy policy, including consumer data privacy.

9. Understand the major systems and compatibility with the buyer's systems.
10. Understand future hardware and system upgrade plans and projected costs.
11. Understand all outsourced activities, including contract duration and costs.
12. Review all software licences.

Where to Find More Information

CPA Canada Publications on Governance
(available at www.cpacanada.ca/governance)

The Director Series

The 20 Questions Series

20 Questions Directors Should Ask about Building and Sustaining an Effective Board

20 Questions Directors Should Ask about CEO Succession

20 Questions Directors Should Ask about Codes of Conduct (2nd ed)

20 Questions Directors Should Ask about Crisis Management

20 Questions Directors Should Ask about Crown Corporation Governance

20 Questions Directors Should Ask about Director Compensation

20 Questions Directors Should Ask about Directors' and Officers' Liability Indemnification and Insurance (2nd ed)

20 Questions Directors Should Ask about Executive Compensation (2nd ed)

20 Questions Directors Should Ask about Governance Assessments

20 Questions Directors Should Ask about Governance Committees

20 Questions Directors Should Ask about Insolvency

20 Questions Directors Should Ask about Internal Audit (2nd ed)

20 Questions Directors Should Ask about IT (2nd ed)

20 Questions Directors Should Ask about Responding to Allegations of Corporate Wrongdoing

20 Questions Directors Should Ask about the Role of the Human Resources and Compensation Committee

20 Questions Directors Should Ask about Special Committees (2nd ed)

20 Questions Directors Should Ask about Strategy (3rd ed)

Director Briefings

Board Oversight of Tax Risk—Questions for Directors to Ask

Controlled Companies Briefing—Questions for Directors to Ask

Diversity Briefing—Questions for Directors to Ask

Guidance for Directors: Disclosure and Certification—What's at Stake

Guidance for Managers: Disclosure and Certification—What's at Stake

Shareholder Engagement—Questions for Directors to Ask

Sustainability: Environmental and Social Issues Briefing—Questions for Directors to Ask

Frameworks

A Framework for Board Oversight of Enterprise Risk

CFOs

Deciding to Go Public: What CFOs Need to Know

Other Publications

Reiter, Barry J, *Directors' Duties in Canada*, 5th Edition, CCH Canadian, 2012.

Smith, Kenneth, Reed Lajoux, Alexandra, *The Art of M&A Strategy: A Guide to Building Your Company's Future through Mergers, Acquisitions, and Divestitures*, McGraw Hill, New York, 2012

About the Authors

John E. Caldwell

John Caldwell has extensive executive level and board experience having served as a chief executive officer in three public companies for over eighteen years. Through his career he has also served on a total of thirteen boards of directors.

In 2011, John retired from being President and Chief Executive Officer of SMTC Corporation, an international public electronics manufacturing services company. John was also President and Chief Executive Officer at CAE Inc., the world leader in civil and military flight simulation and training services and Geac Computer Corporation, a leading ERP software company.

Currently, John is a director for Advanced Micro Devices, Inc., a world leader in semiconductors for computing and consumer electronics; Faro Technologies, Inc., the world leader in three-dimensional manufacturing measurement systems; IAMGOLD, a leading mid-tier gold mining company; and Samuel Son & Co Limited, one of the largest North American metal processors and distributors and industrial manufacturers. Currently he serves on three audit committees, chairing two; four corporate governance committees, chairing one; and three compensation committees, chairing one.

John has board and executive level experience in distressed situations having Stelco Inc., Geac Computer Corporation, Mosaic Group and SMTC Corporation providing valuable insight into enterprise risk. Previous boards also include ATI Inc., CAE Inc., Cognos Inc., Parmalat Canada, Rothmans Inc., and Sleeman Breweries.

John also has a background in finance, having served as a Chief Financial Officer of CAE Inc., and Carling O'Keefe Breweries and attained his chartered professional accounting designation with PriceWaterhouseCoopers.

Kenneth W. Smith

Ken Smith, Managing Partner, Dundee Associates Limited, is a strategy consultant and a corporate director.

Ken has practiced as a strategy consultant for over 25 years, beginning with McKinsey & Company and later with SECOR Consulting, Canada's leading strategy boutique, where he was a Managing Partner and Chair of the Board (SECOR has since been acquired by KPMG). His client work and research interests have been focused on growth strategy and M&A in restructuring industries. He has published extensively on strategy, M&A, and industry restructuring, including articles for the Harvard Business Review, the M&A Journal, Business Week, Canadian Business and the general business press. Much of this work is included in his book "The Art of M&A Strategy" with Alexandra Reed Lajoux, McGraw Hill, New York, 2012.

Ken has been active in corporate governance as a director, an advisor to boards and a leader in the governance community. He is a director of ACCERTA, The Arthritis Society, the M&A Leadership Council (US), and a member of the (federal) Steering Committee for Financial Literacy, serving on strategy, HR and governance committees. He is a former director of the Guelph Chamber of Commerce, former director and Chair of SECOR Consulting, and past-Chair of the Ontario Chapter of the Institute of Corporate Directors (ICD). He has been an advisor on matters of strategy and governance to corporate and crown boards. His views on the board's role in strategy were earlier summarized in "20 Questions Directors Should Ask About Strategy," 3rd Edition, a CPA publication. He has also written on governance matters for the ICD and NACD.

Ken holds a B.Sc. in Mathematics from York University, and an M. Sc. and Ph.D. in Mathematics and an MBA from the University of Toronto. He is also a Certified Management Consultant (CMC) and an accredited director with both the Institute of Corporate Directors (Canada) and the American College of Corporate Directors.



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