Cash in transit

WHAT MUST TREASURERS CONSIDER IN THE EVENT OF A COMPANY M&A? PETER CHARLES AND DANNY DAVIS EXPLAIN

Too often in M&A deals, the treasury function is kept at arm's length in the run-up to the deal. This is usually because the small team responsible for completing the deal feels it cannot afford to involve too many people who will each have their own perspective and opinion. In an ideal world, treasury should be brought into a deal as soon as possible to ensure treasury and cash management issues aren't overlooked until disaster strikes. But, in reality, this doesn't happen often enough.

The cash position of an acquired company will depend on the nature of the transaction that has taken place. If a company buys another legal entity, then the acquirer will gain the ownership of all of the assets and liabilities of the acquired company, and that will include cash. How much will depend on the detailed negotiation that took place before the deal was struck.

But if the acquisition is in the form of a carve-out – where a particular part or division of a business is sold – then it is regular practice that the selling company will strip out all of the money. So there will be zero cash for the acquirer on day one. For those charged with the treasury operations relating to an M&A deal, the first job is to understand the nature of the transaction and what that means in terms of the available cash resources.

If the deal is cashless, then the treasurer – or whoever is fulfilling the treasurer role – has to make an attempt to work out how much cash is needed on day one in order to provide short- and medium-term financing. In particular, some thought needs to be given to the detailed issue of how the funding will be handed over. We've seen cases where companies have nearly collapsed because there was no practical way of making payments to creditors and employees on the date they were due.

On the other hand, acquiring companies need to ensure that they don't take unnecessary financial risks by paying large amounts of money over to their newly acquired company only to find the funds are stolen. Such a mistake may not be common when two large companies are involved in a deal, but we've seen it happen. So if you do acquire an owner-managed business and leave the seller or sellers in situ, it is wise to have a pre-deal discussion about how much you actually trust those individuals you're keeping.

Check the chequebook

One way to manage such a risk is to change the bank signing authorities. This may be necessary anyway since it is common on acquisition for senior directors to leave the acquired company on completion of the deal or a short time afterwards. Amid all the practicalities of their departure, it is a good idea to check who the cheque signatories are and the signing limits. The normal practice is to change the individuals who have power to sign the cheques or make other payments, bringing in a suitable member of the finance team from the acquiring side.

In deals we've worked on, we've seen it take a couple of months pre-deal to decide who and how much, but a rapid decision should not be impossible. And while the risk of fraud needs to be considered, a sensible degree of trust must exist so that people in the acquired company can be left to run the business without needing to refer up the chain for mundane approvals.

Any M&A deal is all-consuming for those closely involved, but for the rest of the business, life carries on and that means the cash keeps flowing both into and out of the coffers. The

core team involved with the deal will expect the treasury experts to get on with that job and only raise queries if there are particular problems.

One of the key drivers of any successful M&A deal is the planning that goes into the deal before it is closed. The more time that is allowed for detailed planning, the better the outcomes, although such a luxury is not always available.

Part of that planning will be a cash flow forecast six to eight weeks before the takeover or merger on the post-cash flow requirement. Treasurers know better than anyone else the difficulties of cash flow forecasting, even for a business in a steady state. Doing a forecast in the middle of an M&A deal is challenging and that is why it is good practice much nearer to the completion of the deal – perhaps as close as three or four days before signing – to ask the FD or the treasurer of the acquired company to look again at the forecast previously submitted to check that nothing material has changed, or whether substantial amending and updating is required.

If the forecast reveals a funding need, then it should be possible to ensure a correct level of funding can be transferred and is available, whatever bank account structure has been agreed, in time for start of business on day one post-merger, so the business can operate. Often that figure will turn out to be inaccurate. Those who work on M&A deals accept that it is a difficult task for even the most competent of FDs or treasurers.

In a deal, the funding work of the treasury department – bank debt, credit facilities and bond instruments – will all be examined as part of the due diligence process, which is carried out by specialists from accountancy firms. Whether such funding options remain in force after the deal is complete, will entirely depend on the financial strength and position of the acquiring company.

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Proceed with caution

But, in a takeover, the acquiring finance team needs to be wary of closing down existing facilities and accounts too quickly. Administrative chaos, accounting errors and a slowdown in cash received from debtors can all occur if the transaction services are streamlined too quickly.

When closing accounts, it is important to establish how many customers and creditors need to be told the bank account details have changed. Treasurers know that any change to a bank account is used by some not to pay, while others blithely carry on paying into the old account no matter how often they are asked to do otherwise. So is it really worth unnecessary effort?

The answer may be 'no', but some reorganisation of banking arrangements is usually inevitable and follows the legal restructuring of the companies involved in the >

PEOPLE AND PROCESSES

- In any M&A deal, the policy and procedures of the companies coming together must be aligned. This covers every aspect of the company from HR through to IT.

- In theory, in every area you could look at the two existing policies and choose to go forward with what looks the best or most appropriate option. Or you could decide that neither option really works and opt for a third way. The reality is, whether it's the best or not, the acquiring company's treasury handbook is the one that wins out.

- Integration processes post-merger will inevitably mean that a new culture and set of rules will emerge about how 'new co' expects accounting and treasury processes to be managed and interpreted.

- Another area where deals create winners and losers is people. The harsh reality is that apart from mega takeovers, there is usually no need for two head office-type finance functions and those involved in integrating the acquired company will immediately seek to take them out. However good a job they have done, that redundancy policy inevitably extends to the treasurer, treasury team and function.

new business. In a large deal, where lawyers are substantially involved in tidying up the new group, finance and treasury must take care to ensure that the banking arrangements reflect the correct, updated legal structures.

Any form of deal will put a spotlight on the acquired company's cash management practices. Companies often have cash pools that have been left to spread far and wide, especially if there is not a treasurer in place to bring them together in a professional manner. And while due diligence should highlight this issue, it is often another item that is not seen as requiring urgent attention pre-deal. While the companies' finance teams will normally have an opportunity to talk to one another, it would be unusual for them to have time pre-deal to discuss detailed issues such as cash management.

The treasury function usually becomes involved with M&A either just before the deal is signed or soon afterwards. And while in large deals treasury departments can establish professional relationships with each other to complete the necessary work, treasurers also know that in many companies, treasury work lands on the desk of the FD. A lack of a treasury function on the other side does not automatically spell disaster, but it does increase the risk of error. In one case we have seen, a deal was meant to close on one day, but – as is not unusual – actually closed two days later. Those closely involved overlooked the fact that the cash flow of the company – which in this case was in administration – fluctuated significantly over the course of the week. This variation hadn't been understood properly, or in enough detail by the acquiring company, and closing the deal when the cash was at a low point meant that the price was significantly, but legitimately, greater than the acquirer had been expecting.

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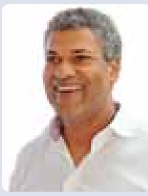
One tool to overcome that problem is to leave the actual level of working capital disposed of/acquired to be finalised some time after the deal has closed in the subsequent completion accounts. Despite the fact that we hear about M&A activity all the time in the media, for many companies – especially smaller ones – an acquisition is something that only happens once or twice in the working lifetime of the directors involved. Due to rarity value alone, the chances of making a mistake are high.

One way to stop misunderstanding is the use of completion accounts. Deals rarely complete neatly on year-end days, but completion accounts are the financial statement drawn up to the date the deal takes place. Although they can be ambiguous, they are the best basis for amending the price and for negotiating net asset and working capital adjustments. In our experience, we have seen various accounting dates – month-end or quarter-end – used as a hook on which to try to ensure a deal is closed. In reality, that is often little more than a negotiating tactic to create some buying urgency, although it does save the finance team the hassle of an extra close.


Peter Charles is turnaround director of Peter Charles. He produces podcasts on a variety of subjects that are available free of charge on iTunes. Email: peter@petercharles.com; web: www.petercharles.com


Danny Davis is programme director M&A for Henley Business School. He is author of *M&A Integration: How to do it – Planning and delivering M&A integration for business success*. Email: danny.davis@ddavisconsulting.com; web: www.ddavisconsulting.com