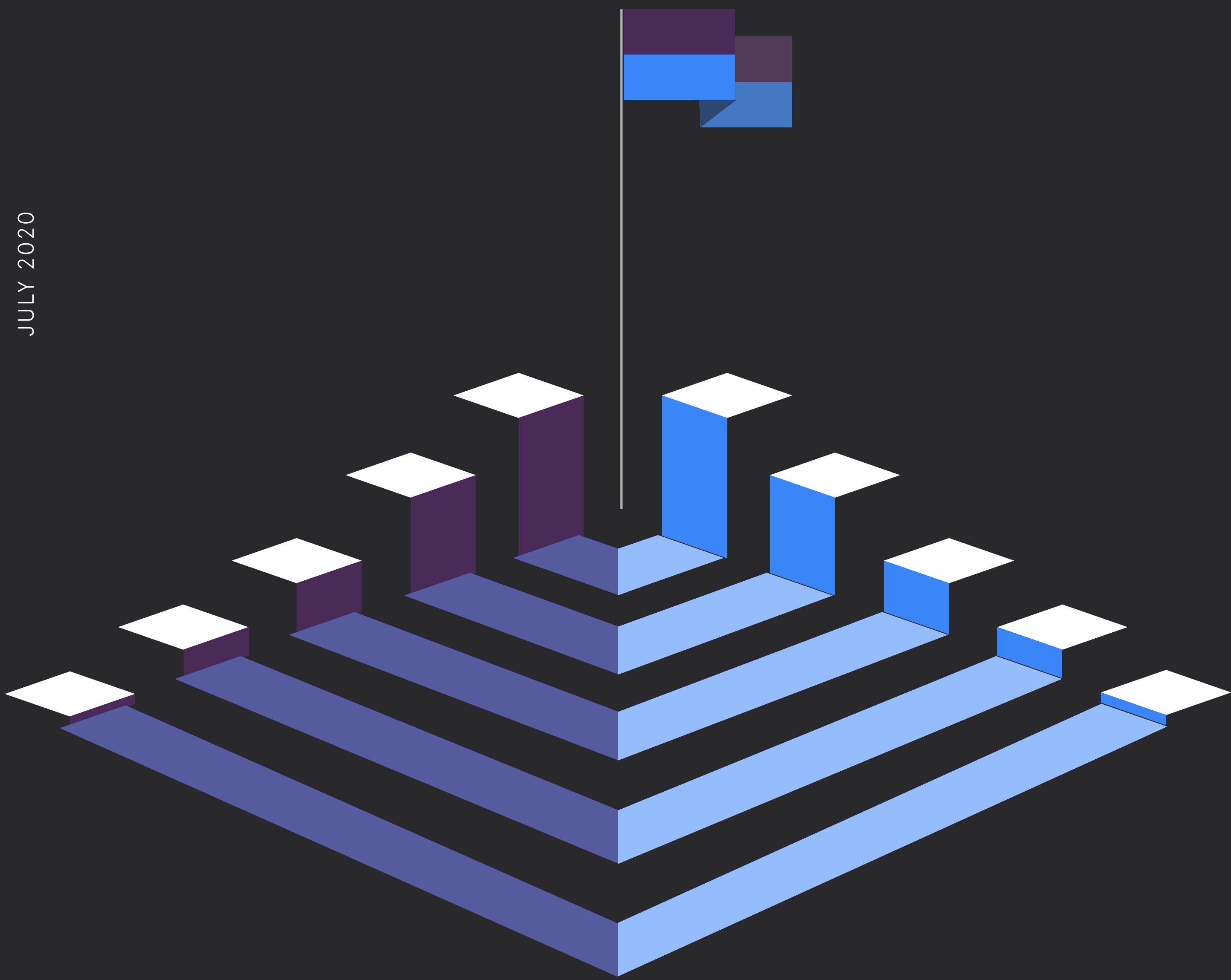
SUCCESS FACTORS FOR INVESTOR RELATIONS IN TAKEOVER SCENARIOS

A Practical Guide for IR Managers



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INTRODUCTION

M&A is a proven growth strategy and an effective method to source innovation. A management team's M&A track record is a critical criterion for investors and media to evaluate its leadership quality. Unsolicited takeover attempts, on the other hand, put management under pressure to preserve the firm's independence, find a "white knight" or negotiate an optimal acquisition price.

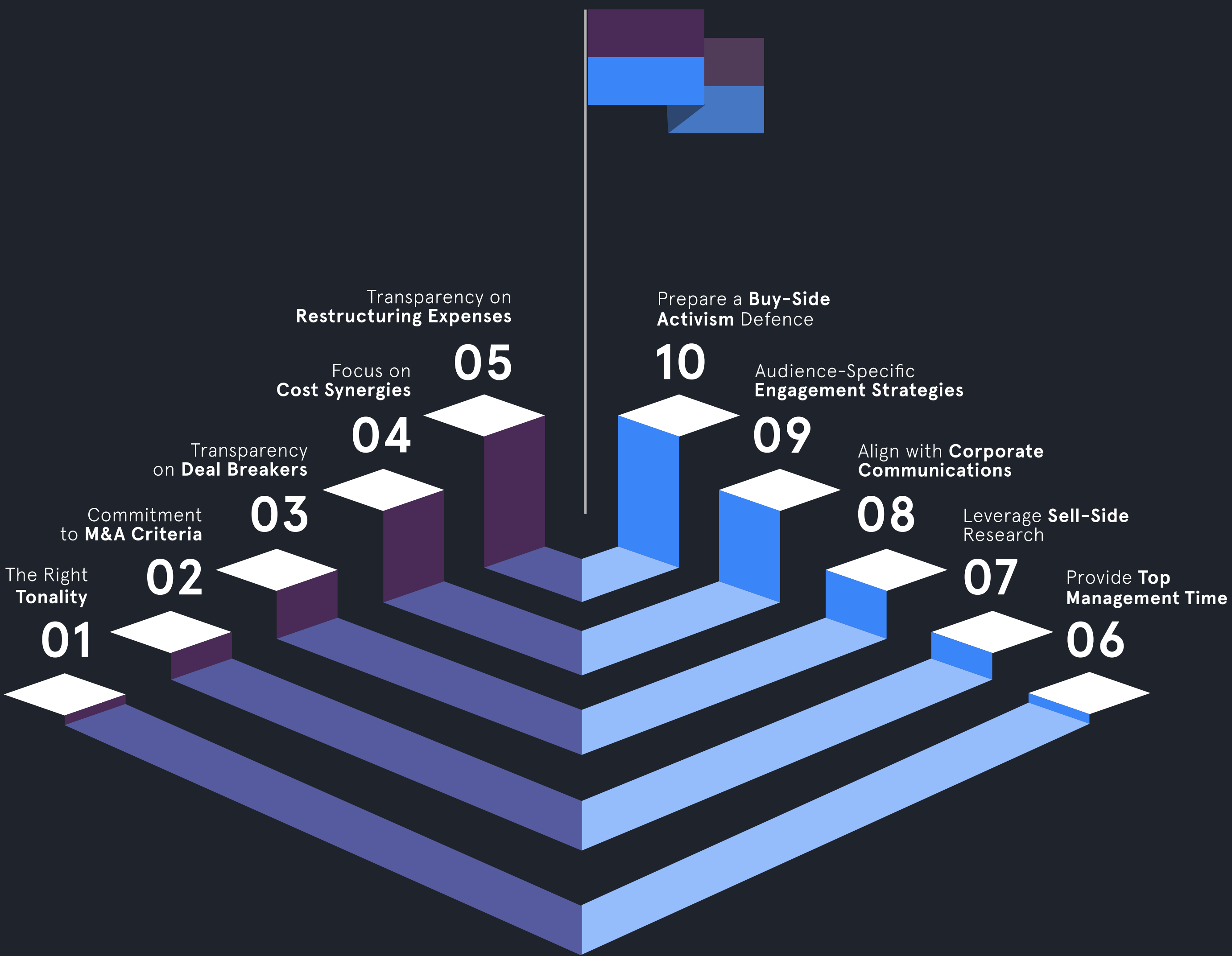
Our experience shows that for listed companies, good Investor Relations ("IR") management is crucial in these scenarios. For one thing, IR is the primary point of contact for shareholders. Their support for top management in takeover scenarios is imperative – regardless whether a jurisdiction requires formal shareholder approval or not. Furthermore, shareholder support is also decisive for the public perception of an M&A project, as the media is always eager to gather fist-hand accounts of investors sentiment. Skillful IR managers know how to use this to their advantage.

All guidelines in this publication share an underlying thread: There are no self-explanatory transactions. Each M&A project has its idiosyncrasies and complexities. These may have become invisible to deal teams that have spent months preparing an announcement. Investors, however, will invariably demand a lot of IR teams during a "deal phase", such as: detailed financials to update models, information on long-term value drivers and milestones, proactive outreach, unrestricted availability, and proximity to top management. On top, IR teams need to consider the perspectives all investors (e.g. bonds, hybrid instruments, retail) – interviewees mentioned that IR departments can be biased towards long-only institutionals. All that shows: You can hardly ever explain too much to your investors.

Methodology

We conducted a series of expert interviews with international long-only investors, hedge fund managers, and IR executives. Combining their insights with our own consulting experience in several hundreds of M&A transactions, we derived a "checklist" of **ten best practice recommendations.** An additional spotlight is dedicated to **defence situations**. This is complemented by **regional spotlights** for Continental Europe, the UK, the US, and East Asia.

TOP-10 BEST PRACTICE TIPS FOR IR MANAGERS IN M&A SITUATIONS



1. **Strike the right chord when discussing the target**

   While IR must of course explain to investors why a target is attractive, IR managers should maintain a healthy dose of conservatism: **Foremost, all communication with markets and media should convey that the buyer is paying an *adequate* price.** You do not want to fuel the target's arguments for demanding a higher premium. At the same time, it is important to bear in mind other important target stakeholders – such as employees. **Over-emphasis on synergies implies to these audiences the threat of job cuts, or facility rationalisation.** Companies that overlook striking the right balance here run the risk of the target company (or elements within it if the transaction is friendly) raising concerns to a local community/government level when faced with the fear of facility closures and job losses. This adds an extra level of communications pressure when working to close a transaction.

2. **State your commitment to acquisition criteria**

   Precise M&A criteria signal a professional, disciplined, and thoughtful approach towards external growth, act as reassurance, and – most importantly – provide ready-to-use arguments in favour of a transaction. They should be in place and communicated long before any takeover announcement, in order to maximize their credibility. Many investors fear that the potential value creation of a takeover will largely go to the target's shareholders – M&A criteria are an effective tool for resolving such fears. Ideally, they are a mix of both quantitative and qualitative factors, such as "EPS accretive", "ROCE above WACC" or "maintain investment grade". Most of the times, investors of companies with clear M&A criteria will be much less surprised by M&A announcements.

3. **Precisely state deal breakers, such as regulatory requirements**

   Communicating clearly on the external circumstances under which management will cease to pursue a deal will reassure investors. Most often, such deal-breakers are regulatory requirements, such as shedding assets to adhere to competition law. This will also signal that you conducted a proper non-financial due diligence.

4. **Focus on cost synergies over revenue synergies**

   Both interviewee feedback and our experience shows that statements on cost synergies have a significantly higher credibility than revenue synergies. We recommend that you mainly build your synergy case around the former. **A main reason for the higher standing of cost synergies is that they are much easier to implement and to predict.**

5. **Establish maximum transparency on restructuring expenses**

   Very cleary state under which accounting rules you are charging restructuring (and integration) costs and when they are expected to be booked and lead to cash outflows. During the course of the transaction, provide regular updates on the development of these costs. Doing so resolves a common fear of investors, namely that a transaction will serve as an excuse for excessive spending, merely disguised as restructuring expenses.

6. **Provide individual investors with top management time**

   Large investors appreciate talking to top management about recent M&A announcements and being able to ask individual questions. This can be a strong signal to investors that they are highly valued stakeholders. **From our experience, The majority of investors states that they preferred talking to the CFO in such situations, closely followed by the CEO.**

7. **Keep close track of sell-side sentiment**

   Sell-side reports can be used as credible third-party sources to support your takeover (or defence) case. That is because sell-side analysts are constantly running through a host of different M&A scenarios. For sufficiently large projects, there is a chance that the transaction (or a comparable scenario) has already been run through by one or more analysts.

8. **Align as closely as possible with corporate communications**

   Ensure that specific deal messages that come from IR are tailored to be understood and accepted by wider stakeholder audiences, such as media, employees or political stakeholders. Vice versa, the market needs to understand why certain topics, e.g. employee or regulatory topics, need to be played publicly. This requires a joint IR and Corporate Communications effort. A message grid that pairs key messages with the firm's stakeholder universe is a convenient means of determining which messages should be adapted to fit different audiences. **IR should always seek to provide communicators with new perspectives that are not yet reflected in media coverage.** Further, IR managers can align with communications and determine which journalists could best be connected to supportive analysts for (background) guidance.

9. **Develop an engagement strategy for different audiences**

   The more "personally" an investor is approached, the more receptive he or she will be. Your messaging strategy should therefore be tailored for different types of investors, including retail/institutional, and long/short term investment perspectives. For distribution, consider the entire spectrum of earned media, owned content, websites, and direct meetings.

10. **Prepare for buy-side activism**

    Buy-side activism has long been a prominent phenomenon in the US and has become a significant factor in Europe and Japan, too. Shareholder activists who claim that a buyer is overpaying or underpaying – depending on their investment position – will try to push for substantial adjustments to the plans, oftentimes with aggressive public campaigns. **This is why large, public M&A projects should always come with a back-up defence plan for buy-side activism. The better an IR department explains a transaction's financial and strategic rationale, the harder it will be for activists to recruit allies for their cause.**

Spotlight:

DEFENCE COMMUNICATIONS

In defence situations, it is the responsibility of IR and communications to work together as closely as possible. Studies have shown that defence teams are most successful when they generate a high degree of media attention and share of voice for their cause. IR takes on a key role in this effort by providing communicators with data that highlights the defender's unique strengths as a stand-alone case.

1. **Do not burn all bridges**

   We identified three core reasons for IR managers to stay moderate when arguing for the rejection of an unsolicited takeover proposal. First, experience shows that a full defence is in certain cases not a realistic option. In such instances, the initial rejection of a takeover plan by management transforms into a mandate to increase the takeover premium and accompanying conditions. Second, management's stance towards an offer can voluntarily change during the process, for example due to concessions made by the bidder. Thirdly, even if a takeover is currently not desired, there might be a compelling strategic rationale at a future point in time. **Thus, while highlighting a strong stand-alone case, IR should never make the unsustainable claim that a transaction is fundamentally value destructive irrespective of current and future developments.**

2. **Encourage your main investors to publicly support your position**

   After having received a hostile takeover offer, IR managers should seek one-on-one talks with as many investors as possible and assess who is willing to publicly support the defence case. In particularly trustful relationships, you can even provide mild encouragement to do so, if need be. Both on- or off-record guidance is useful, while the former is obviously the stronger signal.

3. **Do not shy away from unconventional measures**

   An unconventional, unexpected defence measure can raise the defender's profile and thus increase awareness for his case. For example, a defender can decide to set his own communications agenda with unconventional actions, such as publicly addressing shareholders of the attacking company. **Also – depending on the jurisdiction – digital defence measures have significant potential to improve the reach and reaction time of defence teams.** These measures could be short series of Tweets, video messages or a targeted LinkedIn campaign.

Spotlight:

CONTINENTAL EUROPE

In situations involving targets from Continental Europe, IR needs to pay special attention to the broader stakeholder universe beyond the investment community. **From experience, understanding three stakeholder-related aspects is of particular importance: EU merger control policy, the various forms of corporate governance in Europe, and the high extent of employee interest representation in European firms.** Of course, stakeholder interests have an impact on takeover attempts globally. But it is Europe, where – for political, historical and economic reasons – their influence is largest. In particular, the complex interplay between competition policy, corporate governance and employee representation can be challenging to comprehend for investors unfamiliar with European M&A processes.

Mergers or takeovers exceeding certain turnover thresholds will be subject to a mandatory merger control review by the European Commission. The failed mergers of Deutsche Boerse/LSE or Siemens/Alstom illustrate that even transactions with highly compelling deal rationales can fail due to EU anti-trust concerns – despite explicit backing from two national governments in the latter case. Even if such a worst-case outcome is unlikely – IR professionals engaged in takeovers with EU relevance need to align with public affairs specialists and become capable of explaining to investors how the current political sentiment and may affect a transaction.

Continental Europe has a very diverse corporate governance landscape. For example, the German two-tier board system, with a Supervisory Board halfway composed of employee representatives, and a separate Management Board, is unfamiliar to many foreign investors. **While not all countries in Continental Europe have firms with such a high share of union and works council representatives in their main governance bodies, employee representation and their say on M&A is generally higher than in other regions.** Thus, IR managers must be capable of providing sell- and buy-side analysts with precise information on the implications of different governance systems.

Successful IR managers at an acquiring company excel at explaining to investors how the above-mentioned stakeholder concerns affect the offer, the bidding process as well as everything that comes after a potential signing, such as synergy realization and strategy execution. This requires them to leave their comfort zone and go beyond explaining KPIs and financial benefits of a transaction.

Spotlight:

UNITED KINGDOM

The UK has historically been viewed as a highly attractive and stable destination for investor capital, underpinned by strong financial governance, a mature legal framework and not least for its ease of access to the single market and the EU workforce. While M&A activity has proven resilient over the last year, with the total value of such deals rising almost £15bn despite ongoing political and economic headwinds, 2020 and 2021 remain years of change and challenges given ongoing negotiations with the EU and current market volatility. **IR executives should therefore be mindful that confidence in the market, or specific sectors could change further resulting in deeper scrutiny from investors on company financials, valuation, and strategic ambitions before they show support for a proposed transaction.**

While it's not always possible or indeed sensible to provide all financial data sought by investors, IR managers should draft robust, comprehensive and consistent multi-channel communications materials for M&A transactions including presentations, press releases infographics, and even videos, made easily accessible on the website or microsite. **The UK has an extremely large and sophisticated landscape of institutional investors and sell-side analysts, who will be very appreciative of such high-quality information.**

They should provide as much clarity around capital allocation as possible, a key priority for investors. This means starting early, liaising closely with all working parties throughout the process to ensure a cohesive working vision. The FTSE 100 Phoenix Group's IR materials on its December 2019 acquisition of ReAssure were widely commended for clearly setting out the strategic rationale and potential challenges in transaction documents, and helped build investor support for the transaction.

Further in terms of takeover defence situations, the UK Takeover Panel now expects parties to disclose significantly more information focusing on the outlook and future of their business than previously. While adhering to these additional requirements, IR managers must be mindful when speechwriting for management that any numbers stated will be seen as a commitment and failure to fulfill these will negatively impact investor trust and wider corporate reputation.

NO M&A TRANSACTION IS SELF EXPLANATORY – IR PLAYS A CRITICAL ROLE IN SHAPING THE NARRATIVE FOR *ALL* STAKEHOLDERS.

Spotlight:

UNITED STATES

In 2019, there were a record number of activist campaigns with an M&A-related thesis, according to Lazard's Shareholder Advisory Group 2019 Review of Shareholder Activism. Of these campaigns, activist efforts typically break into three categories: those agitating for the sale of the target and/or encouraging industry consolidation; those agitating for a divestiture of a non-core business line and/or for a company breakup; and those looking to enter into a live M&A situation to improve deal terms and/or block an ill-perceived deal from proceeding.

With M&A-related activism on the rise, it has never been more important for companies to communicate a coherent capital allocation strategy ahead of pursuing a transaction.

Specifically as it relates to buy-side activist situations that arise from buy-side shareholder votes on deals, making your priorities for value creation clear across all investor communications at the onset will help ensure that investors recognize alignment between your strategy and a transaction, enhancing the prospects of securing investor approval. **The "buy-side" situations show there is real money to be made just by making noise. The activist's argument, apart from price, are purely about whether or not the buyer understands what it's buying and the associated risks.**

Creating a strong platform from which to describe a carefully crafted and concise strategic and financial rationale in buy-side situations has proven to be key in defending the transaction in question. You cannot assume management will get the benefit of the doubt. Get on front foot in describing your due diligence, particularly where the target is a distressed asset or if in an industry with perceived regulatory or competitive risks. It's also important to note that ISS and Glass Lewis still hold significant influence in driving voting outcomes and setting the media narrative, and have proven to serve as the "knockout blow" to activists contesting a transaction – no matter how the deal is contested.

Spotlight:

ASIA

Volumes of China outbound M&A have dramatically plunged since record deal year 2016. Those acquirers who are still active are well-aware of the transaction risks and have a key interest in navigating them. A more professional approach to addressing all stakeholder groups, including reaching out and establishing relationships to investors is one of them. **However, by Western standards, the Investor Relations profession is still rather new to China and the regulatory environment and reporting standards are less stringent. At the same time, Chinese IR professionals have leapfrogged their global peers when it comes to using digital and mobile tools.** Key to successfully managing investor relations and therefore, getting deals done, still is to overcome language barriers, educating investors on the long-term story (particularly retail who can create stock volatility) and take a lasting approach to building contacts.

Japan has its own microcosm of IR professionals, with large well-known Japanese companies touting their plethora of domestic awards for annual reports and investor communications. However, this offers a false sense of security as IR in Japan is largely based on rigidly following the disclosure guidelines of the Japanese exchanges and issuing announcements in the according standard format templates. Little consideration is given to the "why" for an announcement – something crucial in a transaction when persuading shareholders of the value. Moreover, many Japanese have international shareholders, with larger companies often seeing international interest comprising upwards of one third of their shareholder base – a crucial threshold when transactions often require two thirds shareholder approval. Few Japanese companies take the time to prepare clear communications in English, often opting for direct translations of Japanese materials making it difficult for global investors to get the information they need to make a decision. Building a comprehensive equity story is often secondary to a transactional IR approach of passively answering investor questions.

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