MERGERS & ACQUISITIONS

Willis

# THE WILLIS INDEX

The Newsletter of the Willis Global M&A Practice | www.willis.com | Q4 2008

# ADDING VALUE THROUGHOUT THE CYCLE

## There is little doubt that we are experiencing one of the worst financial crises of the last 100 years.

As a result we have seen the volume of private equity transactions decline significantly in almost all the territories in which we operate, although this has been partially offset by an increase in corporate engagements.

This pattern correlates on the one hand with a greater proportion of private equity professionals working in more detail with their portfolio companies, presenting opportunities for us to work with them in a less time pressured environment to generate real value through insurance products and initiatives. On the other hand we are seeing buyers who are able to progress with transactions (largely but not exclusively strategic corporates) becoming ever more risk averse. This is fuelling a significant increase in enquiry levels for transactional insurance solutions in general, and contingent liability policies in particular. This increase is combined with a period of real increased competition in this niche area of insurance which has driven down premium rates by up to 75% from prior years as new arrivals in the underwriting space seek to make their mark. The shadow that has passed over AIG in recent weeks is, for a number of reasons, of less concern than it may have been previously when they were the dominant player in this space; we are now able to help clients access Zurich, Ambridge, Chubb, AWAC and ACE as well as AIG as lead insurers.

**Away from the more esoteric areas of our work, we continue to work intensively with our clients on driving value into operating companies.**

Of particular note is that even where the purchaser is comfortable with certain contingent transactional exposures, the financing banks (where available) are regularly seeking to impose conditionality on their lending which requires secured recourse against the risk that such contingent exposures crystallised. The insurance contracts we are able to arrange can provide this recourse and in certain situations are also able to provide capital adequacy relief.

## Can insurance balance sheets help to fill some of the gap left by the contraction of the debt markets?

In addition we have been working with insurers to develop product offerings which can assist with financing structures. These include Trade Finance insurance which can enhance the management and quality of trade receivables so that when receivables financing is investigated it is potentially possible to secure a lower cost of capital from banks and a greater level of finance through an increase in qualifying receivables. In addition we have been working with a number of buyers to incorporate insurer provided surety into financing structures. This replaces the need to secure additional capital (usually through a revolving credit facility) for issues such as advance payment guarantees (very common in Germany). Finally, we are also working to refine a product that has been available for some time; Deferred Consideration Insurance, which provides default protection on the deferred element of any purchase price. In the current environment all of these ideas can assist purchasers and indeed refinancing processes by allowing more efficient structuring of financing packages.

Away from the more esoteric areas of our work, we continue to work intensively with our clients on driving value into operating companies. Leveraging bulk buying opportunities remains a priority but we are also looking to be more creative in areas such as affinity products. This includes the identification of portfolio companies of our PE fund clients which we believe could support and financially benefit from a structured approach to affinity insurance products. We explore this area in more detail within this issue.

It is also worth raising a red flag which we believe our clients should be beginning to consider. We are rapidly approaching a period of hardening insurance rates and pricing. This will have a direct impact on the profitability on portfolio companies and other operating entities. It is difficult to predict when the market will start to turn but we believe that it is important to do everything possible to take advantage of the end of the current 'soft' cycle to ensure that you are starting from the lowest possible pricing point (not to mention widest possible coverage point) when the market does make that move.

Finally we are delighted to include within this issue a summary of the Willis employee benefits capabilities. Now that we are fully resourced and regulated we are increasingly working with our clients on the Employee Benefits aspects of their M&A deals and would be delighted to discuss this further with you.

**We are rapidly approaching a period of hardening insurance rates and pricing. This will have a direct impact on the profitability on portfolio companies and other operating entities.**

Alistair Lester
International Practice Leader
Mergers & Acquisitions Practice

# PORTFOLIO FOCUS: CREATING VALUE THROUGH AFFINITY SCHEMES

- Increase Market Share
- Additional Revenue Generation
- Increase Profit Margins
- Create Competitive Advantage
- Add Value to Client
- Improving Customer Retention

The above represent some of the benefits derived by organisations which have sponsored the development and roll out of branded insurance affinity schemes for the benefit of their customers whether they are individuals or SME businesses.

Types of business/industry sectors that lend themselves to the adoption of affinity schemes include:

- Automotive
- Utilities
- Communications
- Transportation/travel
- Agricultural manufacturers
- Financial services
- Electrical
- Retail
- IT

In 2005 affinity schemes sponsored by U.K. financial service companies, retailers and utilities secured an 8% market share of the U.K. general insurance business, which had a premium spend of £32.2 billion. This represented an eight-fold increase from 2000. In 2006, the additional profit contribution that the financial services products offered by one of the U.K.'s largest retailers, generated approximately £60 million.

The U.K. insurance affinity scheme market, along with the U.S.A., is one of the most advanced, with the rest of Western Europe developing quickly. Obvious candidates for this type of product approach are the emerging markets, in particular Eastern Europe, Russia, South Africa, India and China.

The most prominent insurance products include:

- Household
- Motor
- Travel
- Personal Accident/ Sickness
- Health/Life
- Creditor
- GAP
- Extended Warranty
- Payment Protection
- Pet

The Willis team reviews existing affinity schemes, often redesigning and re-launching them, as well as exploring the possibilities for new affinity schemes. The team will analyse your business and your customer base, and identify and recommend advice, the best product and support service to deliver a comprehensive range of customer insurance schemes for your organisation.

Our full consultancy support includes all elements of the process, from market research to ongoing account management, following the initial roll out of the scheme. Sophisticated modelling tools have been developed to assess viability and projected revenues. The areas addressed include:

- Market Research
- Programme Design
- Market Presentation / Broking
- Implementation & Launch
- Training & Sales Support
- Ongoing Account Management

The most successful affinity schemes are those where the products are simple to understand, homogeneous, culturally relevant and can be sold on a wholesale basis in high volumes, therefore becoming low touch and low cost to the sponsoring company.

## MEET THE TEAM

Nicola Ronconi joined Willis M&A in June 2007 and has over seven years of experience in this field. In his role as Project Director he is involved in managing relationships with U.K. and Italian-based Private Equity firms and in leading insurance Due Diligence projects from the London Office.

In addition to this, he is engaged in developing our focus on alternative insurance solutions such as surety products to enhance financing structures. In the past months Nicola has successfully assisted Willis clients in a number of significant transactions across Europe.

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This article discusses specifically Affinity schemes that are aimed at the corporate's client base. It should be noted that such schemes can also be created for the benefit of employees as an additional employee benefit.

Significant renewable revenue can be generated, as detailed below:

| Example Retailer Household Proposition - 4 Year Business Plan | Year ended - 30 April £'s | | | | | |
|---|---|---|---|---|---|---|
| | Year 1 2007 | Year 2 2008 | Year 3 2009 | Year 4 2010 | | |
| **Brokerage** | | | | | | |
| Basic | 250,576 | 509,103 | 736,666 | 980,793 | | |
| Standard | 139,209 | 282,835 | 409,259 | 544,885 | | |
| Legal expenses | 48,297 | 65,418 | 141,988 | 189,042 | | |
| Home emergency product | 17,709 | 23,986 | 52,061 | 69,314 | | |
| | 455,791 | 881,342 | 1,339,973 | 1,784,035 | | |
| **Profit commission** | | | | | | |
| Basic | 0 | 0 | 162,517 | 330,190 | 716,670 | 1,017,783 |
| Standard | 0 | 0 | 51,507 | 104,649 | 227,139 | 322,572 |
| | 0 | 0 | 214,024 | 434,839 | 943,809 | 1,340,355 |
| **Total Revenue** | 455,791 | 881,342 | 1,553,997 | 2,218,873 | 943,809 | 1,340,355 |
| | 1,337,133 | 2,891,131 | 5,110,004 | 6,053,813 | 7,394,168 | |

# CLEARANCE FOR M&A?

**The emergence of deficits in Defined Benefit pension arrangements in the U.K. has focused the Pension Regulators attention on corporate transactions. The ability of the Pensions Regulator to impose costs on an employer has implications for all M&A deals.**

**Any event that may affect the ability or willingness of an employer to continue to meet its financial commitments to its scheme can be a 'trigger'.**

The Pensions Act 2004 introduced 'Clearance' procedures for employers and trustees allowing either one or both parties to seek the agreement of the Regulator that specific corporate transactions, which might affect the financing of the pension scheme would be allowed without triggering additional payments into the scheme.

The Pensions Regulator specified a number of events that triggered formal Clearance processes but it has stressed that the list is not exhaustive. Any event that may affect the ability or willingness of an employer to continue to meet its financial commitments to its scheme can be a 'trigger'.

Employers and trustees can approach the Regulator for clearance for any financial transaction even if they are uncertain as to whether it is a specified event.

The Pensions Regulator has the power to instruct immediate payment from an Employer to a scheme in the form of a 'Contribution Notice' or require a longer term funding plan to be put in place by way of a 'Financial Support Direction'. It has the power to examine company structures to obtain payment from any company within a group that it believes has the responsibility for the financing, whether or not they are participating members in the pension scheme.

The Pension Regulator's reach extends beyond the borders of the U.K. 'Contribution Notices' and 'Financial Support Directions' can be imposed throughout the European Union and in other jurisdictions such as Bermuda as highlighted by the ongoing case of Sea Containers plc.

## WHAT ARE THE EVENTS?

### There are two types of 'events' - Employer events and Trustee events.

Trustee events are always subject to clearance and include:
- The 'compromise' of a debt
- The 'apportionment' of liabilities between participating employers
- Any event that seeks to avoid a statutory debt

Employer events are only subject to clearance if the pension scheme is in deficit. These can include:

- Changes to the level of security for creditors
- A return of capital via additional dividend payments, share buy-backs or demergers
- A change in control structure of the employer, e.g. the switch of all employment contracts to a service company that doesn't participate in the scheme
- Inter-company transactions not at 'arms length' or on commercial terms
- The closure or winding up of a participating company
- Sales, mergers or acquisitions associated with the business

The Regulator is concerned with the financial strength, long term prospects and cash flow of the employer post-deal. It is also concerned to ensure that a scheme does not become a 'claim' on the Pension Protection Fund and it will take all necessary steps to ensure that the scheme's finances are not adversely affected by corporate activity.

Not all companies or pension scheme trustees are fully aware of their responsibilities and this is an area where we at Willis can add value for our clients by leading them through these potentially difficult areas.

## WHEN SHOULD CLEARANCE BE SOUGHT?

Clearance should be considered as a part of the 'Due Diligence' process at the outset of any transaction. Failure to consider this could lead to a deal being jeopardised further down the line.

Employers or purchasers should agree the issues and the approach to Clearance with the scheme trustees at outset. Employers or purchasers need to be aware of the trustees' powers under the Pensions Act 2004 to obtain an actuarial valuation of the scheme at any time in light of changes to the employer's covenant and the implications that this can have on the employer's future cash flow from increased, unbudgeted costs.

## TUPE

A key issue for all Mergers and Acquisitions is the impact of the Transfer of Undertakings (Protection of Employment) Regulations 2006 (known as the TUPE regulations). This consolidated a number of previous TUPE regulations and the requirements of the Pensions Act 2004 which, for the first time, brought pensions within the remit of this legislation. This can now have a direct bearing on mergers and acquisitions.

TUPE protects the contractual rights of employees in the U.K. where all or a part of a business is sold. It also applies where an organised group of people, i.e. the employees and assets known as a stable 'economic entity' are transferred to a new business and retains their own identity.

Where the transferring scheme is an occupational pension scheme, i.e. trust based, the TUPE regulations apply in the following way.

- The accrued rights will usually remain with the previous arrangement unless a specific agreement to bring these across has been negotiated.
- There are no requirements to set up 'mirror' arrangements replicating the former scheme.
- A defined benefit scheme may be set up provided that it meets statutory contracting-out requirements, provides a pension at least equal in value to a 6% employee contribution for each year of service and provides for the employer to match the employees contributions up to 6%.
- Or, a defined contribution arrangement can be established, which can be a Stakeholder scheme where the employer makes 'relevant contributions'. These are employer contributions that match the employee contributions up to a maximum of 6%.

Life Assurance, long-term disability insurance, critical illness, personal accident and private medical insurance all have their own issues within the Mergers and Acquisitions world.

A number of these are directly covered by the employees' contracts of employment and need to be replicated, whereas some others may be varied.

## OUR VIEW

It is essential that the benefits programme is identified and quantified financially as early as possible in any M&A situation. Overseas businesses need to be aware of the 'reach' of the U.K.'s Pensions Regulator.

The financial consequences of withdrawing employers from trust based schemes are not always transparent and the very act of withdrawal can trigger significant costs by crystallising some of or all of a pension scheme deficit.

Individual members' benefits need to be identified to ensure that there are no tax consequences for a member following completion of the deal.

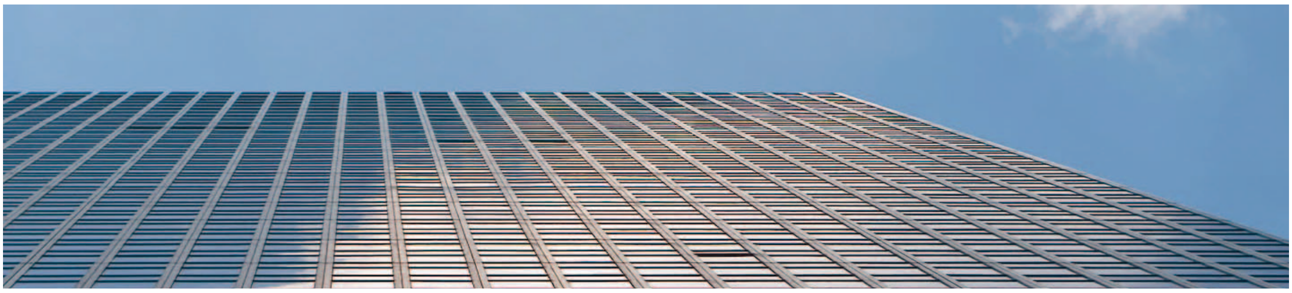
A full benefits audit is a crucial part of the Due Diligence process for both the companies involved in the transaction and their relevant trustees.

**It is essential that the benefits programme is identified and quantified financially as early as possible in any M&A situation.**

# AIG:LATEST UPDATE

No Market Conditions report this quarter would be complete without mention of AIG. If the U.S. Federal Reserve had not reached agreement to support AIG, the rating agencies may have reduced AIG's financial strength ratings and outlook to the extent that AIG could have ceased to be a Willis-approved insurer. Removing one of the leading underwriters of financial lines policies would have impacted on the insurance market by reducing capacity and driving a significant increase in pricing.

Willis Market Security produced a series of Special Report Market Updates on the AIG situation throughout mid September. If you have not already seen the latest version and have an interest in understanding the current position, please speak to your usual Willis contact for more information. Willis Market Security continues to monitor closely the position of AIG group and its core insurance operating entities. The insurer financial strength ratings of these core entities remain rated above our minimum rating guidelines from all the major rating agencies.



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Willis Mergers & Acquisitions Practice performed the insurance due diligence on the

Acquisition of

W.I.S. Wir verbinden Menschen und Technik

by

argantis

and

MEZZANINE

as junior capital partner

April 2008
This announcement appears as a matter of record only

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Willis Mergers & Acquisitions Practice performed the insurance due diligence on the

Acquisition of

CINTERION WIRELESS MODULES

formerly known as "Siemens Wireless Modules"

by
a consortium led by

GranvilleBaird

April 2008
This announcement appears as a matter of record only

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Willis Mergers & Acquisitions Practice performed the insurance due diligence on the

€867m
Acquisition of a 25% stake in

CLH

arranged by

Deutsche Bank

May 2008
This announcement appears as a matter of record only

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Willis Mergers & Acquisitions Practice performed the insurance due diligence on the

Acquisition of

JOST

by

Cinven

May 2008
This announcement appears as a matter of record only

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Willis Mergers & Acquisitions Practice performed the insurance due diligence on the

Management Buy-Out of

KADI Swiss Premium Quality

by Equity Funds managed by

ECM Equity Capital Management GmbH

June 2008
This announcement appears as a matter of record only

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Willis Mergers & Acquisitions Practice performed the insurance due diligence on the

Investment in

Strauss INNOVATION

by

EQT

Opportunity Fund

June 2008
This announcement appears as a matter of record only

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Willis Mergers & Acquisitions Practice performed the insurance due diligence on the

£3.6bn
Acquisition of

angel Trains

by

Babcock & Brown European Infrastructure
Babcock & Brown Public Partnerships
AMP capital investors
Deutsche Bank
PSP Investments
AccessCapitalAdvisers

June 2008
This announcement appears as a matter of record only

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Willis Mergers & Acquisitions Practice performed the insurance due diligence on the

SEK 1,840m (£153m)
direct and indirect Investment in

VE Commercial Vehicles Ltd,

The Indian joint venture company with Eicher Motors

by

VOLVO

July 2008
This announcement appears as a matter of record only

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Willis Mergers & Acquisitions Practice performed the insurance due diligence on the

Investment in

MICROTECNICA

by

STIRLING SQUARE CAPITAL PARTNERS

July 2008
This announcement appears as a matter of record only

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Willis Mergers & Acquisitions Practice performed the insurance due diligence on the

$360m
Acquisition of

NORD ANGLIA EDUCATION PLC

by

August 2008
This announcement appears as a matter of record only

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Willis Mergers & Acquisitions Practice performed the insurance due diligence on the

Acquisition of

WARWICK

Warwick International

by

Close Brothers Private Equity

August 2008
This announcement appears as a matter of record only

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Willis Mergers & Acquisitions Practice performed the insurance due diligence on the

Acquisition of

General Flying Services Pty Ltd

to

Oxford aviation academy

A portfolio company of Star Capital

STAR Capital Partners

September 2008
This announcement appears as a matter of record only

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Willis Mergers & Acquisitions Practice performed the insurance due diligence on the

Acquisition of

Ad van Geloven

by

LION CAPITAL

September 2008
This announcement appears as a matter of record only

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Willis Mergers & Acquisitions Practice performed the insurance due diligence on the

Acquisition of a 45% stake in

KEF Holding

by

DUBAI INTERNATIONAL CAPITAL
A member of DUBAI HOLDING

September 2008
This announcement appears as a matter of record only

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Willis Mergers & Acquisitions Practice performed the insurance due diligence on the

£37m
Acquisition of

Accura

by

AUGUST equity

September 2008
This announcement appears as a matter of record only

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Willis Mergers & Acquisitions Practice performed the insurance due diligence on the

€90m
Management Buy-Out of

NOONAN SERVICES GROUP

by

ALCHEMY

A newco backed by the Alchemy Investment Plan

September 2008
This announcement appears as a matter of record only

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