STIMULATING CORPORATE GROWTH THROUGH MERGERS & ACQUISITIONS

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Some Home Truths

SEC Recapitalisation Deadline

- It is unlikely that the SEC recapitlisation deadline or amounts, will change
- The increasing cost of regulation and new operator standards set by the SEC and NSE require better capitalised market participants
- The revenue and profit pool currently available on the NSE does not support up to 300 brokers
- Additionally, regulating and supervising so many market participants is in itself challenging
- However, it is not possible for anyone to legislate that they would wish to see 30 or 50 brokers
- The market opportunity, market forces, natural or forced consolidation ultimately will determine the eventual number of market participants
- Demutualisation of the NSE represents the unlocking of the value in a Dealing member's seat on the NSE
- The delay in the NSE demutualisation may mean that this value may not be realizable before the deadline
- It is therefore imperative that the NSE and the broker community, immediately agree a register closure sometime in the next few months, in order to ensure that whatever happens, the owners of the NSE that will be demutualized are already known
- There will be fewer but better capacitated brokers in future years

Mergers & Acquisitions: An Introduction

Rationale behind M&A

- Growth drives value for companies across all industries, with mergers and acquisitions ("M&A") being a major strategy for growth
- It is widely believed that M&A is a strategic solution to financial distress in corporate bodies
- With lack of market transparency, investment decisions are made and merger strategies developed with a degree of uncertainty, leading to growth investments falling short
- Success of M&A largely depends on the following

Key Considerations

Does someone else have a capability that would enhance your business?	Is the ROI higher to buy it than develop it internally?	Can you articulate a parenting advantage?

If yes, then M&A

Organic vs Inorganic growth

Is M&A a good way to grow?

- M&A has had mixed successes, with many of M&As in developed markets turning out to be value destructive post-transaction

- There are a variety of reasons why not all M&A globally works, but those are largely irrelevant in a fast growing frontier market

- **In Nigeria, however, M&As have largely been value accretive**

- The acquisition of a Nigerian entity is the preferred way for foreign investors to gain entry into the Nigerian market

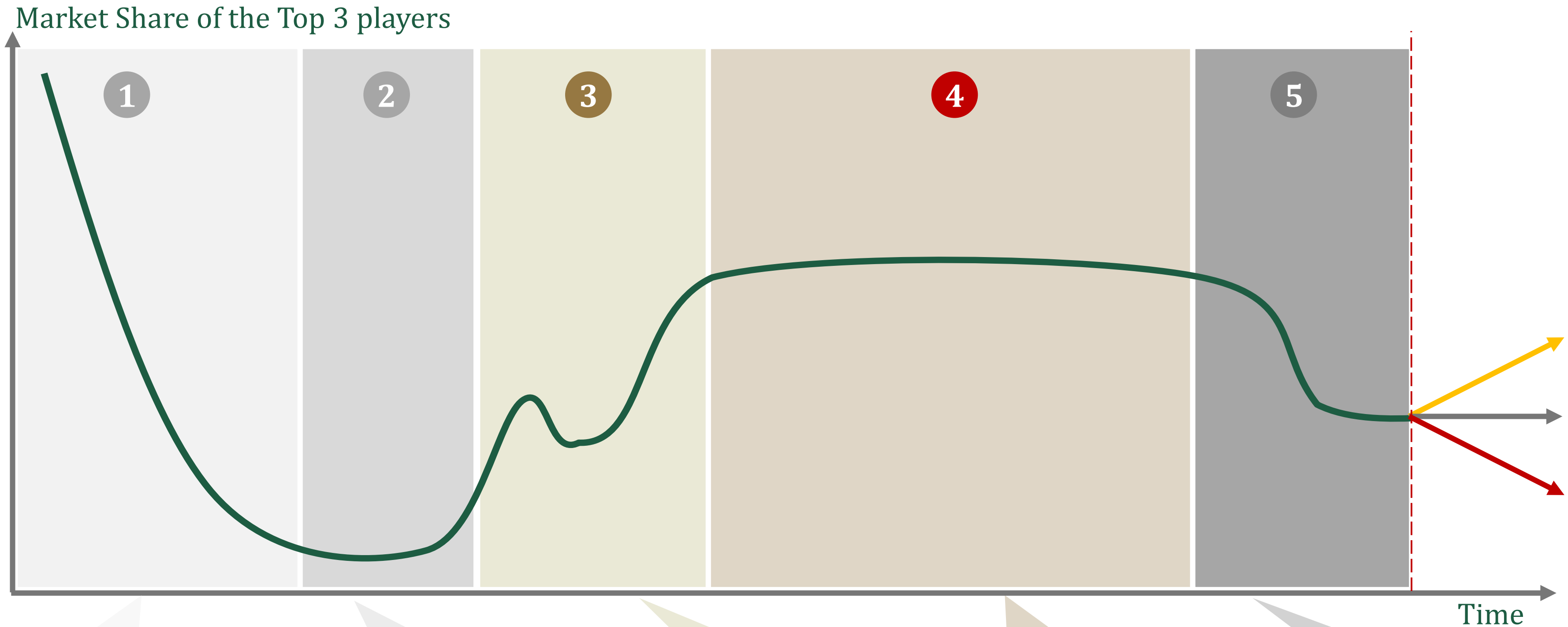
- An acquisition provides access to existing structures, with permits and assets in place (e.g. Tiger Brands acquired from UACN and Dangote Flour, Bharti Airtel acquired Zain, Old Mutual acquiring Oceanic Insurance assets)

- M&A could lead to an increase in market share by buying out smaller rivals (e.g. Dangote Cement acquired Benue Cement, Custodian merged with Crusader, Lafarge Wapco acquired a number of Cement assets in Nigeria and South Africa)

- M&A can be a way of avoiding being pushed out of the market (e.g. banking consolidation in 2004 -2005, e.g. Capital International and Marina Bank doing a deal with Access Bank to ensure sustainability)

Consolidation Cycle

Is now the time?



Opening 1

New, profitable business opportunity emerges, **encouraging market entry**

Plateau 2

Many players jostling for market share and dominance, with **no justification for consolidation**

Concentration 3

International expansion and economies of **scale** drive consolidation

Dominance 4

Limited or no consolidation, as top 3 players ("T3") dominate

Reopening 5

Market share of T3 players declines due to new product innovations and technology, entry of foreign players

SEC Recapitalisation Drive

Capital Requirement for CMOs

- Capital market operators ("CMOs") such as the Broker/Dealer, Trustees, Ratings Agencies and Fund/Portfolio Managers will be the most affected by the new capital requirements.
- Most CMOs will need to meet up to capital requirements before the end of 2014, failing which they might lose their license.
- As such, CMOs may decide to raise capital or merge with their peers.

Capital Market Operator	Old Minimum Capital Requirement (M'N)	New Minimum Capital Requirement (M'N)
Broker /dealer	70	300
Broker	40	200
Dealer	30	100
Issuing House	150	200
Underwriter	100	200
Registrar	50	150
Trustees	40	300
Rating Agency	20	150
Corp. Adviser	5	5
Indv. Adviser	0.5	2
Fund manager	20	150

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Mergers & Acquisitions

Viable Options Available to CMOs: Largely two options

Raise Capital

Sell Capital Raising Story to Investors

- Capital markets operator's equity story is not compelling
- Return on capital not robust ...
- Shrinking margins ...
- Cost of capital higher than return, so...
- ...must have existing deep-pocketed shareholders commited to the success of the firm

Mergers & Acquisitions

Creating a situation where 1 + 1 = 3

- Potential synergies are appealing
- Identify potential partners complimentary to your existing business (e.g. customer base, skill set, geographical location...)
- Must think carefully about structure of the transaction
- A faster way to grow capital base without the need for additional capital

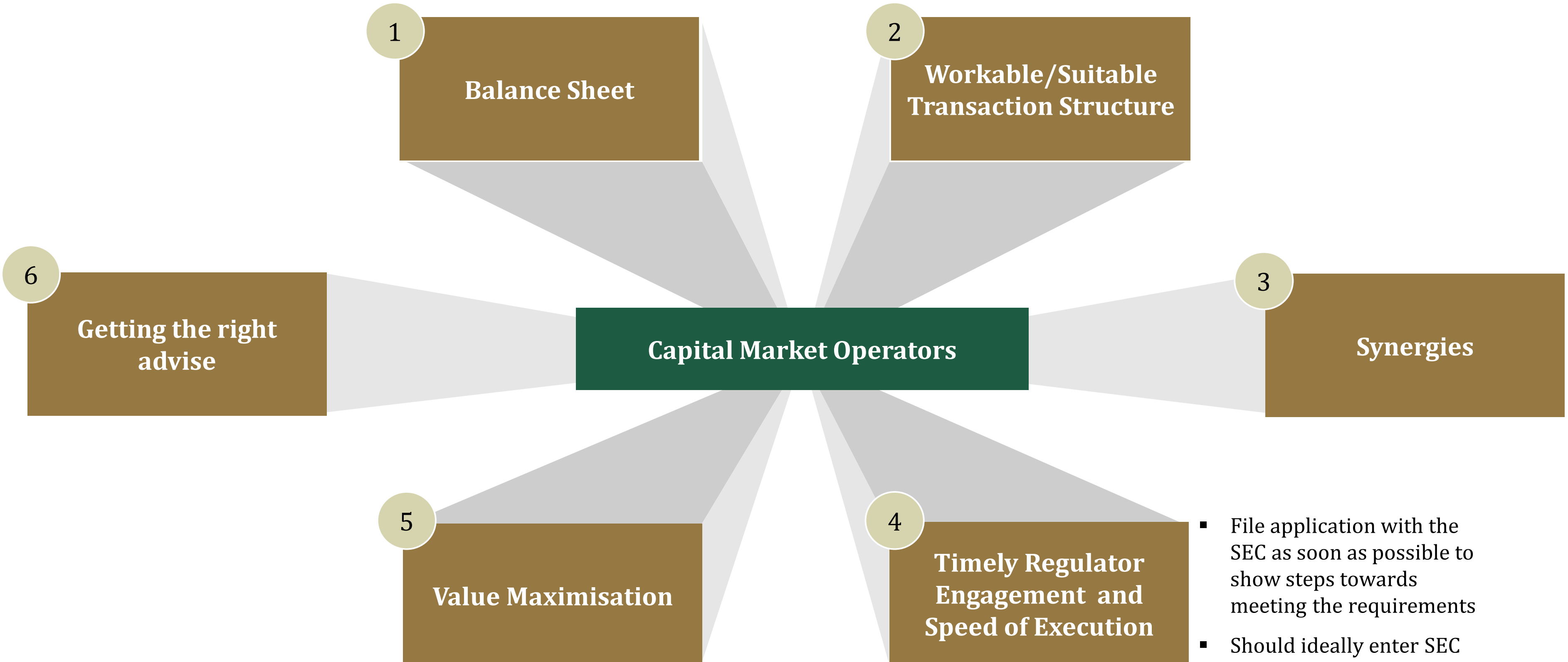
Mergers & Acquisitions

Process Structuring Considerations

	Mergers	Acquisitions
Description	■ Corporate action involving the consolidation of two companies ■ Emergence of one enlarged entity worth more than the sum of its parts	■ The purchase of one company by another in which no new company is formed ■ Target still exists as an independent legal entity controlled by the acquirer
Main Benefits	✓ Cost savings as a result of economies of scale; hence, improved profits ✓ Enhanced shareholder value for both shareholder groups ✓ Improved market reach and industry viability ✓ May provide additive things such as skill set, license, geographical reach	✓ Expedited timetable with less business disruption ✓ Chance for target's shareholders to exit and monetise shares in the target ✓ Cost savings as a result of economies of scale ✓ Increased profitability
Main Issues	× Longer process, requiring more regulatory approvals	× May not be a mutually agreed transaction, and may thus carry negative connotations × Loss of control and ownership by target's shareholders
Approvals Required	■ Shareholders ■ SEC ■ NSE ■ Federal High Court	■ Shareholders ■ SEC ■ NSE

Mergers & Acquisitions

Transaction Considerations for Capital Market Operators



- File application with the SEC as soon as possible to show steps towards meeting the requirements
- Should ideally enter SEC next month

Mergers & Acquisitions

Key Next Steps for Capital Market Operators

1. Generate a term sheet of needs
2. Run a quick combination analysis with target partners to measure best fit
3. Estimate the Synergies from the transaction
4. Determine the quickest way to complete the transaction
5. File application as soon as possible

Mergers & Acquisitions

Term Sheet Key Considerations…

1. Governance
2. Brand
3. Management
4. Location
5. Valuation and consideration

Ultimately its all about being fair!!!

Mergers & Acquisitions: Case Study

The Nigerian Banking Sector: A continuously evolving landscape

Top 5 Banks as at 2005

FirstBank, Union Bank, Oceanic, Intercontinental, Zenith

2005

Consolidation (1st wave)

- Regulator-driven Consolidation (minimum capital requirement of N25bn)
- Emergence of 24 banks from previous 89

2007

Dramatic Expansion

- Drive to increase capital base
- Expansion to other African countries
- Increasing exposure to capital market

2009

Liquidity / Solvency Crisis

- Industry crisis triggered by global events
- Stock market collapse; significant increase in NPLs
- CBN Assessment of Banks (liquidity, capital adequacy & corporate governance) and subsequent intervention

2011

Major Regulatory Reforms / Consolidation (2nd wave)

- M&As, recapitalisation of banks
- Improved regulatory oversight, greater co-ordination amongst regulators
- Divestment from non-banking businesses

2012>

A New Era of Competition

- Enhanced competition (potential new foreign entrants, larger banks with increased capacity post consolidation)
- Divestment from non-banking businesses
- Push for profitability and earnings sustainability

Top 5 Banks as at Q3, 2013

FirstBank, Zenith, GTBank, Access, UBA

	2004	**2007**	**2013**
No of Banks	89	24	24
No of Branches	3,492	4,200	5,639
PBT (₦'bn)	104	242	535
Total Assets (₦'bn)	3,753	10,982	24,301
Capital Reserves (₦'bn)	686	2,225	3,870
Liquidity Ratio/LDR	51/69	49/71	46/36

Mergers & Acquisitions: Regulatory framework in Nigeria

M&A transactions are subject to regulatory approvals in Nigeria

Regulator	Securities & Exchange Commission	Corporate Affairs Commission	Central Bank of Nigeria
Jurisdiction / Reach	Rules & Regulations (Issued pursuant to Investment and Securities Act 2007)	All Companies and Allied related matters	Rules & Regulations (CBN Act of 2007)
Relevance to the Transaction	<u>Investment and Securities Act 2007</u>: Part XII, section 118 (i) of the ISA states that "notwithstanding anything to the contrary contained in any other enactment, every merger, acquisition of business, combination between or among companies, shall be subject to the prior review and approval of the Commission." Part I, Rules 421 to 439 of the new SEC Rules & Regulations pursuant to the ISA regulate mergers, takeovers and acquisitions in Nigeria	<u>Companies and Allied Matters Act (1990)</u>: The CAMA is the most important law governing all corporate matters in Nigeria Chapter 4, Part XVI I of CAMA deals with reconstruction, mergers and takeovers	The preferred bidder must be competent and management of the bank post-acquisition must be deemed as ''fit and proper'' and capable to run a financial institution in Nigeria prior to appointment CBN "no objection" to acquisition required

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