Belgian M&A Survey 2020

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pwc

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Dear Sir, Dear Madam,

In December 2019, we launched our M&A Survey, a few months before COVID-19 entered our lives.

Although you will see from reading the results that many of the respondents expected a downturn in the coming year, no one expected what happened in March 2020: a health crisis, followed by an economic crisis, which will have a huge impact and will most probably change the way we behave, the way we work and live together. Obviously, it will also impact the way we drive a deal and look at deal issues going forward.

Although the M&A outlook as part of the survey is no longer up to date with the events of the past months and weeks, a lot of topics and conclusions emanating from this survey will remain important or will gain importance when doing deals, also in the post COVID-19 era.

In the introduction to the survey hereafter, I provide you with an update of the M&A outlook and our first view on important points of attention for future deals.

I wish you an interesting read.

Best regards,

Nancy

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Introduction

COVID-19 changed the M&A landscape rapidly

The M&A survey was launched in 2019 – a year particularly prone to lots of M&A movements with some record-making deals occurring and all-time high multiples applied on pricings. Buy-outs were as active as ever. New trends continued their emergence and some "new normals" of M&A were making their way into our daily work as the last quarter of 2019 pushed the stock market to maximum height.

> "COVID-19 brought economies around the world to a quasi stop.

These optimistic facts understandably impacted the result of our survey and showcased a somewhat optimistic outlook albeit with necessary precautions on risk factors for upcoming transactions.

Since the results of the survey have come in, a new factor has impacted the world's economy and our way of living: COVID-19. COVID-19 brought economies around the world to a quasi stop, triggering a stock market drop and credit tensions.

Several European nations have gone into a sudden and sharp recession due to COVID-19[1], and the International Monetary Fund (IMF) sees the world economy suffering its worst recession since the Great Depression[2]. At this stage, many economists are still guesstimating the longer term impact of the global pandemic on the macro-economy, specific sectors and the M&A activity.

One thing they seem to agree on is that regional, national and international economic resilience will depend on a combination of (i) effective public health response and (ii) effective government economic policy[3].

We have already experienced in the past weeks and months a slowdown of transaction volume mostly due to the fact that Transaction players are understandably regrouping, focussing efforts on short and medium term cash needs. Many of the financial players have, for the time being, curtailed financing. Exits are seen and will continue to be seen to fall quickly within the next two quarters as onsite due diligence cannot happen and multiples are dropping[4].

While the insights provided by the industry in the pre-Covid era remain very relevant and highlight the state-of-mind of transactions actors, one cannot avoid the elephant in the room.

[1] Pitchbook Q1 2020 European PE Breakdown
[2] World Economic Outlook, April 2020: Chapter 1
[3] McKinsey & Company, "COVID-19: Briefing note, March 30, 2020"
[4] Pitchbook Q1 2020 European PE Breakdown

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The post-Covid world requires us all to rethink some of our ways of working and force us to adopt some new attitudes and reflexes in a Deal flow:

Sourcing the deal

- ***Impact of Covid on sectors:*** A general trend pinpointed by the economists seems to be that **all sectors of the economy will not be equal** when dealing with the aftermath of the pandemic. The strong appetite for Technology, Business Services and Pharma, Medical & Biotech actors, is likely to continue. Conversely, Consumer, Leisure, Travel or Financial Services actors may pique the interest of less actors.

- ***New sourcing opportunities:***

  - troubled sectors could nonetheless see a greater deal of activity as they may present opportunistic opportunities for distressed M&A or good bargains. Distressed M&A, while presenting interesting opportunities, brings its own set of challenges and should not be approached as a traditional acquisition. The negotiating positions are very different and risk appetite is a prerequisite for such activities.

  - bolt-on, take-private and private investment in public equity (PIPE) activity are expected to rise in 2020 due to severe public market dislocation and the relative ease of financing for smaller minority investments compared to full-scale takeovers in this environment[5]

  - large buy-out funds will likely convert themselves into credit funds buying distressed corporate debt at a large discount, reducing leverage and restoring companies into the post-Covid economy.

- ***Pricing the Deal:*** Prices are expected to be impacted in the coming months. The **median EBITDA buyout multiple**, which has already declined to 11.1x in 1Q20 (from 12.1x in FY19), is likely to see further downward pressure in the coming quarters. But more generally, **valuation methods** of companies could also see a change from the standard DCF to an Adjusted Net asset Approach and/or particular focus on the recoverability of net financial debt in a post-Covid environment.

"The world will never be the same again after COVID-19.

- ***Investigating the Deal:*** During a **due diligence**, some additional attention points should be included to assess the response and resilience of the target at the time of Covid and understand their action plan in case of new or similar pandemics going forward. Appropriate attention should also be given to understand the regulatory and HR environment in which they operate as we have seen in the past months how important these factors can be on the resilience of companies.

- ***Financing the Deal:*** The European leveraged debt markets are now largely shut since COVID-19, hampering larger or even mega-deals6, credit spreads have reached double digit numbers that were not experienced since the 2008 financial crisis. In the coming months however, various States, Regional banks and sovereign funds are expected to receive or have already received mandates to provide financial support for investments which could present some opportunities for the savvy buyers. Focus will largely be on local financing and syndicated deals will be the exception in the coming months.

- ***Closing the Deal:*** negotiating certain clauses in an **SPA** are expected to come under particular scrutiny, such as MACs, representations on bank covenants etc. If a W&I Insurance is sought to secure the deal, appropriate attention should be given to understand limitations on coverage in case of pandemic-related risks and the impact such coverage has on premiums. Further, one can expect that far more use will be made by parties of earn-out clauses as impact on future EBITDA and cash flow often remains unpredictable.

One thing is sure: we have interesting times ahead. The world will never be the same again after COVID-19 with new business models popping-up, new ways of thinking, companies never heard of before on the rise. This Coronacrisis is creating problems, but will definitely also create opportunities.

Nancy De Beule
M&A Partner

[5] Pitchbook Q1 2020 European PE Breakdown

[6] Pitchbook Q1 2020 European PE Breakdown

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Outlook on the Belgian M&A Market for 2020

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more than **50%**

of respondents expect a stable M&A market with significant activity, but without further price increases.

more than **40%**

of corporate correspondents see 2020 as a year with a focus on external growth.

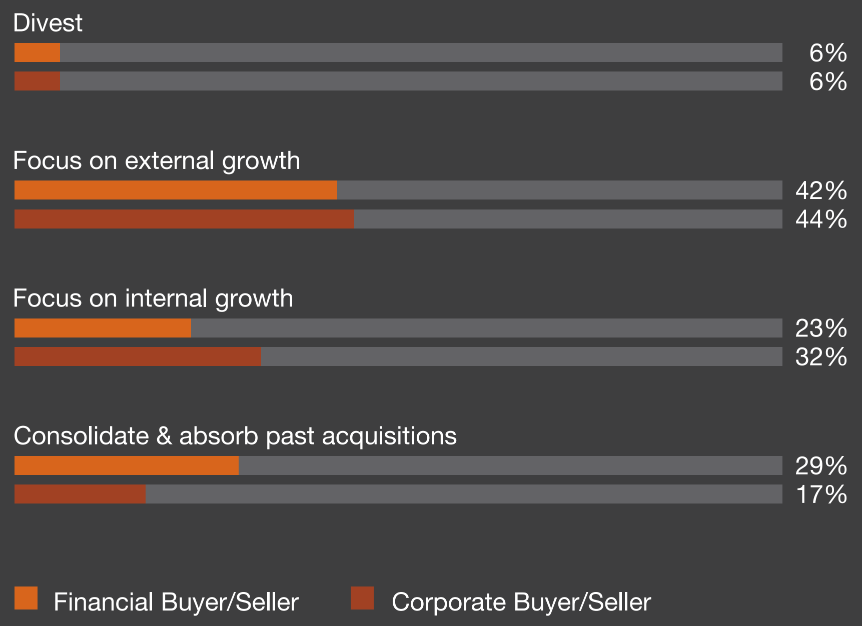
Expected deal volume

Of our corporate survey respondents, 25% are thinking of carving out and/or selling a business in the coming year. Around 40% of the financial buyers intend to do the same in 2020, a total which forms the basis for a sufficient deal volume in the coming year on the Belgian market.

According to our M&A survey, 2020 will very likely remain a seller's market: more than 40% of corporate correspondents see 2020 as a year with a focus on external growth, and 17% will focus both on integrating acquired business and on new acquisitions. For the financial buyers, the main focus remains on extending their buy-and-build strategies in combination with integrating what they've already acquired in previous years.

More than 50% of respondents (both corporate and as financial buyers) expect a stable M&A market with significant activity, but without further price increases.

In the coming year, will you:



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more than 65%

of survey participants expect a downturn within one year or so.

Downturn predictions

The mindset within the Belgian M&A community remains positive. Still, more than 65% of survey participants expect a downturn within one year or so, but most of them don't expect this to happen within the next six months.

How the M&A market will behave in the short term is very difficult to predict. Events of the past year, including significant political uncertainty, undoubtedly lead to a loss of confidence within many organisations. Despite this, M&A volume remained stable, and the first months of 2020 seem to indicate a continuation of that trend.

It's expected, however, that after a period of record highs in M&A volume, a downturn will inevitably follow. A recent PwC[7] study demonstrates that the expectations of an M&A decline may be exaggerated: multiple factors are driving the drop in volume of deals from the broader economy. Declines in deal volume are largely due to high valuations, which made certain investors reluctant to buy. On the other hand, the ability to buy will be stronger than in past downturns, thanks to the level and mix of capital. However, not all potential acquirers will be in the same position, turning them into potential targets.

> "It's expected that after a period of record highs in M&A volume, a downturn will inevitably follow.

[7] www.pwc.com 'Winning through M&A in the next recession'

30%

of financial buyers changed their strategy over the past two years.

35%

of corporate respondents changed their strategy.

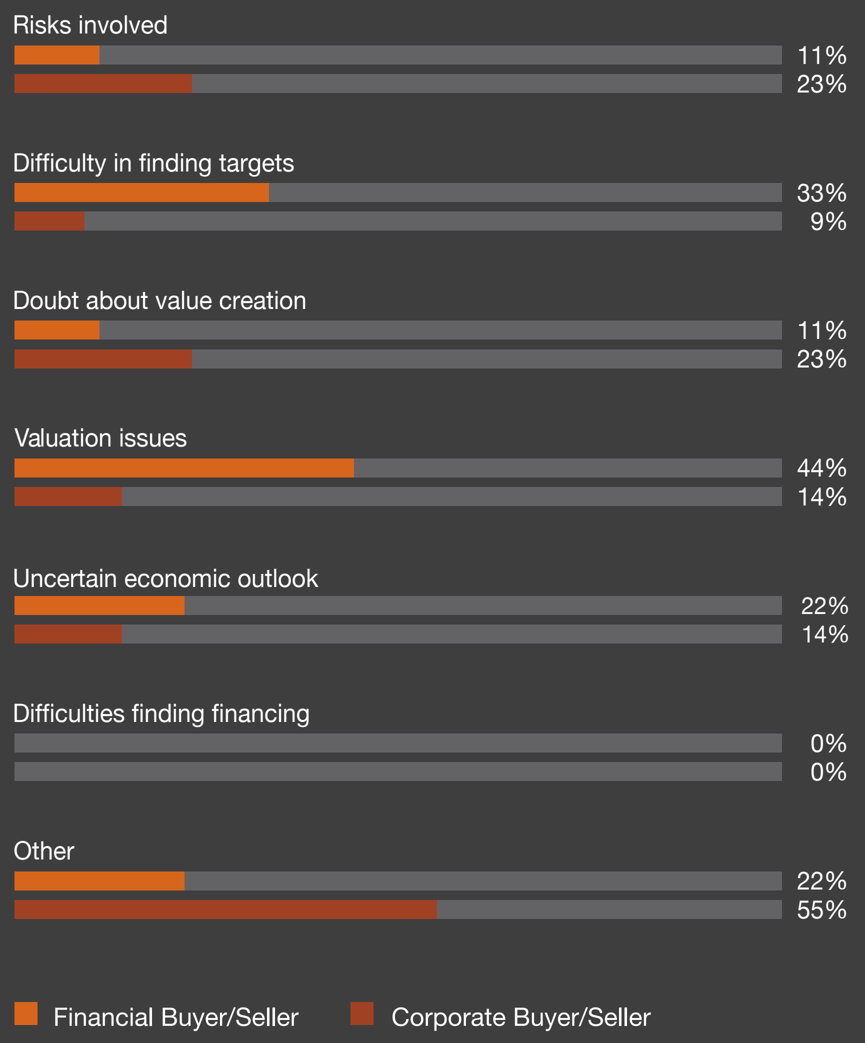
Increased interest in technology and IP-driven, less mature companies

As usual, both corporate respondents and financial buyers are looking for steady cash flow generating assets (SB 71% vs PE 84%). Survey data shows that corporates' main drivers for M&A are increasing market share and extending client base in both new and existing geographical markets. For financial buyers with a 'buy-and-build' strategy, these drivers are very relevant as well. They also find access to managerial knowledge and talent important (more so than strategic buyers).

Further, we notice an increasing interest in acquisitions of scale-ups and, to a lesser extent, of start-ups (40% SB vs 42% PE), often due to intentions to acquire technology assets. Both corporate and financial investors prefer to acquire 100% of these companies, to set up a joint venture or to take a minority stake.

We also asked survey participants whether they changed their M&A strategy recently and if so, why. Of the financial buyers, 30% changed their strategy over the past two years, mainly because it was difficult to find targets (33%), valuation issues and high prices (44%) and the uncertain economic outlook (22%). Among the corporate respondents, 35% changed their strategy. Their main reasons were doubt about value creation (23%), too many risks involved (23%) and the integration capacity of the group (15%).

Reasons for changing the M&A Strategy



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70%

of Belgian respondents stated that they expect to invest exclusively in Europe in the coming year.

6%

of financial buyers will look into opportunities in the US market, but only 3% are considering Asia or Africa.

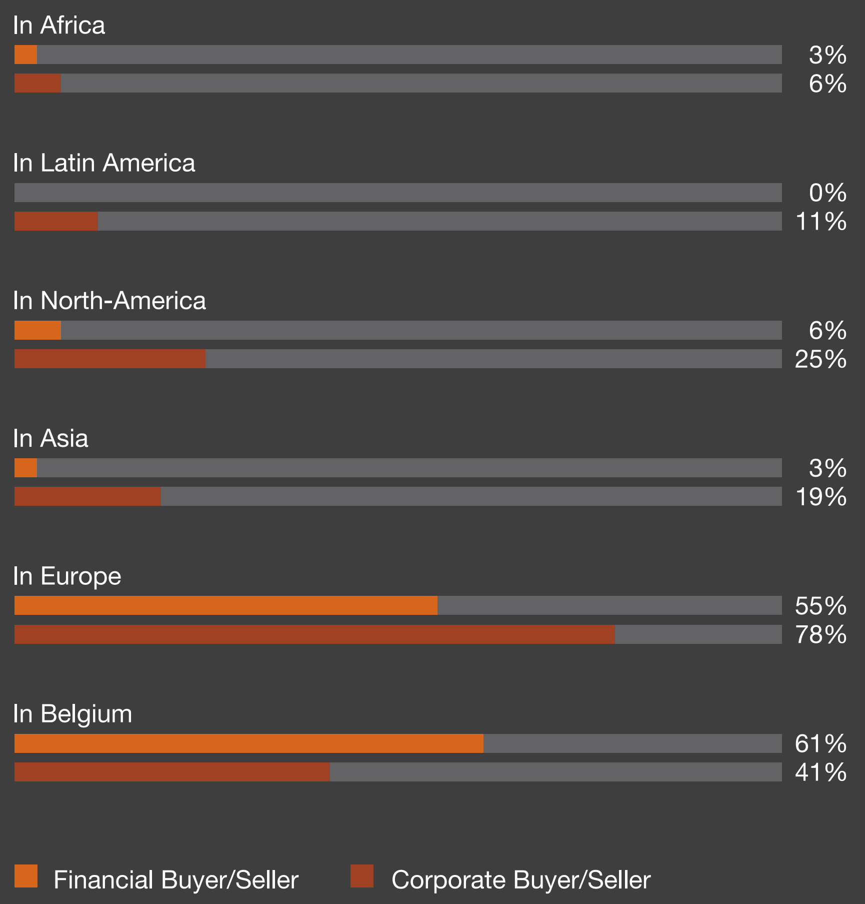
External growth abroad

In Belgium, 70% of respondents stated that in the coming year, they expect to invest exclusively in Europe. Of the financial buyers, 6% will also look into opportunities in the US market, but only 3% are considering Asia or Africa. Corporate respondents expect to invest up to 25% in US opportunities, 19% in Asia and 11% in Latin America. Africa is also low on their priority list.

This is interesting compared to European outlooks[8], which show an increased interest in the US and Asia-Pacific markets due to the political uncertainty and regulatory intervention within the European market. For the US M&A market[9], China even holds the number two spot (after Canada) as the preferred foreign market to do M&A.

Belgian acquirers are somewhat concerned about making acquisitions outside of Europe, due to the many differences which increase the difficulty and complexity of integration: cultural differences, differences in regulations and rules, etc. Further political uncertainty also contributes to their hesitation.

Investment regions



[8] European M&A outlook 2019 - CMS

[9] M&A Trends 2019, Deloitte

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A typical Belgian deals process

Are the current economic outlook and changes to the M&A landscape impacting the way Belgian acquirers cope with their deals process?

In PwC’s 2019 Creating value beyond the deal report, we pointed out that amid the macro-shifts in the deals environment, creating value in deals has never been more important. To do so, it’s crucial that organisations approach deals as part of a clear strategic vision and a long-term objective.

52%

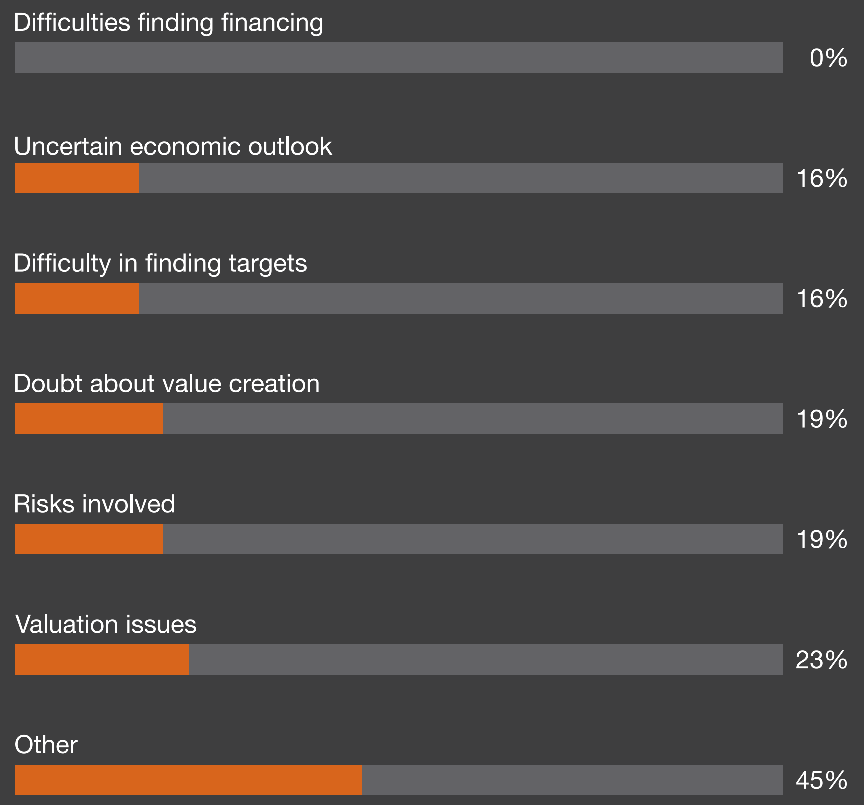
of Belgian M&A players have a clearly defined M&A strategy.

M&A strategy – regularly revised and updated

One of the trends over the last years in the strategic vision that drives M&A is that more deals are focusing on acquiring new capabilities, people and technology to realise the company's objectives. These deals are not only very specific in scope, but in many cases are also characterised by alternative deal models like joint ventures, alliances and minority stakes, although buy-and-build strategies and realising economies of scale that fit with the strategy are still important M&A drivers for both Private Equity houses and corporate buyers. Indeed, our respondents' priority when considering potential targets is clearly to 'fit with the current strategy' (around 60%), followed by the 'buy-and-build' driver (24 %). Although these two drivers are ranked first and second by both financial and corporate buyers, the first is even more important to the corporate buyers (68%) and the buy-and-build strategy is cited as most important by about 39% of the financial buyers.

Although the importance of a strategic M&A approach is clearly considered key, our survey shows that only half of Belgian M&A players (52%) have a clearly defined M&A strategy, while the other half still adheres to an opportunistic approach. The financial buyers scored 58% on M&A strategy, whereas corporate buyers lagged at 49%.

Reasons for changing the M&A Strategy



Those that have a strategic M&A plan regularly update it to stay relevant: around 47% do so every few months to two years, and an additional 25% every two to five years. However, the survey shows that although their M&A strategy is updated, 67% of respondents confirm that these updates don't lead to important changes in their longer-term M&A strategy. For those whose M&A strategy did change, all reasons were closely linked to changes in their overall corporate strategy.

A dedicated in-house M&A team

Bringing a more strategic lens to M&A also requires developed in house M&A capabilities that are focused on continuous screening of targets and building relationships.

In line with global trends in M&A, our Belgian respondents acknowledge the importance of a dedicated M&A team to focus on corporate growth strategy and constantly look for new targets and sources of growth.

around 62%

of respondents confirm they have a centrally controlled department for M&A transactions.

Around 62% of our interviewees confirm they have a centrally controlled department for M&A transactions, while some have a standalone department (to a lesser extent for corporate respondents). Others have a dedicated 'virtual M&A team', which is multidisciplinary and only works together when the need arises (for a significant number of corporate respondents).

94%

of respondents call on external support in due diligence.

Focusing on the transaction phase

Respondents find qualitative due diligence very important. The more deals evolve to acquiring new capabilities, the greater the importance of expanding due diligence and bringing in external experts to assess the value and risks of the target and its assets.

Respondents see the most value in using external support in the transaction phase, namely in providing due diligence assistance. Around 94% call on external support in due diligence, both among corporates and the financial players.

In cases where scaling is the driver, as in acquisitions focusing on acquiring new technologies, talent and capabilities, it’s essential to test the pre-deal assumptions, the quality of the target and the targeted synergies. When acquiring new capabilities, the synergy potential should also be challenged in the due diligence phase.

Remarkably, some respondents confirm that IT and cyber due diligence are not really on their radar, but they admit that they should be: nowadays, getting a view on the system security level and the cost of integrating systems and converting IT systems to an acceptable security level have become as crucial in the transaction phase as they are in the post-deal integration phase.

only 2%

of respondents consider turnarounds a priority when defining targets.

> “Based on survey results, we can conclude that Belgian M&A players still approach the M&A process in a more traditional way.

Calling on external support, mainly for traditional due diligence

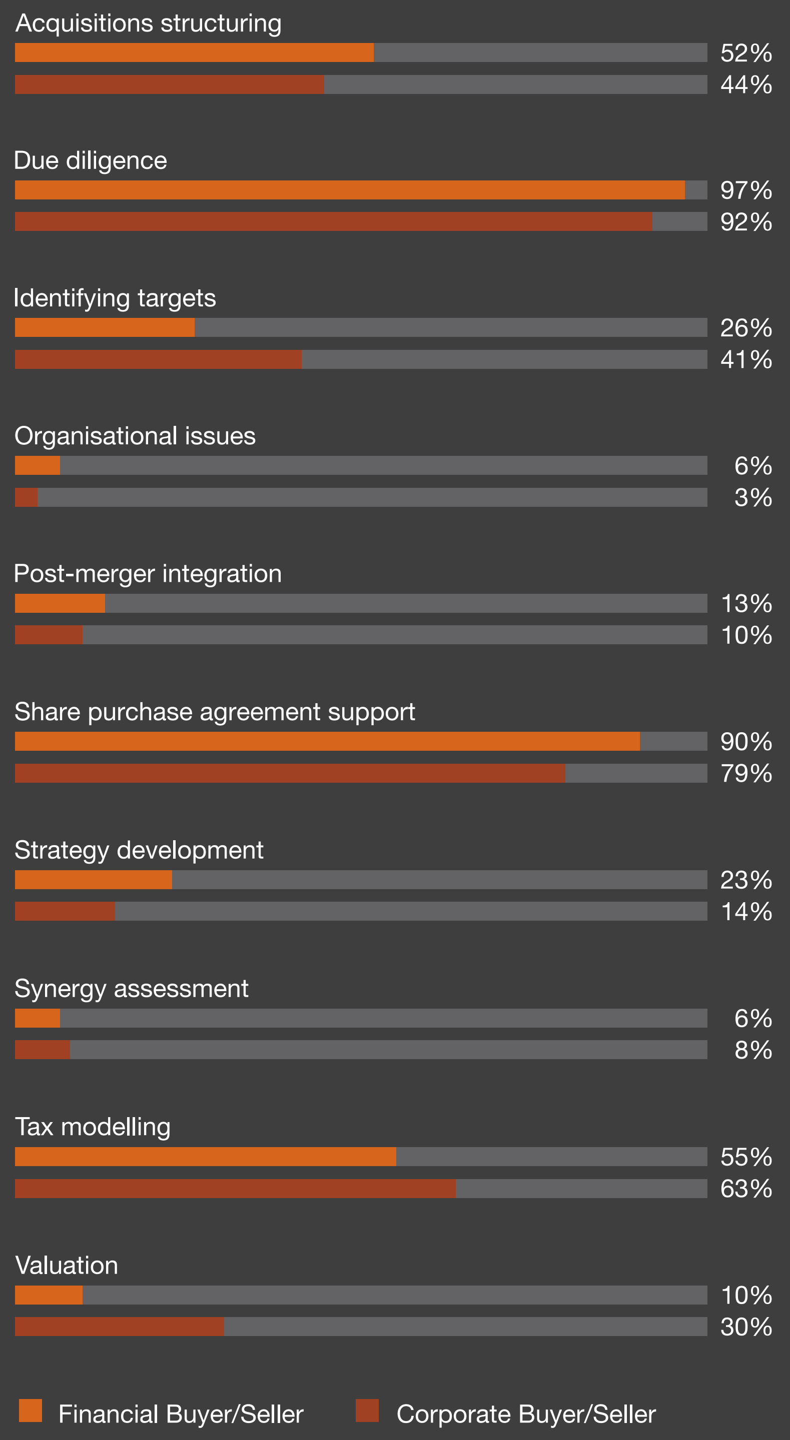
In PwC’s Creating value beyond the deal report, we stressed the importance of more sophisticated diligence and examining value-creation opportunities more deeply, yet those surveyed admitted that due diligence still predominantly focuses on tax and financial issues.

This is also reflected in the results of our survey. Our Belgian M&A actors still focus on financial, tax and legal due diligence, whereas technological, commercial and strategic due diligence, ethics, cybersecurity, risk of personnel loss and management assessment are less of a focus. External support on organisational issues and synergy assessment actually round out the bottom of the list of support areas, along with post-merger integration.

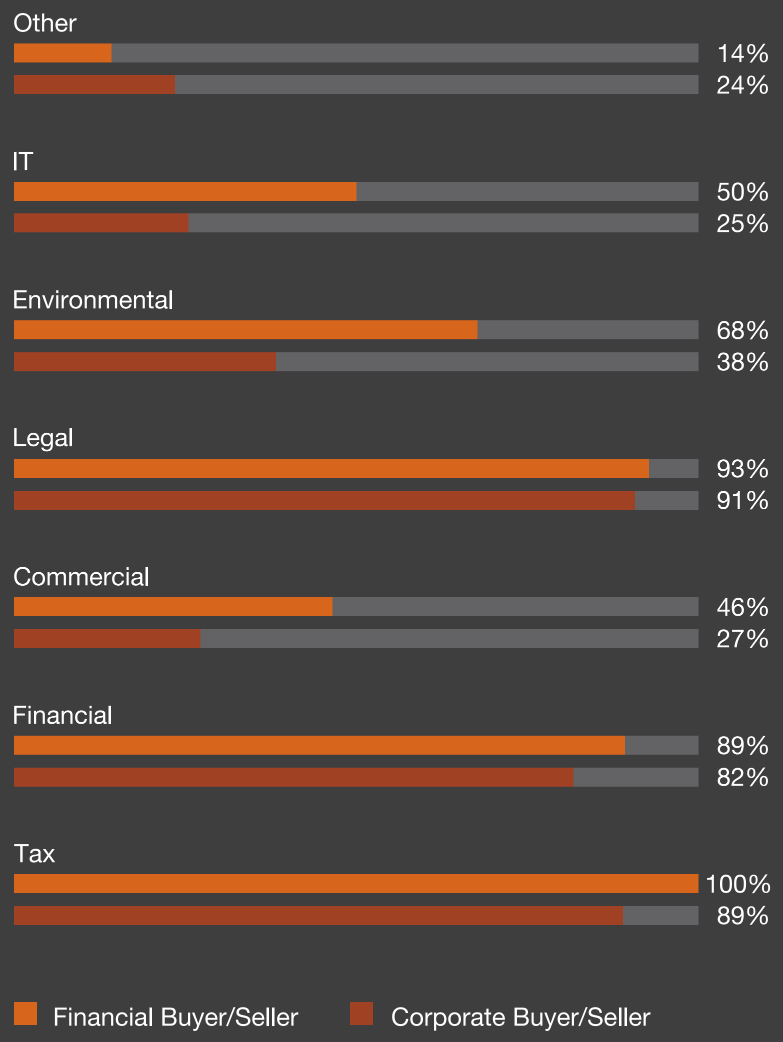
It’s surprising to find that in today’s M&A market, turnarounds are not really valued by Belgian buyers. Only two percent (mainly corporate buyers) consider them a priority when defining targets. This may change over the coming months, however, as waning growth and economic slowdown are expected to fuel distressed M&A.

Based on survey results, we can conclude that both corporate and financial Belgian M&A players still approach the M&A process in a more traditional way, with a focus on scale deals and the use of external support in traditional areas. Nevertheless, the importance of a strategic M&A approach with a dedicated internal M&A team and an eye for less traditional deal types (acquiring talent, capabilities, technology, etc.) is gaining ground.

In which areas do you get external support?



Due diligence



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The competitive edge of M&A

PwC's M&A survey 2020 results enable us to take a closer look at what motivates respondents to engage in M&A transactions. What are the main benefits to be gained from deals? Are the (expected) benefits different for financial buyers compared to strategic buyers? Are there any trends that emerge?

Based on survey results, we see that the benefits of M&A are manifold. Below we delve into the perceived value of scale deals, scope deals and capability deals.

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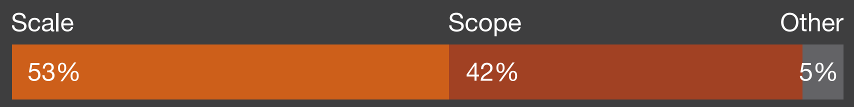
64%

of respondents believe access to new markets to be the dictating stimulus for deals in today's business environment.

Benefits of scale deals vs. scope deals



Surfing the global wave of scope deals

As M&A is one of the catalysts for shareholder value creation, it's not surprising that the main benefits of deals include cost reduction and increased market share.

In an M&A context, acquisitions lead to economies of scale, which in turn promote cost reduction. When companies join forces to become a bigger industry player, there's an expectation that output will increase while the production cost per unit diminishes.

Another recurring benefit in M&A is increased market share: in deals, one plus one equals three.

More than half of survey respondents rank traditional enablers like realising scale economics (53%), cost reduction (30%?) and/or increasing market share (60%) among the main benefits of their M&A activities.

Therefore, the Belgian market is still very much oriented on expanding a company's existing business – often referred to as a scale deal in M&A jargon. Scale deals are mainly about realising efficiencies through economies of scale, top-line growth and valorising business overlap between buyer and target.

Echoing the global shift towards scope deals, two thirds (64%) of respondents believe access to new markets to be the dictating stimulus for deals in today's business environment. Also in line with the prevalence of scope deals, about one in three (29%) respondents cites access to new distribution channels among the main benefits of M&A.

> "Most companies are past the tipping point where acquisitions are standalone projects with a sole focus on growth.

There's no doubt about it. Scope deals – enabling the buyer to take the company in a different direction by penetrating new markets, accessing new distribution channels or developing new products – have been steadily rising for several years. In 2018, scope deals outranked scale deals for the first time, accounting for 51% of global M&A activity.[10] [https://www.bain.com/insights/M-and-A-in-disruption-2018-in-review/].

Our survey shows that the Belgian M&A market followed suit.

A 2013 McKinsey study stated that "strategy provides only vague direction on where and where not to use M&A – and an unspecific idea of the expected source of value creation. Companies use M&A indiscriminately to purchase growth or an asset, without a thorough understanding of how to create value in a deal. Rarely there is an explicit link to organic investments or the business cases for broader growth initiatives, such as developing new products or building a sales force to deliver an acquired product."[11] Looking at the 2020 results and our day-to-day field experiences, this has probably been the biggest game changer of the past decade.

In our view, most companies are past the tipping point where acquisitions are standalone projects with a sole focus on growth. In today's M&A climate, deals increasingly form an essential part of a group's core strategy. A new level playing field has emerged.

Of course, this doesn't mark the end of scale deals, as many transactions will continue to be driven by the need to boost revenue and cost synergies. Yet the trend of scope deals changes the focus of a transaction, which undoubtedly has an impact on how targets are presented in the market, how due diligence is conducted and how deals are negotiated.

[10] https://www.bain.com/insights/M-and-A-in-disruption-2018-in-review/

[11] https://www.mckinsey.com/business-functions/strategy-and-corporate-finance/our-insights/m-and-a-as-competitive-advantage

Next-level capability deals

When it comes to gathering capabilities, where access to talent, access to technology and access to managerial knowledge are at the core of the deal, the capabilities dimension seems less prominent in Belgium than what's observed on an international scale. The US market, the home turf of digital pioneers, disruptors and unicorns, seems to be a frontrunner in this area.

When referring to capability deals (as a subset of scope deals), it's tempting to think immediately of digital upskilling with a view of coping with the ubiquitous challenges of digital transformation.

However, merging capabilities is not confined to tackling digital challenges. Capability deals are mainly about combining the complementary capabilities of a buyer and a target for a new value proposition or product development to generate future growth. In that respect, capability deals are different from the more common growth scope deals, which involve buying companies with faster-growing products or in faster-growing markets for an immediate growth uplift.

Companies that have embraced the potential of upskilling are reaping the rewards, like a stronger corporate culture, greater innovation and higher workforce productivity. Those furthest along in the upskilling journey cite employee retention as the primary challenge, whereas those just beginning the process find motivation and lack of resources to be the biggest obstacles. One thing is clear across the board: increases in automation, changes in demographics and new regulations are making it much harder for organisations to attract and retain the skilled talent they need to keep pace with the speed of technological change.

Considering the rapid pace at which businesses need to recalibrate to stay relevant (for some industries at least), the almost nonexistent entry barriers fuelled by disruptive business models and the continuous quest for talent, we expect to see many more transactions in this segment in the years to come (cf. infra).

What else did the survey results reveal?

- Strategic buyers still believe very strongly in access to new markets, increased market share and economies of scale when it comes to the benefits of M&A. Although financial buyers share these views, the latter seem to lead the way when it comes to access to new distribution channels and access to technology. In other words, financial buyers seem more convinced of the benefits of capability deals than strategic buyers.
- While access to talent and access to technology score similarly across the board in our survey, it's not surprising that financial buyers believe access to managerial knowledge to be about twice as important as do strategic buyers.
- Only 16% of financial buyers indicate financial return to be a main benefit of their M&A activity.
- Most of our respondents are expanding rather than folding back. While buy-side M&A activities are mostly about growth and exploring new horizons, a sell-side M&A trajectory may, on the other hand, be driven by a return to the core business. In our survey, less than 10% (9%) indicated their M&A activities to be (partly) motivated by a return to the core business.
- A deal isn't over when the share purchase agreement is signed or the transaction has closed. On the contrary, completion only marks the start of challenging times. With over 70% (74%) of our respondents signalling that value is lost in the post-acquisition integration phase, it is – once again – confirmed that the true value of a transaction lies in the successful integration of the acquired business.

Conclusion

While scale deals are often attributed to buyers that are making their first steps in M&A, and seasoned buyers are believed to be equally engaged in scope deals, we believe that the global economic outlook is a better indicator of what's to come.

According to PwC's 2020 global CEO survey, the percentage of CEOs who believe global GDP growth will decline has increased dramatically in the past two years. CEOs also have significantly diminished confidence in their own organisations' 12-month revenue growth prospects, while interest rates remain historically low. Due to the anticipated economic slowdown, we expect further consolidation in several industries. This could potentially result in a revival of scale deals, and a relative slow-down of scope deals.

As companies take their digital transformation and upskilling programmes to the next level, many are increasingly aware that they lack the resources to successfully complete the journey. As a result, we could anticipate an increase in capability deals, at least in relative numbers.

From an M&A perspective and in business in general, organisations are facing unprecedented challenges and uncertainties, which could lead to changes in strategy. The impact of COVID-19 on the global economy is for example a recent uncertainty that could give rise to an accelerating cooling off of the economy, slowing down the M&A market.

5

A fresh approach to value creation beyond the deal

Corporate as well as financial dealmakers are under increasing pressure to deliver more value from each deal they do. To make the task harder, turbulence in global stock markets is creating uncertainty around valuations, while companies are wrestling with challenges such as keeping up with technological change or moving at speed into new and untested markets.

Amid these macro-shifts in the deals environment, creating lasting value in deals or avoiding value being lost has never been more important. Many executives that we surveyed admitted that there is work to be done in overhauling their approach to value creation.

Our survey and conversation with corporate executives show that companies that genuinely prioritise value creation and post-deal integration early on - rather than assume it will happen as a natural consequence of the actions they take as the transaction proceeds - have a better track record of maximising value in a deal.

With acquisition prices being high and once-reliable sources of deal value generation - such as cost reduction and the ability to generate returns through leverage - being squeezed, financial investors now have to work harder to secure payback on their transactions. Meeting return expectations requires a clear focus on value creation levers that have traditionally been seen by financial investors as overly complex and difficult to control.

The survey results clearly provide the following findings:

- Almost 75% of the correspondents (both corporates and financial buyers) see value being lost in the post-deal integration phase.
- While 92% of the corporate dealmakers and even 97% of financial dealmakers get external due diligence support and see the value of the advisors in the transaction phase, less than 15% of both categories calls in external advisors for synergy assessments and post-merger integration advice and see value of this in the post-deal phase.
- As many as 75% of the corporate dealmakers say that clashes of corporate cultures contributed to M&A failure, followed by insufficient integration planning (46%) and management attitude (44%). Financial dealmakers see the same 3 factors as most important reasons for failure, but management attitude (74%) is more important than culture clashes and insufficient integration planning (both 55%).
- Whereas the majority of the corporate dealmakers start with post-deal integration planning before or during the due diligence, 15% only start up this planning after signing the deal.
- In the post-deal phase, underestimation of cultural differences (73%) and lack of attention to change management issues (60%) are considered by corporate dealmakers as the largest contributors to post-deal integration failures; the same reasons are coming back at financial dealmakers. Technology is used by 67% of the corporate dealmakers and even 84% of the financial dealmakers to steer post-deal integration.

Factors that lead to failure in the post-deal integration phase

Acquisitions allow companies to expand and diversify, but our research confirms something buyers won't want to hear; many deals do not create value. To win deals and extract maximum value afterwards, companies need to consider all aspects of a "value creation plan" and embed this in a post-deal monitoring plan.

Based on experience of deals we advised on, we believe the following actions guide to value creation and avoid value destruction after a deal:

1. Start with a clear M&A strategy as part of the overall business strategy and avoid opportunistic or "ego" deals.
2. Focus on value creation from the start (value is to be created in the deal) and not after signing the deal.
3. Ensure comprehensive due diligence and examine value creation opportunities more deeply than simply conducting financial and tax due diligence as in the past. Also technology due diligence and assessing new technology-led commercial opportunities, such as monetising data, creation of new services and driving cost efficiencies, will continue to increase in importance.
4. Be a "ready buyer": traditional post-deal planning is no longer enough. Acquirers need to be ready with a comprehensive value creation plan 30 days before signing the deal so that key assumptions (including synergies) can be tested and validated through diligence, to implement the plan straight away;
5. Devote more resources to integration. Many organisations build large teams focused on transactions, but these people often also have day-to-day responsibilities and work on a deal on the side, making it difficult to give it the focus it needs. Businesses must invest time, resources and advisors in the process to succeed.
6. Focus on people. The ability to bring cultures together should be a key factor in deciding whether or not you do the deal. Savvy dealmakers also identify crucial employees before an acquisition, and ensure they are incentivised to stay. Further, communication is critical; mostly there is more effective communication during and at the conclusion of the deal than after the deal.
7. Keep tax and legal professionals engaged in planning the deal and executing the deal, but also after the deal, as not properly addressing tax and legal aspects or missing opportunities can hinder value creation.

Most of the above guidance, as we've learnt from deal experience, is valid for both corporates and financial buyers, but we want to add four practical ways to boost multiples and improve the returns of financial investors:

1. Maximise revenue growth. Revenue enhancement receives still less focus than cost-cutting and working capital efficiency.
2. Enhance value through strategic clarity, embedded early on. Knowledge of the market and the asset (more obvious for corporates) are key as is the knowledge of the value creation levers. These days, value creation is more important than financing. A value creation plan that is rigorously tracked afterwards is key.
3. Have a closer eye on management and talent retention. Also, culture if poorly managed can be a "deal destroyer", especially when carving out from large corporations or family businesses.
4. Boost exit opportunities by thinking about the business from a future bidder's perspective. This makes it vital to improve monitoring of KPIs. Consider also how the environmental, social and governance initiatives of the target could create value ahead of the exit.

To conclude:

if you want to create deal value and not to destroy it once the deal has been completed, it is our strong belief that a modern, effective approach to value creation must be built around three core areas:

- **Stay true to the strategic intent** and align deal activity to the long-term objectives of the business.
- Make **value creation opportunities part of the due diligence phase** and this from all the different angles (commercial, operational but also finance, IT, tax, HR, …)
- **Be clear on all the elements of a comprehensive value creation plan** - it should be a blueprint, not a checklist. Start early and take every opportunity to validate the key assumptions through advanced data analytics and diligence, and continue validation and monitoring post-deal.
- **Put culture at the heart of the deal**. Recognise key skills, ensure clear communication and incentivise core talent to stay engaged. Buying a brand but losing the people can destroy the value of a deal.

Our analysis confirms the importance of seasoned, experienced people to generate maximum value from a deal. Where organisations lack that experience in-house or where teams have insufficient time to focus on this - aside their normal day-to-day job -, they should reach out to third parties to temporarily assist them to create value beyond the deal.

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> Forewarned
> is forearmed.
>
> Abraham Tucker, 1768

6

Insurance in deals on the rise

In the deals environment, insurance is brushing off its status as the new kid on the block. Just five years ago, it was a novelty, almost exclusively linked to larger Anglo-Saxon deals. According to the latest trends, insurance is now also an integral part of the Belgian M&A scene. The focus on insurance in M&A increased dramatically, as the number of Belgian articles and newsflashes published on the subject in the last year have skyrocketed. Unsurprisingly, last year's flagship deals were supported by a type of insurance called representation and warranty (R&W) insurance, which in the past was considered nothing more than a gimmick. However, due to the many advantages that parties have found in deal insurance, this is no longer the case.

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Insurance in M&A: a recap

Concluding a deal means that you have a strong belief in the asset you're acquiring, but you're also managing a great deal of uncertainty. When both uncertainty and a strict time frame collide, the question of insurance is bound to arise: that's where deal insurance comes in.

In a typical acquisition, negotiations between parties on forms, share and asset deals, mergers and transactional documents can eliminate many uncertainties. Although the seller and the buyer may be on opposite sides, the common goal of sealing the deal will often glue parties to the negotiation table.

The most common way to negotiate and manage uncertainty is to list representations and warranties, specific indemnities, escrow accounts and other types of provisions in the transactional documents. It is exactly in this space that insurance can play a role, almost regardless of the nature of these provisions (tax, financial, environmental, commercial etc.). If the seller wants a clean exit without escrows or pending guarantees, it can conclude an insurance to cover its obligations towards the buyer. However, in the current seller's market, it is mostly the buyer (in about 75% of the deals) who takes out the W&I insurance, in case the seller is not willing to provide any guarantees.

Several variations and types of insurance are available. Some of these are linked to a specific item, such as Pension Buyout, Discontinued Products Liability, Tax Liabilities, Contingent Liability, etc.

The insurer will mostly rely on the work done by the seller (vendor due diligence) or by the buyer (regular due diligence). In case one specific tax risk needs to be covered, we often see that insurance companies also require – on top of the (vendor) due diligence – a tax opinion from the buyer's advisor.

From a legal and tax perspective, sufficient thought should be given to who will be the beneficiary of the insurance. This is important, as, generally speaking, any payment received from the Insurer would be considered a repayment of damage incurred ('a compensation payment'), and not, as is common in many Belgian deals, a reduction in the purchase price. The two have a distinct tax treatment, which should be reflected to obtain full payment of the damage.

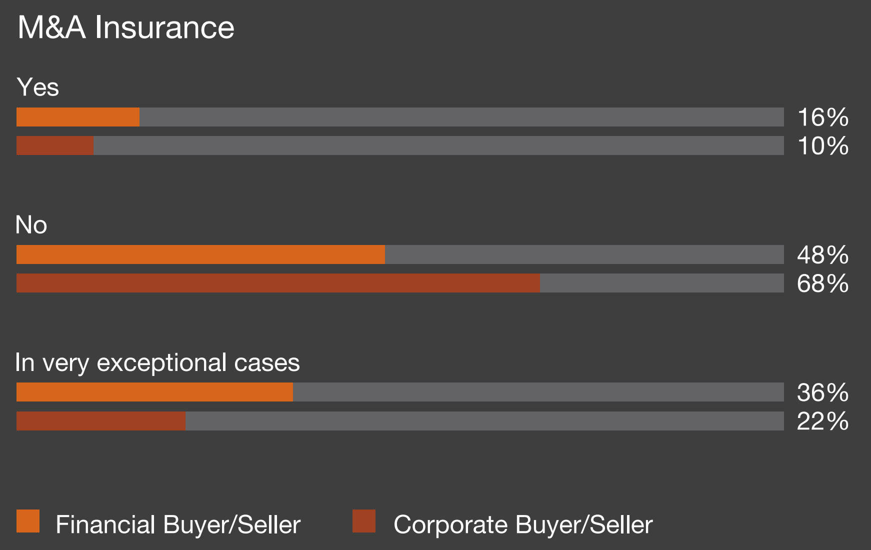
Although it's theoretically feasible, we have not seen insurance for (larger) internal restructurings yet.

Trends

One third of all interviewed persons have considered covering deal risks through insurance. In the end, 10% of the interviewed persons confirmed that, for Belgian deals, insurance was taken out. This means a steep increase, compared to what prior studies revealed. Of course, there is a whole range of insurance types that can be linked to a deals process, although in particular the W&I insurance is gaining ground.

The current hit-rate of 10% of the deal market already using insurance and 22% considering it is relatively high, as this product is less suitable for smaller deals, which – given the nature of the Belgian market – are more frequent. That would also explain the 66% who currently do not opt for any type of insurance.

Compared to the Anglo-Saxon deal market, these numbers are still far behind. Generally in that market 1 in 5 deals would be supported by deal insurance.



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Advantages

Several factors have jointly contributed to the current rise in deal insurance.

The current state of financial dealings and the abundance of available cash, which, together with other factors, lead to a seller's market in 2019, contributed to the success of deal insurance. Especially in an auction process (or a similar competitive process), adding a – 'pre-cleared' – W&I insurance to the bid, together with a seller-friendly share purchase agreement (SPA), may be a tipping factor to win the deal.

Of course, a seller can also do the work upfront, before entering into the market, by offering a packaged deal themselves, to increase market appetite and/or to limit in-depth due diligence processes by (potentially) various buyers and lengthy negotiations on W&I.

Especially in deals where private equity or other funds are involved, W&I insurance is top of mind. All the advantages are used in such a case:

- The buyer is protected against a closure of the fund and is certain of payment.
- The risks - for the seller - surrounding the deal are ring-fenced, without escrows or long periods in which claims can arise.
- There is an additional alternative instead of direct price reductions.
- The proceeds of a divestment can be upstreamed towards the investors, or the Seller/fund can be closed without having to take into account future potential claims ensuing from sales processes involving escrows and indemnities that are valid for a few years.
- Members of management, who in many cases co-invest, should not be engulfed in post-deal discussions, creating a better atmosphere.

Prices for deal insurance have dropped significantly over the past years as the market matured. Insurers now better understand ins and outs, creating a more attractive pricing, whereas also sellers and buyers became more comfortable with this instrument.

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Constraints

As the saying goes, all that glitters is not gold. When opting for insurance, being it the seller or the vendor type (or any other type), the legwork put in due diligence and proper SPA negotiation becomes even more important. One may think that off-siding the financial risk for some uncertain matters immediately takes away the need for a diligent review, but that is not the case. On the contrary, by taking out insurance, next to the – sometimes already crowded – M&A deal space, an additional party enters the arena. It is best practice to align the scope of any (vendor) due diligence with the insurer. As such, this report is often a basis for the overall insurance contract. Many things come to mind that should be thought of: (i) determining the areas of risks (legal, tax, HR, environmental, commercial, …) (ii) the amounts at stake, (iii) the likelihood, (iv) the de-minimis threshold, (v) the years in scope of the report, (vi) reliance, etc. Practice shows that, if an insurer is only brought in during the deal, an adjustment of the scope is often needed.

The same goes for the legal documentation, such as the SPA. Especially for W&I insurance, it goes without saying that these sections of the SPA are crucial.

Not all specific indemnities are insurable. Transfer pricing is for example a topic for which it is difficult to obtain insurance protection, and neither are items that are disclosed (often the full dataroom). On top, the insurance contract will have limits that are not necessarily 1:1 with the W&I in an SPA. This means that the seller could still be held liable when the insurance limits are exceeded. This would typically be the case for some ‘fundamental’ warranties, such as ownership of the shares. For such matters, a title policy is more suitable.

All these items will likely directly feed into the agreeable limits, deductible, de-minimis, premium etc. of the insurance contract.

Finally, as a side note, on such insurance premiums, the Belgian insurance tax is due.

Conclusion

Covering risk through insurance in the Belgian deal scene has become more than a gimmick. The steep rise in the number of deals where key dealmakers would consider this shows that it has become part of the general tool-set/framework for negotiating deals.

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Pricing expectations

51%

of respondents expect the world economy to experience slow growth, and none expect high growth.

74%

of respondents do not believe the next financial crisis will occur in the short or medium term.

Outlook

The past few years, partly due to interest rates being low, private equity ("PE") firms have succeeded in raising additional funds with wealthy families and individuals looking to directly invest their wealth in the economy and with foreign investors showing an increasing interest in Belgian privately owned companies. Corporates have also been quite active, which has led to serious competition in the Belgian M&A space.

In this context, the number of active PE firms in Belgium and foreign-based firms investing locally more than doubled from 2000 to 2015. Meanwhile, as the dry powder increased, the purchase multiples have been going up since 2015. Belgium has been cited as being more attractive for PE investment in the next five years by 44% of our respondents in a recently issued PwC Private Equity Survey 2020[11] and now hosts 6% of PE headquarters in Europe.

Back in 2018, market analyses displayed widespread pessimism about the outlook for 2019. One year down the road, the stock market still outperformed in 2019 with a 25% increase in 2019 and listed PE multiples at 10x in Belgium.

This year began with a sense of uncertainty after key stock indices lost the gains made throughout the first quarter of 2020. Still, early this year, 51% of the respondents to our PwC Private Equity Survey 2020 expect the world economy to experience slow growth, and none expect high growth, while 74% do not believe the next financial crisis will occur in the short or medium term. The outbreak of the Coronavirus may, however, affect this sense of optimism.

[11] PwC Private Equity Trend Report 2020, available on www/pwc.de

Uncertainty is the key aspect of 2020

Hard Brexit or soft Brexit, pension strikes in Paris, trade tensions between the US and China and the recent virus outbreak are affecting business confidence and may cause M&A activity in Europe to slow down and stock prices to go down. In a Belgian context, the formation of the government and the uncertain political situation might worsen confidence and have an impact on investment projects and acquisitions.

Volatility returned to stock markets in the first quarter of 2020, with several major indices ending the first months of 2020 at a severe loss as the world economy is now very much impacted by the slowdown of activity imposed by the Coronavirus. This has sparked concerns that equities might slip into persistent bear markets after years of rising valuations.

Competition

Since 2015, the M&A market has experienced heavy competition driving deal multiples to historic highs. Ever since 2018, we have seen a stagnation of the multiples, which continued in 2019. In this context, the market has been extremely competitive between corporate and financial buyers.

In the case of attractive targets, there is stiff competition for PE players, which tend to be more aggressive than corporate buyers in terms of auction prices. However, when faced with a strategic acquisition, corporate buyers may be willing to pay more in order to advance corporate objectives and capture synergies.

While it is unlikely that there will be a shortage of companies to acquire, the real question is whether there will be enough investable companies, at fair valuations, to absorb the capital recently raised by private equity firms. Many respondents to our PwC Private Equity Survey 2020 told us that increasing competition between corporate and financial buyers would be a challenge, again illustrating concerns about the supply of quality assets being adequate to meet demand[12].

The heavy competition for assets and the flood of capital – both debt and equity – into the market since 2010 have had the inevitable effect of raising asset prices. The average multiples for leveraged buyouts in the US and Europe have sometimes increased EBITDA by over 11 times in recent years, above levels leading up to the global financial crisis. This is also observed in the stock market where the PE multiples reached 11x on Euronext in 2019.

As we will see below, multiples and premiums observed on the Belgian market are, however, lower than those double-digit figures. This is certainly one of the reasons why French, German and UK PE firms are now looking more carefully to the Belgian M&A market as their own markets are currently overpriced.

[12] Two-thirds (66%) of respondents of our Private Equity Survey 2020 say that, in 2019, competition among PE firms as well as against corporate buyers increased.

Multiples and premiums

While, in 2018, most M&A active players worried about increased acquisition prices, a survey conducted by Vlerick School points to a recent slight drop in the EV/EBITDA multiple across all Belgian transactions from 6.0 to 6.5. Most surveyed experts do not predict a significant decrease in multiples in 2020.

It is therefore widely agreed that the recent volatility is no more than a market correction after stocks had reached record highs. This is supported by the fact that underlying earnings remain relatively robust and the global economy continues to grow, albeit at a slower pace in many countries.

The expected slowdown in deal activity seems to be driven by political and economic uncertainties imposed by the Coronavirus rather than financial constraints, with a cost of borrowing staying at a historically low level (see below). The results of our survey confirm that deal activity surged in 2019 but, at the same time, most respondents expect a stabilising market in the years to come, which is also observed in the PwC Private Equity Survey 2020.

Most respondents combine intrinsic and extrinsic valuation methods, and 65% of them would do those valuations internally. Most of our respondents would take the tax benefits into account in their valuations. As explained below, the change in Belgian tax legislation as regards deductibility of interest is likely to impact the valuation approaches in an M&A context.

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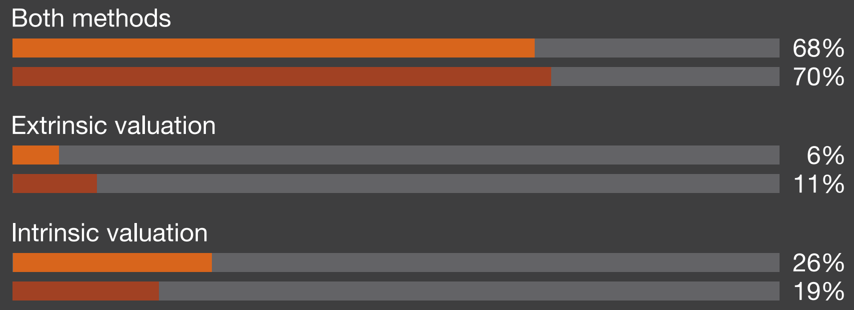
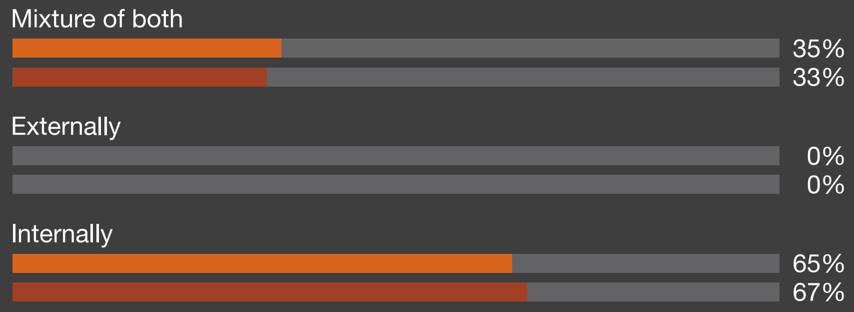
Premiums over stand-alone values would typically range between 10% and 30%, with a median set at 25%. Those premiums are in line with the one observed in public transactions, which would typically range from 18% in the case of a friendly take-over to 30% in the case of a hostile take-over.

How do you usually determine the price?



Who determines the price?



Financial Buyer/Seller   Corporate Buyer/Seller

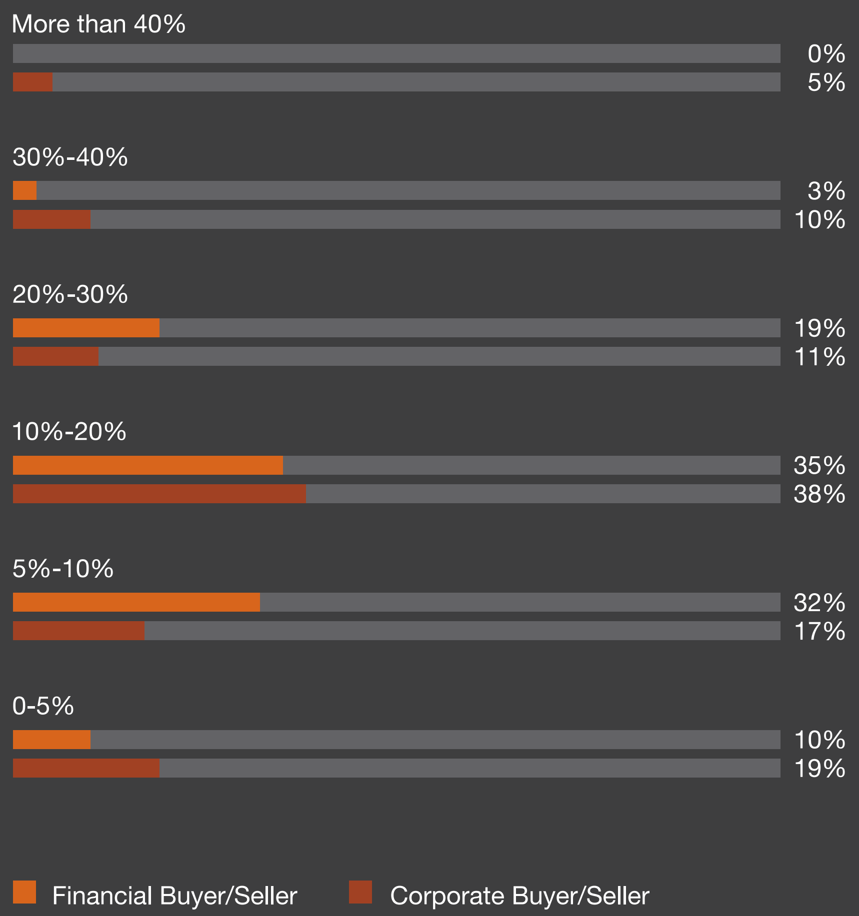
Strategy

Ever since the financial crisis, the strategy of PE players is focussed on operational excellence as well as on multiples by using buy-and-build strategies as a form of arbitrage – essentially scaling up valuable new companies by acquiring smaller, cheaper ones[13]. Against this background, corporate competitors execute large-scale strategic mergers that create value out of synergies and combined operational strength.

Buy-and-build strategies are popular because they offer operational excellence to optimise deal multiples. They offer the possibility to compensate large acquisitions with high valuations with smaller acquisitions. As such, a buy-and-build strategy can justify the initial expensive acquisition with the opportunity to achieve smaller add-ons at lower multiples. This arbitrage brings down the firm's average cost of acquisition while realising synergies that reduce costs or increase the top line.

[13] Two-thirds (66%) of respondents of our Private Equity Survey 2020 say the impact of operational improvements has increased over the last 3 years.

Average premium paid in excess of a standalone enterprise value in an M&A transaction



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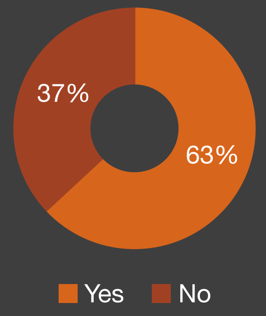
Leveraging deals & refinancing

Outlook – access to financing

The debt markets encouraged PE players and corporates to keep doing deals through much of 2019. Despite the rise in US interest rates, the EU rates are still at an historic low (now negative EBC rates or minus 0.5%) while the maintenance of the quantitative easing program/loan purchases by the ECB as well as the nomination of Christine Lagarde will certainly keep interest rates low in the coming years.

Lenders, meanwhile, are competing aggressively to extend credit on easy terms. So-called covenant-light loans are becoming increasingly common in lending markets, and we have seen an increased number of shadow lenders (i.e. non-bank lenders) such as credit funds or private equity mezzanine funds entering our market.

Do you see more M&A opportunities with the interest rates remaining low?



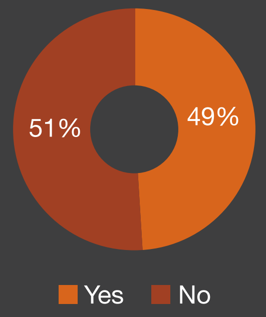
Sentiment around obtaining leverage is broadly positive, but there does appear to be some anxiety, which might be expected, given recent turbulence in capital markets. Most of our respondents told us that they expect the availability of cheap credit will have a positive impact on the M&A market and told us that they expect this to stay the same in 2020 as in 2019. About half of the respondents to our PwC Private Equity Survey 2020 also anticipate the same trend.

If confidence in the capital markets remains and sustains, financial buyers should expect to be able to access the capital market to finance their deals in 2020. Here again, we hope the Coronavirus will not alter this sense of optimism.

Covenants – tax impact

Overall, we experience that Belgian companies are breaching their banking covenants less frequently, which indicates that either they are using leverage more prudently or earnings growth is sufficiently robust to meet interest and amortisation repayments, or both.

Does the changing tax environment have an impact on structuring the financing of a deal?



The change entailed by the European Anti-Abuse Directive introducing an overall cap on the deductibility of interest expenses of €3 million or 30% of EBITDA at group level may, however, decrease the tax shield advantage. Hence, while from an economic viewpoint, limiting the cost of funding may be found interesting, the tax advantage of a leveraged acquisition is now also limited, which could potentially limit the credit. About 50% of our respondents believe that the changes in our tax environment will have an impact on structuring the financing of a deal. Similar concerns about increasing regulation were also voiced in our PwC Private Equity Survey 2020.

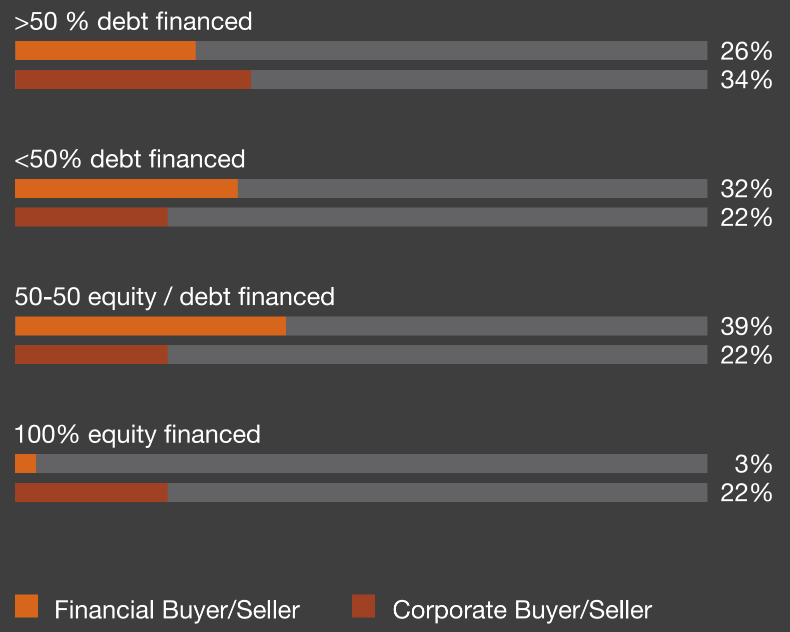
32%

of respondents informed us that they had already refinanced their existing credit facility in the past years.

Average leverage

Some respondents told us that they see challenges on the horizon regarding servicing debt, in terms of not just breaching covenants but also the impact of the cost of meeting debt obligations on future returns. Most respondents are, however, cautious in limiting the level of debt in their acquisitions. More than 50% of firms say that the average debt-to-equity ratios applied in their deals in 2019 were 50% or below, with only 265% using more than 50% debt in their transactions. Similar results are also observed in our PwC Private Equity Survey 2020.

What was your leverage model in past acquisitions?



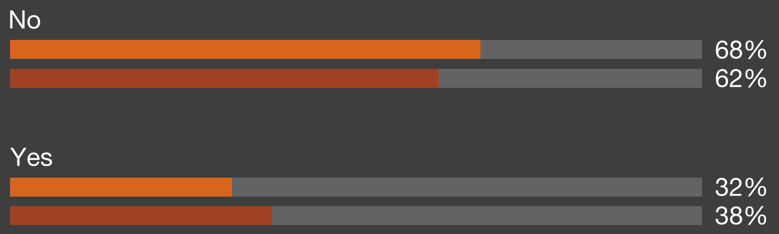
With an average deal multiple of 6.0/6.5, this would result in an average ratio of net financial debt (NFD) to EBITDA of 3.0/3.5. This varies by sector, for instance despite relatively lower valuation multiples, real estate deals are amongst the most leveraged deals with a loan-to-value ratio reaching between 70% and 80% in some cases, such as in the recent acquisition of the Finance Tower by a Korean fund, reflecting the sector's lower risk profile.

This is a good thing at a time when there are signs of a global economic deceleration, which has largely been associated with a slowdown in China and trade war effects. For instance, the Belgian economy grew by 1.5% last year, and Germany was at its slowest rate since 2013 as performance weakened in the latter half of the year. Given the close trading ties with China, any slowdown in Asia's largest economy following the Coronavirus (for which the IMF already predicts a 30% drop in GDP growth) is contagious for Germany, which will eventually affect Belgium, as Germany is our biggest trading partner.

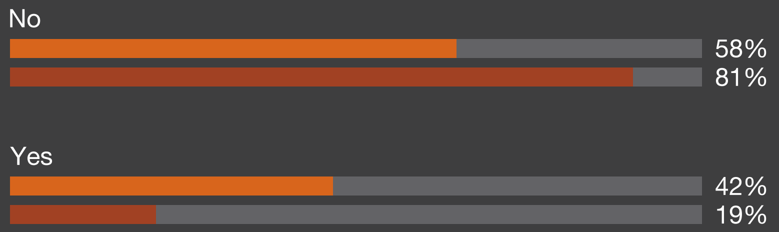
This suggests that prudent levels of acquisition debt will give companies greater headroom and decrease the risk of companies breaking covenants and losing control to lenders. Aside from the debt and equity financing, we have also seen, in recent years, an increase in delayed payments that are fixed (vendor loans) or that depend on post-M&A performance (earn-outs), especially in small and medium-sized deals.

As the interest rates are currently low, and have been for several years, about 32% of respondents informed us that they had already refinanced their existing credit facility in the past years. About 40% of respondents are still considering doing so in the coming year, leading to the hypothetical conclusion that most firms already did this.

Did you perform a refinancing of you existing debt the past year?



Do you expect to perform a refinancing of your existing debt the coming year?



Financial Buyer/Seller
Corporate Buyer/Seller

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The importance of an attractive tax and regulatory framework

Increased complexity cancels out the efforts made to stimulate the investment climate

Despite the fact that tax and regulations are very rarely the drivers behind an M&A transaction (except in cases such as a forced divestment following anti-competition rules), a solid and efficient tax and regulatory environment is nevertheless of key importance for a positive investment climate and a successful M&A transaction.

Throughout the deal continuum and even beyond, tax and regulatory factors can contribute to – or hinder – a successful transaction/ investment:

- Local tax regimes and profit repatriation rules directly impact the return on investment and hence the opportunity, valuation and bid competitiveness of an acquisition.
- The stability and reputation of a country, its regime and authorities, as well as its attitude towards (foreign) entrepreneurs and investors are important decisive factors in whether or not to enter a new or lesser-known market.
- Antitrust, together with other regulatory proceedings and approvals, can negatively affect the timing of a transaction and entail a certain level of deal uncertainty. Whether or not such proceedings apply can be an important differentiator on the sell side when selecting preferred bidders, especially where offers are financially equivalent/comparable.
- Bidders who are able to implement a tax-efficient acquisition, financing and exit structure have advantages over others, especially in today's highly competitive deals market. This also implies that bidders with presence in jurisdictions with an accommodating and supportive legislation and attitude towards (the financing of) inorganic growth have structural advantages over foreign competitors.
- Post-merger integration (PMI) requires the flexibility to achieve an effective (group) structure supporting operational integration motives. Such a structure should be implementable in a time- and cost-efficient, tax-efficient (preferably neutral) and risk-free manner in order to safeguard synergy potential.

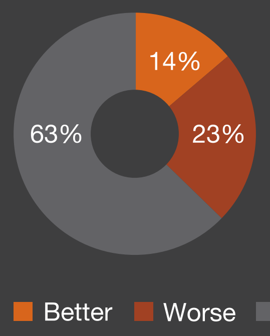
63%

of survey participants indicated that the current regulatory and tax environment in Belgium is 'the same' as before.

The Belgian regulatory and tax environment assessed by Belgian M&A stakeholders

When to assess the evolution of the Belgian regulatory and tax framework, a clear majority of survey participants (63%) indicated that the current regulatory and tax environment in Belgium is 'the same' as before, whereas 23% feel the current environment is 'worse'. A minority of respondents (14%) cited a 'better' regulatory and tax environment.

As an investor, do you believe that compared to before, the current regulatory and tax environment in Belgium is:



According to our survey, a significant number of participants highlighted the following elements as positive recent evolutions:

- The decrease of the corporate income tax rate following the latest tax reform from 33.99% (FY17 and before) to 29.58% (FY18 and FY19) and 25% (FY20 and onwards).
- The increase of dividend-received deduction and participation exemptions on capital gains to 100%.
- The introduction of (the concept of) a group contribution regime allowing transfer of current year losses to other profitable group entities (however, this is perceived as complex and of limited use in an M&A context).
- The new Belgian Companies Code installing further flexibility and simplification.

Despite these positive elements, the vast majority of participants indicated that there's still a necessity and room to improve the Belgian tax and regulatory framework. The feeling is that the overall framework didn't improve in a structural way following the above-mentioned measures. The explanations below were given as underlying reasons by survey participants and by other (M&A) professionals:

- **Complexity and overregulation lead to an increasing compliance burden and costs**

  Overregulation has been flagged by a number of participants as a key attention point in today's regulatory and tax environment. A similar conclusion was derived from the 23rd PwC Annual Global CEO Survey: When looking ahead to 2020, "overregulation was reconfirmed the top threat after having questioned 1,581 chief executives in more than 80 countries. One aspect of this complexity is a compliance burden which is still continuing to increase and which requires significant costs and efforts, entailing a risk of distraction from the core business."

- Participants in our M&A survey also flagged the need for a more straightforward tax environment, as the Belgian tax framework as a whole (including recently introduced measures such as the group contribution and the 30% EBITDA limitation on exceeding borrowing costs) is perceived to be very complex, leading to a high degree of uncertainty and an increasing cost of compliance.

Fast-changing regulations result in the need for legal certainty and political stability

Whereas entrepreneurs and investors are looking for mid- and long-term stability, they're in practice often confronted with uncertainty. At the time of publication, for instance, the formation of the federal government is still pending following last year's elections. With regards to the positive elements of the latest tax reform, the Belgian business community and foreign investors are concerned about the risk of a reversal of certain measures. Needless to say, a stable and sustainable tax and regulatory climate (exceeding one government term) is necessary to create trust in investors and to allow entrepreneurs to focus on their core business. Despite a divergent Belgian political landscape, sufficient reassurance on the future availability and application of legislation, incentives, tax consequences, etc. is key to supporting strategic decisions (including M&A transactions and investments) and improving competitiveness. On a global scale, it's noticeable that the uncertainty following Brexit, Trade Wars, other international conflicts and recently COVID-19 leads to a more conservative approach and/or delayed decisions on investments in markets which are (presumed to be) affected.

'Compensatory measures' reduce the effective impact of the corporate income tax reform

The efforts of the previous Belgian government to increase the competitiveness of Belgium were very welcome. The decrease in the corporate income tax rate gave (for certain taxpayers) limited to no benefit as it was compensated by certain 'compensatory measures' aiming to limit the budgetary impact of the overall tax reform.

Limited/delayed use of the group contribution regime in an M&A context

Unlike other countries, Belgium did not historically have any form of fiscal unity/consolidation for direct tax purposes. As of 2019, the Belgian legislator introduced a group contribution system allowing the transfer of a current year's loss to a profitable group company. Unfortunately, as a stringent minimum five-year holding period is required, the potential use of the group contribution system for leveraged acquisitions, or to 'pool' losses and profits of the buyer group with losses and profits of the acquired group, is delayed for a significant period of time. Any carried-forward tax losses which are built up during this waiting period can only be used on a standalone basis. As a result (especially in relation to Private Equity transactions, where five years represents an important part of the average investment cycle), the Belgian group contribution system is, contrary to full and immediate fiscal unity regimes abroad, not an (immediate) enhancing factor for M&A transactions. This is considered a missed opportunity.

Involvement of (local) regulators needed on complex and international deals

Cross-border deals and changing market conditions make it challenging for (local) regulators to grasp the complexity and international aspects of certain transactions. An increasing number of regulated groups are planning on separating their regulated from their non-regulated business in order to increase flexibility for further expansion of their non-regulated business.

Conclusion

When asked about the evolution of the Belgian tax and regulatory framework, participants in our M&A survey were positive about the beneficial elements within the latest corporate income tax reform and corporate legal reform. However, to maintain competitiveness within today's challenging business and M&A environment, participants flagged an important need for (i) deregulation, simplification and reduction of compliance burden, (ii) enhancement of legal certainty and stability, and (iii) further initiatives to accommodate an investor-friendly tax framework to enhance Belgian M&A activity and the success of Belgian bidders on international transactions.

10

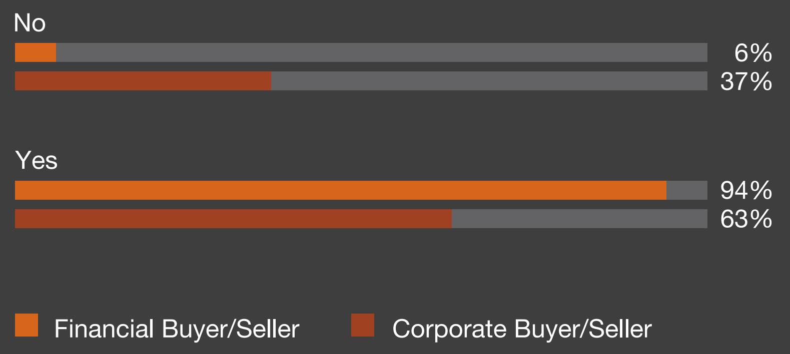
Management incentives in an M&A context

Outlook

Successful transactions consider all aspects of a corporation, not just the business or the potential synergies, but also the often-overlooked human factor.

The human factor cannot be handled in a silo. It should be considered throughout the deal process, which is why most respondents incentivise management as part of the acquisition process. That said, between corporates and financial buyers, there can be significant differences in the approach taken to reward.

When doing a deal, do you incentivise the management of the target?



Post-deal: in with the new

Reward in transactions is often more complicated than stakeholders think at first. The reality is that certain benefits granted in the past should be restructured or even cancelled.

Next to job security, one of the key concerns for employees is the impact on their existing equity incentive plans. The success of a deal ultimately depends on the motivation of the employees and the alignment of their objectives, including reward packages, with those of their investors. In other words, making sure that their reward package remains attractive is vital.

The reward approaches often greatly differ between public and privately-held companies as well as in corporate or financial players. Public groups tend to use traditional incentives such as stock options or restricted stock units. In private groups, management is often offered “sweet equity”, i.e. tax-optimised incentives.

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Reward in Belgium: the tax angle!

Getting the right balance between employee expectations and costs is another challenge, especially in a rapidly changing tax and legal environment.

Tax efficiency emerges as a key area where businesses could improve, particularly in Belgium, considering its high tax and labour costs. Our Belgian Reward Barometer study[14] indicates that only 15% of employees were highly satisfied with their employer's efforts to optimise the tax efficiency of remuneration.

The results of our study are no surprise. The usual net-to-cost ratio of a cash bonus is approximately 30%. This is due to the 50% income tax rate already applying from €38,000 yearly gross pay and to employee and employer social security contributions, which are uncapped and amount to 13.07% and +/-30%, respectively, of gross pay.

The Belgian government took action in the "tax shift" agreement to lower employer social security contributions. Even with the decrease in employer contributions to 25%, the improvement of the net-to-cost ratio of a cash bonus is expected to be limited to some 2%, leading to only a 32% net-to-cost ratio.

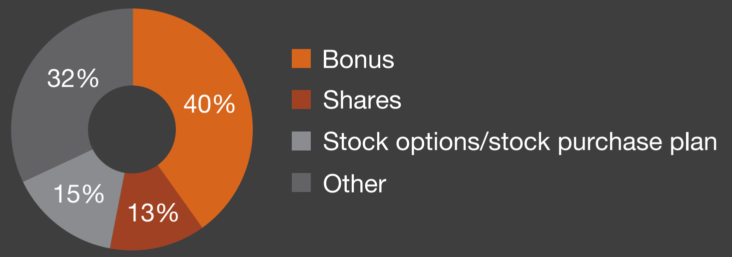
[14] *2016 Belgian Reward Barometer*. The Reward Barometer is an annual study on how financial and non-financial rewards influence employee motivation.

In practice, employers struggle to select the right instruments to optimise reward packages from a tax, social security and labour law perspective and to keep the package consistent with the remuneration philosophy and challenges. Our Reward Barometer study shows that half of all respondents believe that their pay package does not adequately reflect their efforts.

Employers can increase return on reward by evaluating the role of different components in the total reward programme. Certain tax-friendly remuneration elements determine the taxable benefit on a lump-sum basis, lower than the actual financial value.

In Belgium, the most frequent equity incentives for corporates are stock options, restricted/performance stock units and share purchase plans. Straightforward cash bonus schemes only represent 3.5% of the reward package. While, in several countries, stock options are taxed at exercise, Belgian law provides for a lump-sum taxation at grant under certain conditions.

Corporate Buyers/Sellers
Management Incentives



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Reward in private equity companies

The reward approach in a private equity (“PE”) transaction may significantly differ from a corporate approach.

Aligning the financial interests of portfolio company executives and fund managers with those of investors is the most effective way of motivating the executives. Portfolio company executives and fund managers are asked to commit private funds to the transaction equity package. In return, they can expect to receive gains when performance objectives are achieved.

The challenge in designing or resetting incentive arrangements lies in designing them to support a successful behaviour from portfolio company executives and fund managers at a cost that is acceptable to the other PE stakeholders. As a result, incentive arrangements need to be tax-effective, and their financial implications should be understood and agreed by all stakeholders from the outset.

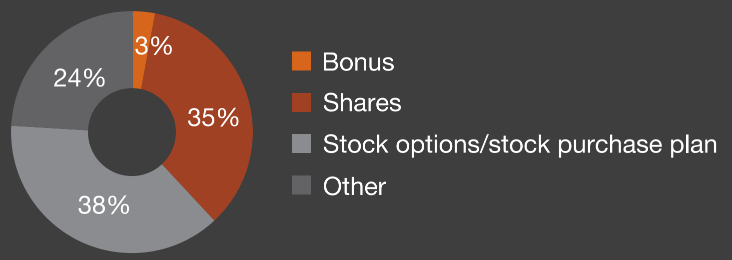
We experience in Belgium that the compensation of PE executives and portfolio managers generates a continual debate on whether such incentives should qualify for favourable tax treatment as capital gains/investment income or be subject to a higher tax charge as earned income.

Belgian tax legislation does not provide specific laws or guidelines addressing the tax treatment of income and capital gains arising from incentive arrangements for fund managers and portfolio company executives. The taxation of these incentive arrangements will essentially depend on the way they are legally designed but, in most cases, the resulting income will qualify as movable income if acquired at fair market value. Hopefully, recent rulings have confirmed this approach in the case of sweet equity and carried interest.

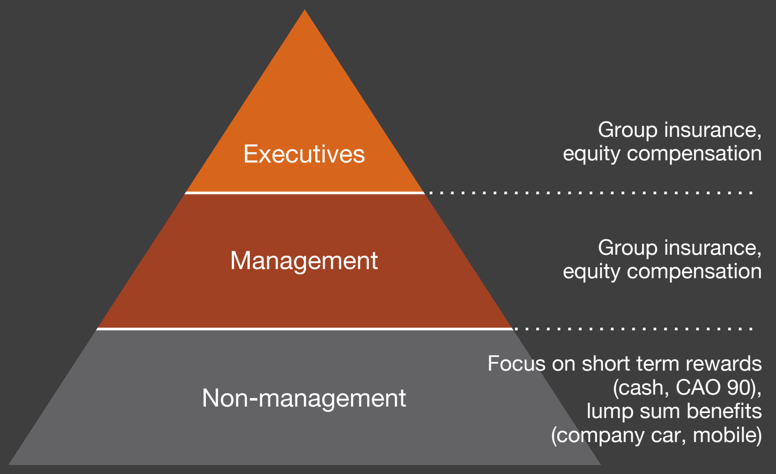
Reward approaches: executive vs lower-tier managers

Reward can take several forms depending on the level of the individual, but equity incentives in general remain extremely popular for first-tier and second-tier managers. Overall, equity and stock options represent 70% of the rewards considered by the respondents in our survey.

Financial Buyers/Sellers
Management Incentives

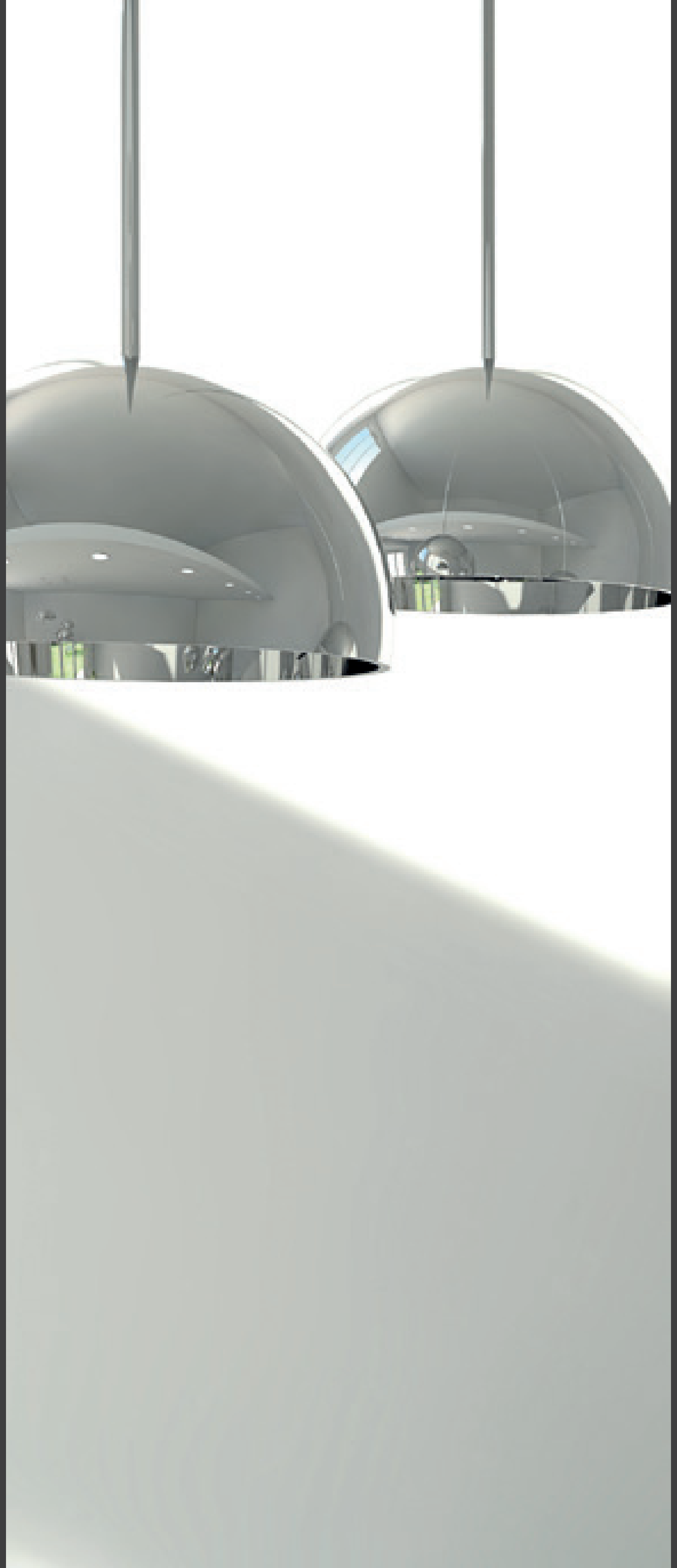


Reward approach



The 2018 Global Equity Incentives Survey[15] indicates that 45% of the non-US grants of equity incentives were meant to align compensation with business strategy. However, since 2012, there has been a decline in broad-based grants (with the exception of employee stock purchase plans, which are usually offered to all employees). While this might be surprising at first, we noticed that the prevalence of performance awards has increased since 2012. Clearly, equity compensation is increasingly being used to reward executives and management for their performance instead of being a part of the compensation package for all employees.

[15] *2018 Global Equity Incentives Survey.* The Global Equity Incentives Survey is one of the most comprehensive studies on the design and administration of equity-incentive-based compensation plans for multinational companies.



A word of thanks

I want to thank our M&A management team for their valuable input and energy put in helping to realise this report, our marketing department for the look & feel of the survey and certainly also my fellow partners Hugues Lamon and Lieven Adams for their useful views and help in achieving this result.

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