

Successful M&A transaction depends on advance preparations 1/6/23



Director, Tax, PwC Latvia
Vita Sakne

The mergers and acquisitions (M&A) space is justifiably perceived as one of the indicators of economic activity – greater interest in acquiring, merging and investing in companies means more dynamic development of the economy. Compared to recent years, 2021 set a record in terms of number and volume of transactions (up by 48% in the Baltic States) but 2022 saw a slowdown in M&A activity because of geopolitical turmoil. Some transactions are still taking place, while others are put on hold, and the business community is preparing for times that will bring more certainty and stability. Since a successful M&A transaction needs preparation, this is a good time to do the homework while considering the next cycle of economic activity.

How to lay the foundations for a successful transaction

As we advise companies of different sizes in a variety of sectors wishing to sell their business or buy another company, we emphasise that preparations made in advance are crucial for the successful completion of an M&A transaction. This applies to tax compliance discipline, a well-thought-out human capital policy, a transparent corporate structure and aligned business processes, as well as ESG initiatives. These are all issues that cannot be resolved within a few weeks or months before the transaction, and recognising their positive results might require the close of the financial year. An experienced adviser with international reach is likely to see more potential for business growth that might go unnoticed by the busy owner or CEO.

The length of preparations for a successful M&A transaction depends on its complexity and scale, but usually this pre-deal phase involves working on three key processes.

First, we need to analyse the company's present structure and create one that is acceptable to the buyer and the seller after the M&A transaction. The company may have to be reorganised by carving out one of its business lines to stay outside the transaction perimeter. Or the other way round – if the buyer is interested in one or more business dimensions in a larger company, then we need to create a structure that fits this goal. In this phase we not only have to assess day-to-day operations, legal aspects and financial flows, but we also need to carry out a comprehensive assessment of the tax position. For example, the company might need an advance tax ruling on its rights in order to carry out complex transactions involving an obligation to register for foreign VAT or in order to apply taxes correctly. Eliminating tax risks and creating a strategy can be beneficial and help complete the transaction as close to the parties' scenario as possible.

Another important process involves identifying and assessing hidden risks. This covers current and earlier obligations for which the parties will be held jointly and severally liable (under the Commerce Act this condition applies to the relevant part of the company for five years after the transaction). We also need to assess what role the owner's know-how plays in the company's success story to avoid it being unable to operate successfully without its previous owner (or CEO). From the perspective of hidden risks, we also need to assess the tax issues mentioned above – both tax compliance and how the company applied tax

laws earlier.

Thirdly, the business needs structuring to carry out the current owner's desires and vision in the context of the M&A transaction, while considering the interests of a range of potential buyers. The owners often want to sell a part of their company in order to raise funds for developing another line of business. So we need to create a new business structure or structures capable of functioning successfully after the M&A transaction is completed. In more complex cases, the structuring involves a number of stakeholders, such as investors and banks. Once the company is sold, the question arises how to use the know-how and brand, which may often be sitting in another company that has merely issued a licence to the company being sold.

We must emphasise that the consultant advising the parties to the transaction will not undertake a special investigation of the buyer's or seller's transactions but will usually receive sufficient information on the target to be able to warn the parties of risks identified after analysing financial and commercial documents and public information. If any material risks or irregularities are detected in this phase, the consultant will normally ask for additional information or suggest a way to eliminate any shortcomings that allows the transaction to continue. As we advise the Latvian business community, we see fewer and fewer companies in need of extensive improvements. Most of the companies have been sufficiently careful and disciplined, have put transparent business processes in place and have paid their taxes on time. A special effort is required to set up an ESG policy and adopt ESG principles in the company's operations, as investors are now paying more attention to this aspect.

Added value in preparing the transaction

Keen observation from the outside and involvement in preparing the transaction (from tax policy, business structuring and legal aspects to ESG) is just one of the benefits an experienced consultant provides to the parties to an M&A transaction. Another key thing is that the consultant's international experience can prepare the company's owners for a realistic transaction scenario. Both parties usually tend to see the future that the upcoming transaction will bring through rose-tinted glasses, but the consultant's role is to weigh all the pros and cons, assess risks and offer an assessment of the situation based on facts. Taking a realistic view allows each party to defend its position in negotiations and find compromises faster in order to close the deal. Involving an international consultant also means immediate access to accurate and current information worldwide. There are many examples of this international dimension having been crucial in M&A transactions in Latvia or in deals involving Latvian companies abroad.

Family business in M&A

With independent Baltic companies having operated for 30 years, there are several examples of a company's founders wishing to retire and leave their company in the care of another family member. In such cases the company is often restructured by attracting one or more investors who will acquire a part of the business. The characteristics of such cases arise from the essence of a family business - the company is inherited from generation to generation. More expenses are incurred in the succession (including education) of generations and in employing other key people of the family business. These characteristics should be taken into account when preparing for an M&A transaction whose structure often involves, for example, loans and related companies or a certain governance structure.

In summary, a company of any structure and type should be thoroughly prepared for an M&A transaction in advance. This may take a lot of time and effort - the pre-deal phase involves analysing the company's

processes, looking for its untapped potential and finding a way to achieve the best bargaining position. Experience becomes the most valuable asset - the more diverse M&A transactions a consultant has handled, the better they are at finding a solution acceptable to both parties.