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What is the current market thinking on how to design a new incentive structure in anticipation of or immediately after an M&A transaction?

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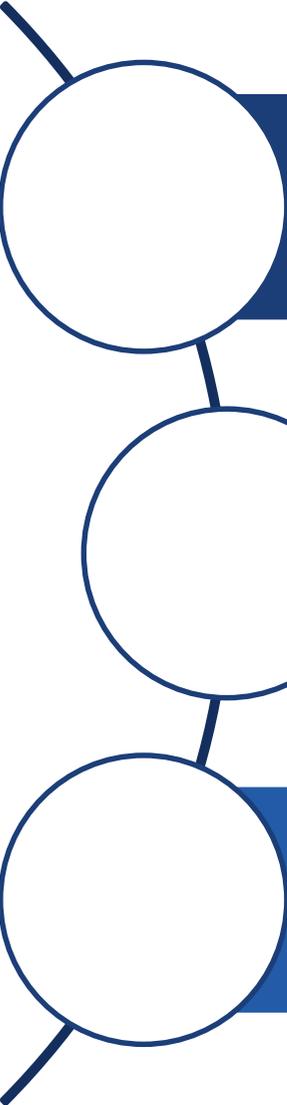
Overview

- Incentive arrangements for private companies anticipating an exit
- Dealing with incentives on a transaction
- Retention issues
- Post-completion incentives for public companies
- Demystifying sweet equity – post-completion incentives in private companies

Pre-exit arrangements

- Public companies do not generally structure incentive arrangements with M&A as a focus
 - plans will generally deal with takeovers and including discretions is often useful
 - may be some historic pre-floatation plans with more unusual change of control provisions
- Private companies need to focus more on exit events as this is their opportunity for liquidity
- Whilst goal may be an exit, the key design factor will be how best to incentivise performance to make an exit more likely
- Focus on business value and share price growth
 - share options; does the company qualify for EMI?
 - growth / hurdle shares
 - joint share ownership
 - combination of the above
- Are performance conditions necessary?
 - corporate performance
 - increasing hurdle value
 - ratchet/flowering shares with performance trigger

Dealing with public company incentives – driving design



General Considerations

- equality of treatment between participants
- IA Guidelines
- rationale for exercising discretion to move from “default position”
- disclosure in shareholder documents: consult with bidder and be mindful of shareholder concerns

Time pro-rating

- market practice is not transparent
- reasons for disapplying or modifying will be transaction specific
- considerations include proximity to normal vesting, whether rollover is being offered, possible redundancies/retention

Performance conditions

- rare for plan rules to now provide for discretion in relation to application of performance conditions
- discretion arises in the context of determining the application of the performance conditions
- do the current performance conditions remain appropriate in the context of a transaction?
- discretion to override the formulaic outcome of the performance conditions, for example based on value delivered

Dealing with public company discretionary plans

Offer	Date	Value	Discretionary Share Plan Treatment	Link
Takeaway.com N.V. offer for Just Eat plc	R2.7 - 5 August 2019 Scheme document – 22 October 2019	£5bn	For PSP (executive) and RSP (general population) awards: <ul style="list-style-type: none"> performance conditions will be applied; and time pro-rating will be waived for 2017 awards, but continue to apply for 2018/19 awards but that replacement "transitional" awards will be granted by Takeaway.com following completion with equivalent value to the pro-rated aspect of 2018/19 PSP/RSP awards, on the same vesting timetable and with equivalent performance conditions (where relevant) 	https://www.justeatplc.com/pr/otected_file/720 https://www.justeatplc.com/pr/otected_file/704
Barrick Gold Corporation offer for Acacia Mining plc	R2.7 – 19 July 2019 Scheme document – 12 August 2019	£950m	Time pro-rating and performance conditions applied to LTIP awards. It is not clear whether this approach is due to strict rules or a choice not to exercise discretion.	https://www.acaciaminging.com/possible-offer-to-acquire-acacia-mining-plc-disclaimer.aspx
Kirkbi AS (Lego) offer for Merlin Entertainments plc	R2.7 – 28 June 2019 Scheme document – 1 August 2019	£4.8bn	Co-operation agreement stated that PSP awards would vest to the extent determined by Target Remuneration Committee . Circular stated that for PSP awards, the Remuneration Committee will waive time pro-rating but apply performance conditions.	https://www.merlinentertainments.biz/disclaimer
Sports Direct offer for Game Digital plc	R2.7 – 5 June 2019 Offer document – 20 June 2019	£52m	For PSP awards, the Remuneration Committee waived time pro-rating , but applied performance conditions.	http://www.gamedigitalplc.com/investor-relations/offer-for-game-digital
Macquarie offer for KCOM Group Plc	R2.7 – 3 June 2019 Scheme document – 18 June 2019	£627m	For PSP awards, the Remuneration Committee waived time pro-rating , but applied performance conditions.	https://www.kcomplc.com/investors/investor-information/offer-for-kcom-documentation-meif-6-fibre/
LondonMetric Property plc offer for A&J Mucklow Group plc	R2.7 – 23 May 2019 Scheme Document – 30 May 2019	£400m	For PSP awards the Target Remuneration Committee determined to apply performance conditions and time pro-rating.	https://www.londonmetric.com/investors/recommended-offer-may-2019
One Savings Bank plc offer for Charter Court Financial Services Group plc	R2.7 – 14 March 2019 Scheme Document – 15 May 2019	£730m	For PSP awards: <ul style="list-style-type: none"> performance conditions were applied; time pro-rating was waived for 2017 awards but continued to apply for 2018/19 awards; and OSB will grant replacement awards granted under the OSB LTIP following completion with equivalent value to the pro-rated aspect of 2018/19 PSP awards with equivalent vesting schedule / performance conditions. 	https://www.chartercourtfsc.co.uk/InvestorRelations/Disclaimer

Retention issues

- Public companies are often concerned with retention once a deal has been announced
- Bidders are restricted from offering incentives before the transaction has completed
- Targets may argue for retention arrangements to be put in place during the offer period
- Consider whether retention bonuses are necessary and who is a flight risk:
 - Are the existing incentive arrangements, which may pay out early, sufficient retention at least to completion of the transaction?
 - Could discretions under the existing incentive arrangements be used rather than new arrangements
 - Is retention until completion sufficient, or do some individuals need to be retained for a period post-completion
 - Are there any other arrangements in place which will have a retentive effect, for example enhanced redundancy packages?
- Irrespective of retention, there may still be an argument for rewarding those individuals who have been key to delivering the transaction.
 - Consider Rule 21.1 of the Takeover Code – arrangements which are not “ordinary course”
 - Consult the Panel if amounts may be considered material
 - Have arrangements been agreed with a bidder as part of a Cooperation Agreement?
- Retention payments for directors?
 - Consider whether these are appropriate
 - Timing of payment needs to be considered in light of the Remuneration Policy

Retention arrangements

Offer	Retention arrangements
Comcast Corporation offer for Sky plc	<p>LTIP awards vested on a time pro-rated basis, but without performance conditions.</p> <p>Replacement awards were granted by Comcast following completion with equivalent value to the pro-rated aspect of LTIP awards, on a replacement (shortened) vesting timetable</p>
Merger of Standard Life plc and Aberdeen Asset Management plc	<p>Retention arrangements were implemented for key employees to recognise contribution through the integration period following the merger.</p>
Ball Corporation offer for Rexam plc	<p>Cash retention awards were made to employees (excluding directors) whose retention was considered critical for achieving the successful completion of the offer, where such employees did not participate in the LTIP.</p>

Post-completion incentives issues for public companies

- Great care should be taken in relation to any discussion or agreement with the Bidder about incentives for members of the Company's management, particularly if they hold shares
- Takeover Code Rule 16 – Special Deals and Management Incentivisation
- Rule 16.2 governs entering into or reaching “an advanced stage of discussions” on arrangements for managements
 - Any discussions or arrangements will need to be disclosed in the shareholder documents and may require a “fair and reasonable” opinion from the financial adviser
 - The Panel must be consulted if the value is significant and/or the nature of the arrangements is unusual either in the context of the relevant industry or good practice
 - The Panel may require separate shareholder approval of the arrangements

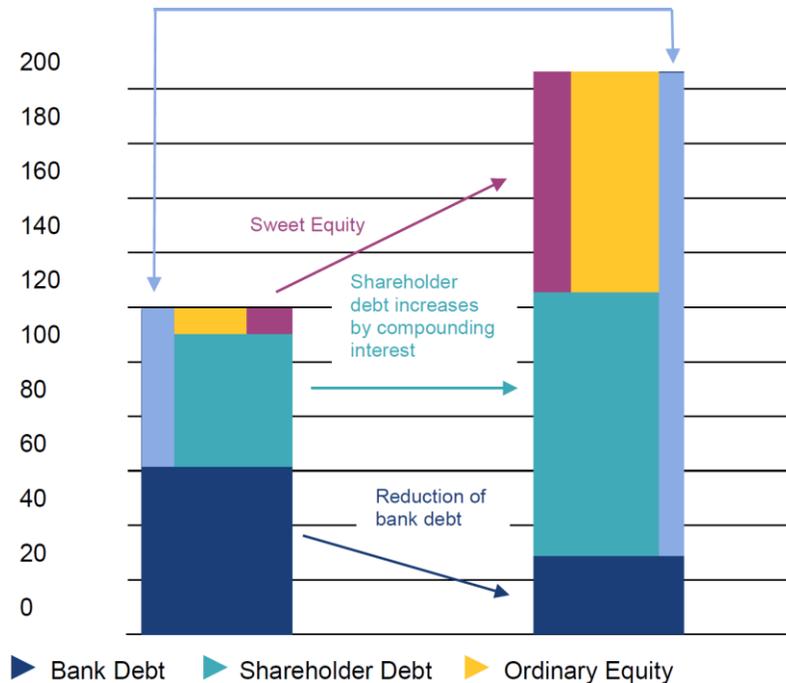
Demystifying sweet equity

- Sweet equity is simply a portion of equity that has been ring-fenced to incentivise management
- Expectation from management that the arrangements will deliver CGT treatment
- Can take the form of ordinary equity in leveraged BidCo, possibly with ratchet shares which “flower” once certain hurdles have been met; or “growth” or “hurdle” shares
- Sometimes are simply share options with performance hurdles
- Structure will depend on financing of the bid and investor ownership interests in the target
- Structure may need to comply with HMRC/BVCA MoU

Private equity incentive arrangements

Leveraged Bidco structure over life of investment

Management's **institutional strip** is typically a combination of Shareholder Debt and Ordinary Equity held in the same ratio as the Investor, delivering a risk and return profile in line with the Investor's return



Management

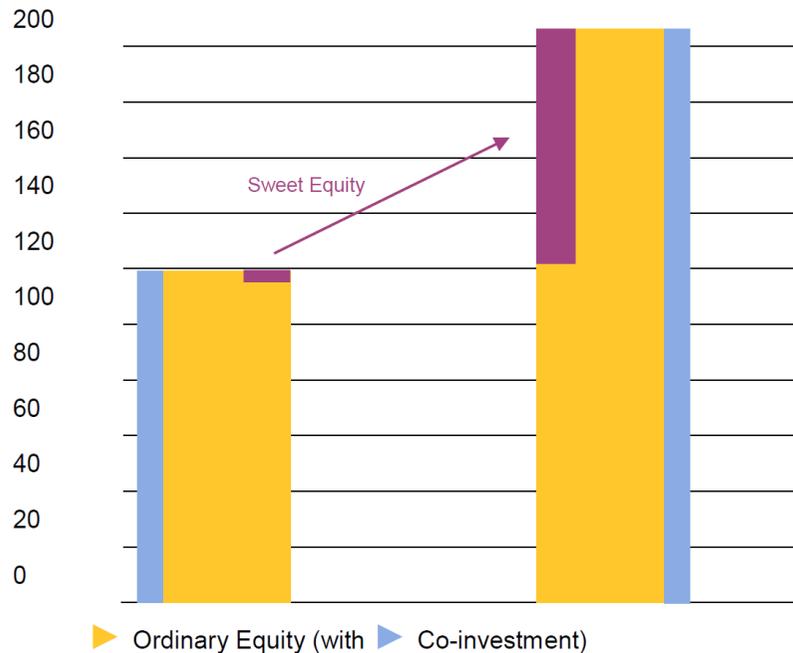
- Sweet equity – expected return of 15x to 20x initial investment
- Institutional Strip – aligned to investors, so expected 2x to 3x initial investment

Investor

- Ordinary Equity (<5%) plus shareholder debt (e.g. loan notes, preference shares)
- Target investment returns of 2x to 3x initial investment and a 20% to 30% IRR

Private equity and trade buyer incentive arrangements

Equity investment with Hurdle Shares



Management

- Sweet equity – share in future growth above hurdle
- Co-investment – aligned to investors

Investor

- Ordinary Equity

Exit Arrangements

- Private equity expected investment period generally around 5 years
- Trade buyers may not anticipate an exit; alternative investors (e.g. sovereign wealth and infrastructure funds) have a 10 – 25 year ownership expectation
- Management will typically expect a 3 – 5 year incentive horizon
- Consider synthetic structure, particularly if investor requires reinvestment of a significant proportion of proceeds received on a deal
- Varying levels of comfort/commitment: soft comfort; contractual commitment (put option); “share shops”/internal market

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