DON'T GO MAD: LESSONS FROM THE TRENCHES ON MERGERS, ACQUISITIONS AND DIVESTITURES

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Scott Bellinger is responsible for a dedicated and unique relationship management team at Computershare that administers all aspects of both employee equity plans as well as stock transfer agency for a small group of large and fully integrated client companies with highly customizable and complex needs.

Scott specializes in bringing an in depth consultative approach to bridging the gap between plan design, system capabilities and ongoing administration.

He joined Computershare in 2012 with the acquisition of the Shareowner Services business from The Bank of New York Mellon.

He brings over 25 years of experience in the equity compensation, stock transfer agency, corporate banking and financial services industry.
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Michael Thompson is a Senior Director in Willis Towers Watson’s Executive Compensation practice in Toronto. Michael’s expertise focuses on executive compensation and incentive program design.

Michael is widely recognized in North America as a leading consultant in Executive Compensation. He has over 30 years experience consulting to boards and executive management of some of the largest firms in both Canada and the United States.

His clients include large listed companies, closely held private organizations as well as public agencies and regulated companies.

He is an active writer and researcher on organizational performance and reward program effectiveness and is widely published. Michael was an editor of the Executive Handbook on Compensation published by the Free Press. In addition, he is a frequent lecturer on Compensation Governance at the Rotman School of Business’s Director Education Program and at The Schulich School of Businesses MBA program. Michael has recently been engaged as a lecturer in Executive Compensation in the GPLLM program at University of Toronto.

Prior to joining WTW, Michael was a Partner with Mercer in Toronto and previously the North American Practice Leader for Reward Consulting for the HayGroup based in New York and Philadelphia.

Michael holds an MBA from the IVEY School of Western University, a B.Admin from the University of Ottawa and is a Chartered Professional Accountant (CPA CMA).
Today’s Discussion

➢ Strategic Viewpoint
  ❖ Overall corporate objectives
  ❖ Holistic people issues and identification of key staff
  ❖ Willis Towers Watson’s M&A Retention Survey
  ❖ Priorities broader than equity

➢ Tactical Viewpoint
  ❖ Actions Pre-Close
  ❖ Tasks Post-Close
Business Case for HR as a Key Component of Overall Deal Success

People issues directly affect realization of the strategic value of the deal

- Expected deal outcomes
  - Increase revenue
  - Create cost synergy

- Future business strategy
  - New products/services
  - Cross-sell
  - Expand customer base
  - Geographic expansion
  - Optimize costs
  - Improve processes
  - Enhance buying power
  - Reduce headcount

- People-related drivers of success or failure
  - Pension and Retirement Plans
  - Health and Welfare Benefits
  - Compensation
  - Organizational Design and Leadership
  - Talent Management and Workforce Architecture
  - Severance and Retention
  - Sales Force Structure and Compensation
  - HR Operations and Technology
  - Culture
  - Communications and Change Management
Need for Holistic Analysis of People Issues

Although our focus is on compensation and benefits, you should be looking at the full range of people issues.

**Financial**

**Goal:** Understand the cost structure. Identify and quantify all items affecting financial statements.

**Employee Plans, Programs and Contracts**

**Individual**
- Leadership/Talent: identify, assess, select, retain, terminate and/or motivate
- New executive contracts
- Workforce reductions

**Organizational**

**Talent**

**Goal:** Understand productivity drivers by understanding how work is done, and who does it to determine what needs to change.

**Culture**

Typical Acquirer Business Goals During Integration

- Keep the base business running, without disruption to sales or profits. Requires (among other factors):
  - Successful identification and retention of critical talent
  - Early assessment of culture and organizational fit
  - Effective design and implementation of communication and change management plan

- Manage the integration to achieve target synergies. Requires (among other factors):
  - Early decisions relating to Organization Design
  - Cost/benefit analysis of restructuring plans and severance costs
  - Stream-lined but robust HR operations and technology

- Invest in the business as a platform for future growth Requires (among other factors):
  - Cost-effective but market-competitive compensation structure and retirement and benefit plans
Prioritization of Integration Activities

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<tr>
<th>Deal decision drivers and influencers</th>
<th>Immediate strategic priorities</th>
<th>Immediate HR functional priorities</th>
<th>Deferred HR issues: when things stabilize</th>
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<tr>
<td>Reasons for the deal and goals for integration</td>
<td>Organization model, structure and design</td>
<td>Transition of payroll and enrollment in benefit plans</td>
<td>Organizational processes that are not critical to integration</td>
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<tr>
<td>Integration strategy and level of integration anticipated</td>
<td>People decisions on key leadership</td>
<td>Employment contracts for key talent</td>
<td>Performance management and incentive harmonization</td>
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<tr>
<td>Communication strategy</td>
<td>People decisions on key talent</td>
<td>Broader based staffing and selection decisions</td>
<td>Retirement plan design changes</td>
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<td>Integration management</td>
<td>Terminations relating to large scale reductions in workforce</td>
<td>Union negotiations</td>
<td>Broad based compensation levels</td>
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<td>Evaluation of HR's current strategic credibility</td>
<td>Change management strategy</td>
<td>Integration of business and employee communications</td>
<td>Ongoing and consistent communications</td>
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About the Willis Towers Watson Third M&A Retention Study (2017)

Survey participants responded in terms of one particular merger or acquisition their companies had initiated and/or completed within the past two years.

- Survey data collected between March and May 2017

**Number of full-time workers employed by acquiring organization**
- Less than 500
- 500 to 999
- 1,000 to 2,499
- 2,500 to 4,999
- 5,000 to 9,999
- 10,000 to 14,999
- 15,000 to 29,999
- More than 30,000

**Respondents by industry groups**
- Energy and Utilities
- Financial Services
- General Services
- Health Care
- IT and Telecom
- Manufacturing
- Public Sector and Education
- Wholesale and Retail
Having key skills or being on a leadership team were the main factors for retention agreement eligibility.

- Employees below executive level with key skills in the context of the transaction: 55% (All Respondents), 64% (USA)
- Information from seller defining "leadership team": 54% (All Respondents), 61% (USA)
- Job title/level: 48% (All Respondents), 50% (USA)
- Job function/department (e.g., Finance, Legal): 37% (All Respondents), 36% (USA)
- Other recommendations from seller, below leadership team: 27% (All Respondents), 31% (USA)
- High-potential status: 25% (All Respondents), 27% (USA)
- Management discretion: 23% (All Respondents), 29% (USA)
- High-performance status: 22% (All Respondents), 27% (USA)
- Other factor(s): 13% (All Respondents), 14% (USA)

High-retention companies (61%) are more likely to consider employees with key skills than low-retention companies (47%).

Base: Total respondents
Senior leaders are asked to sign retention agreements at an earlier stage of the deal than employees

At high-retention acquirers, 28% of senior leaders were asked to sign before the initial signing (versus only 11% for low-retention)

Base: Those giving a valid response (percentages exclude "Not applicable" and "Don’t know")
Cash bonuses are by far the most common financial award used in retention agreements.

<table>
<thead>
<tr>
<th>Financial Award</th>
<th>All Respondents</th>
<th>USA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash retention bonuses</td>
<td>77% (80%)</td>
<td>83% (89%)</td>
</tr>
<tr>
<td>Time-vested full shares/share units</td>
<td>29% (18%)</td>
<td>23% (38%)</td>
</tr>
<tr>
<td>Increases in base pay</td>
<td>20% (18%)</td>
<td>22% (18%)</td>
</tr>
<tr>
<td>Guaranteed payment of regular bonus</td>
<td>18% (16%)</td>
<td>16% (14%)</td>
</tr>
<tr>
<td>Stock options</td>
<td>16% (6%)</td>
<td>15% (5%)</td>
</tr>
<tr>
<td>Division-specific incentives (i.e., earn-out plan)</td>
<td>14% (6%)</td>
<td>9% (3%)</td>
</tr>
<tr>
<td>Performance-vested full shares/share units</td>
<td>10% (4%)</td>
<td>13% (3%)</td>
</tr>
<tr>
<td>Other type(s) of financial awards</td>
<td>5% (3%)</td>
<td>8% (3%)</td>
</tr>
</tbody>
</table>

- Senior leadership n = 228
- Other employees n = 188
- Senior leadership n = 104
- Other employees n = 92

Base: Those giving a valid response (percentages exclude “Not applicable” and “Don’t know”)
Those that use stock options or shares for retention most commonly set target values as a fixed value that is converted to a number of shares or options.

### All Respondents

- **As a fixed value converted to a number of shares/stock options**: 48% (50%)
- **Target value set as a percentage of salary/converted to a number of shares/stock options**: 21% (19%)
- **As a fixed number of shares/stock options**: 21% (24%)
- **Other method**: 6% (7%)

### USA

- **As a fixed value converted to a number of shares/stock options**: 50% (50%)
- **Target value set as a percentage of salary/converted to a number of shares/stock options**: 19% (23%)
- **As a fixed number of shares/stock options**: 21% (18%)
- **Other method**: 8% (9%)

**Base:** Those giving a valid response (percentages exclude “Not applicable” and “Don’t know”)

- Senior leadership n = 89
- Other employees n = 42

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Over half of senior leaders receive target values equal to at least 60% of salary, compared to less than 20% of other employees.

Base: Those giving a valid response (percentages exclude “Not applicable” and “Don’t know/prefer not to say”)
Over 60% responded that values that employees earned at sale had no effect on retention awards.

Base: Those giving a valid response (percentages exclude “Don't know/prefer not to say”)

- Those with higher payments at sale received higher retention awards in order to provide better enhancement to stay
- Those with higher payments at sale received lower retention awards, because the need to provide high compensation was diminished due to the value gained from the sale
- Payments received at sale had no effect on the individual retention awards
In the US, over half have a retention budget of less than 1% of the total transaction cost.

2017 versus 2014 results:
Globally, median value as a percentage of transaction cost in 2014 was 1.9%. 2017 results are lower by about 50%.

We believe this reduction reflects greater average deal values due to a rising equities market, without a corresponding total cost increase in retention awards.

- Individual award values are up modestly vs. 2014

Base: Those giving a valid response (percentages exclude “Don’t know/prefer not to say”)
Nearly two-thirds of buyers covered retention costs in full

- **All Respondents n= 185**
  - Costs were 100% borne by the seller: 62%
  - Costs were partially borne by the seller: 25%
  - Costs were 100% borne by the buyer: 12%

- **USA n=84**
  - Costs were 100% borne by the seller: 63%
  - Costs were partially borne by the seller: 27%
  - Costs were 100% borne by the buyer: 10%

Base: Those giving a valid response (percentages exclude “Don’t know/prefer not to say”)
Time-based agreements are the most prevalent for both senior leadership and other employees.
Those using time-based metrics establish a longer retention period for senior leaders than for others.

### All Respondents

- **Less than three months after the close**
  - Senior leadership: 3%
  - Other employees: 1%
- **Three to nine months after the close**
  - Senior leadership: 8%
  - Other employees: 14%
- **10 to 18 months after the close**
  - Senior leadership: 28%
  - Other employees: 35%
- **More than 18 months after the close**
  - Senior leadership: 44%
  - Other employees: 31%
- **Other period**
  - Senior leadership: 18%
  - Other employees: 20%

### USA

- **Less than three months after the close**
  - Senior leadership: 1%
  - Other employees: 2%
- **Three to nine months after the close**
  - Senior leadership: 7%
  - Other employees: 12%
- **10 to 18 months after the close**
  - Senior leadership: 32%
  - Other employees: 40%
- **More than 18 months after the close**
  - Senior leadership: 40%
  - Other employees: 25%
- **Other period**
  - Senior leadership: 20%
  - Other employees: 20%

**Base:** Those giving a valid response (percentages exclude “Not applicable” and “Don’t know”)

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Over 80% of US acquiring firms were able to retain a high percentage of employees (more than 80%) for the full retention period.

<table>
<thead>
<tr>
<th>Percentage Range</th>
<th>All Respondents (n=145)</th>
<th>USA (n=72)</th>
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</thead>
<tbody>
<tr>
<td>Less than 20%</td>
<td>4%</td>
<td>3%</td>
</tr>
<tr>
<td>21% to 40%</td>
<td>3%</td>
<td>1%</td>
</tr>
<tr>
<td>41% to 60%</td>
<td>2%</td>
<td>1%</td>
</tr>
<tr>
<td>61% to 80%</td>
<td>11%</td>
<td>10%</td>
</tr>
<tr>
<td>More than 80%</td>
<td>79%</td>
<td>85%</td>
</tr>
</tbody>
</table>

2017 versus 2014 results: Globally, companies are more successful in meeting their retention goals — 68% of companies reported more than 80% retention in 2014, vs. 79% in 2017.

Base: Those giving a valid response (percentages exclude “Not applicable” and “Don’t know”)

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In the US, over half who left before the end of the retention period were uncomfortable with the new culture

- They were uncomfortable with the new/changing organizational culture: 44% (USA: 51%)
- They were more aggressively recruited by competitors: 26% (USA: 36%)
- Other reason(s): 29% (USA: 33%)
- They did not like their new role(s): 25% (USA: 30%)
- They did not agree with the focus/direction of the company: 18% (USA: 21%)
- They did not like their new manager(s): 12% (USA: 11%)
- Their retention package was not generous enough: 7% (USA: 9%)
- They were displeased with the new pay structure: 4% (USA: 4%)
- They were displeased with the new benefit structure: 2% (USA: 2%)

Base: Those giving a valid response (percentages exclude “Not applicable” and “Don’t know”)

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Pre-Close tactics to ensure a smooth transition

- Get involved as early as possible

- Do your homework / due diligence
  - Full and complete inventory of awards
  - Complete understanding of plan provisions

- Make contact with all of your counterparts
  - Don’t forget about other award types; Deferred awards, cash plans, etc.
  - Ensure Transfer Agent / Exchange Agent are prepared for potential plan interactions

- Financial reporting needs
  - Time crunches and potential need for projections
Pre-Close tactics to ensure a smooth transition (*continued*)

- Don’t wait to plan & Devil in the details
  - Target company blackout / scheduled vesting events
  - Timing of accelerations (which stock)
  - Proper taxation (sequence of other payouts vs equity)
  - Responsibility and flow of calculations

- Involve your vendors
  - Information sharing and expertise

- Participant Communication
  - Silence breeds anxiety during a difficult time
Post-Close tasks to ensure success

- Understanding and communication around timing
  - Payout of cash, shares, awards, etc.

- Tasks involving Day 1 / Day 2 terminations
  - Converted awards (timing, taxation, settlement)

- Potential of new grants to assist with retention
  - Equity vs Cash
  - Larger awards to compensate for loss of annual compounding
  - Inflated stock price / FMV immediately post close

- Eligibility / Enrollment in other equity benefit plans
  - Grandfathering or timing of eligibility (Deferred Comp Plans, ESPPs, etc.)
Post-Close tasks to ensure success (continued)

- Payroll interfaces for target employees
  - Transition period before payroll integrations

- Access to historical transactions and records
  - Administrator data reporting, continued engagement, conversion of records
  - Potential ongoing requirement for backup related to SOX audits
  - Staff retention

- Communication, Communication
  - Starting Day 1
  - Don’t add to potential employee concerns with new culture and corporate environment
WTW Retention Study: the leading source for structure, use and effectiveness of retention agreements during transactions

**Key takeaways**

**Define success before implementing**
- What are the corporate goals for the acquisition: stand-alone business or integrated with the parent company? Top-line or bottom-line growth? Where are the opportunities for synergies or efficiencies?
- Are you trying to retain employees forever or only for a select time period?

**Conduct a thorough participant selection process**
- High involvement of senior leaders at the acquired company to select participants is aligned with higher retention.

**Beware of complicated plan designs**
- Simple plan designs are correlated with high retention; cash bonuses are effective.
- Earn-out plans that pay on the future success of the acquired business are often appealing to the seller, but do they align with the acquirer’s definition of success?

**Understand that retention plans can buy the acquirer time, but not loyalty**
- Acquirers still need comprehensive plans for leadership development, cultural integration and communication.
- Use the retention time period to build loyalty and commitment to the new parent.

**Employers**

- **Senior leaders**
  - Time-based agreements are most prevalent for both:
    - 48% of companies
    - Performance-based only 8% of companies
    - Combination 43% of companies

- **Other key employees**
  - Time-based only 64% of companies
  - Performance-based only 6% of companies
  - Combination 30% of companies

**Countries**

- **Senior leaders**
  - Cash bonuses are the most common financial award in retention agreements for both:
    - 40% of companies
    - 77% of companies

- **Other key employees**
  - Cash bonuses are the most common financial award in retention agreements for both:
    - 26% of companies
    - 80% of companies

- **79% retained 80+% of targeted employees for full retention period:** What they do differently:
  - Selection at all organization levels
  - Early communication
  - Delayed vesting
  - Awards not net of individual values earned upon sale
  - Median budget around 1% of deal value

- **In addition to retention agreements, most common tactics are:**
  - Enhanced severance
  - Personal outreach and enhanced career opportunities

**Most common reason for termination before end of retention period is discomfort with new culture**

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