Integration:
The forgotten cousin of M&A

Roland Lawrence

- Roland retired in 2022 after 10 years as the CFO of Carlsberg Asia. He was the Chairman of the public listed Chongqing Brewery Company Limited and a director of public listed Carlsberg Malaysia Berhad. He also held directorships for Carlsberg business in Vietnam, India, Nepal, Hong Kong, Laos, Myanmar and the Asia holding company.
- He was previously SVP and CFO Walmart (China) between 2008 and 2011 in . In Australia, for 20 years he worked for the Coles Myer Group. His roles included being the General Manager, Group Planning & Finance, Coles Group and General Manager, Finance, Coles Supermarkets.
- He is an FCPA (Australia) and has a Master of Enterprise (Melbourne University)

The Challenges a Director faces regarding M&A

- Should I question the executives on their strategic growth plan?
- Am I overstepping my mark when I question some of the details of the strategy?
- Should I review the outcomes on a regular basis after the deal is done or is this the domain of the executives?

- The short answer is you must.

This entails the company strategic direction, significant employment of shareholder funds and it raises the temperature profile of risks. All of which fall under the ambit of director's duties and understanding and measuring integration becomes a key duty of directors

The Perils of remaining strategic in Corporate HQ

- Strategy does not end at the boardroom table but must become operational and measurable

  PowerPoint presentations can be seductive. "Death by PowerPoint"

- Don't fall in love with your strategic concept or idea only

  Demand and probe details of the integration plan

  Be wary of words such "synergies", "expanding bandwidth", "pivot" and when it gets too hard to explain "let us take it offline." Directors need to probe behind what these impressive sounding words mean

- Start by understanding the risks, knowing what is it is to be done and measuring results

  What does success look like at each stage. We will see that Integration is a long game continuing well after "the deal" is done and merchant bankers and other advisors have collected their cheques

- Today we will look the duties of directors regarding M&A Integration plans

  Look in detail at the Coles-Bi Lo integration plan and the Chongqing Brewery integration plan as examples

5 Key Principles on Integration

1. Understand the value drivers and risks
2. Deep Dive the Culture, Geographic and Consumer Dynamics
3. Focus on Cash and not the P and L
4. Integration is a long game
5. Prepare to handle underperformance

1. Understand the value drivers and risks

- Insist on an integration plan. Start with a good Due Diligence to foment your integration plan.
- Know and probe the risks

Tax, environmental, legal, people and consumer risks. Expect that the best plan will start to fray on contact Day 1 but having no plan will ensure failure. Are mitigation plans on stand-by?

- Understand the major elements of the financial plan and measure progress

Procurement synergies (how, how much savings and when), headcount reduction (how, how many & how much benefit), revised layout or brands (when and what do the first trial results show regarding consumer acceptance).

Know the terminal value of your NPV versus the initial 10-year returns. *

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* *(see last slide for the formula)*

2. Deep Dive the Culture, Geographic and Consumer Dynamics

- Culture

  The most underrated challenge. Do you convert to one culture or remain autonomous

  Will the decision-making process be centralized or if autonomous how do you manage the risks?

  What is the change management plan?

- Geographic reach

  How do you overcome the tyranny of distance?

  Do not underestimate the value of general office informal chats and discussions

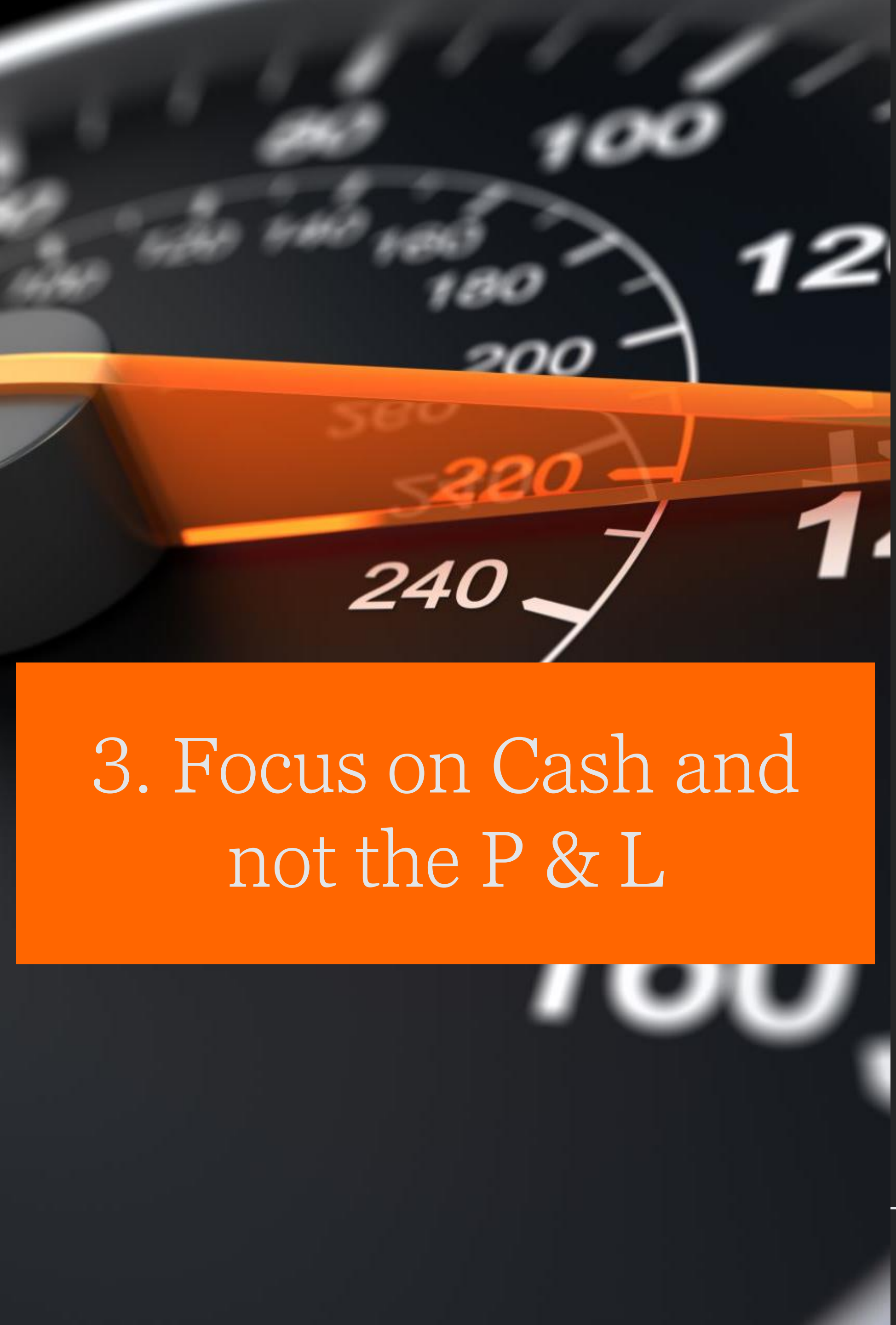
- Consumer profile: Branding and positioning

  What is the genuine strategic fit and overall brand architecture?

  How different is the target to your core business? How does one obtain synergies in this differentiated world? Be wary consumer revolutionary plans and large synergies. We will look at the Coles Myer example

2.a. Consumer Dynamics Thums UP in India

- Bought by Coca Cola in 1994
- Today it is a US$1B business.
- The biggest Cola business in India and it 20% market share of the soft drinks business
- Coca Cola is not letting ego get in the way of consumer dynamics and choice



3. Focus on Cash and not the P & L

- Fact: There will be skeletons in the closet of every deal
- Clear non-performing assets through the P and L. Understand the true asset values. The temptation is to do a Purchase Price Adjustment (PPA) that only impairs ROIC through bloating the goodwill balloon or inflating assets. It distracts management from a growth focus

  Clear the guff that detract management: old stock, unnecessary factories and extreme long dated receivables bloat. Encourage management to clear the decks than constantly dealing with legacy issues

  Note: Selling non-performing assets at a loss will generate positive cash flows

- This allows the management to focus on longer term outcomes than shoring the results for bonuses

  The TPG Myer experience (clearing outdated fashion stock getting cash and closing warehouses)

  The Chongqing example on bottles and Eastern Assets

4. Integration is a long game

- Measuring the results in stages is essential
- Have post M&A reviews on agreed KPIs at each stage of the integration plan

  100 and 200 day reviews and thereafter, at least once every 6 months. Integration can last 5 years or more
- Processes and Systems

  Finance, procurement, administration, IT, logistics changes are long, complex
- People

  How do you ensure talent is assessed and developed within the acquired company?

  When does the entire management comprise of the local personnel? Who is measuring and driving this change?

The Coles – Bilo Rapid rebranding exercise: A case study in brand and consumer impact in Integration

Coles and Bi-Lo History and Context

- In 2006, Coles and Bi Lo generate d AUD$18B revenue and circa AUD$700m EBIT
- Coles had 450 stores

  Located in premium malls

  High margin focus and a large quality focused SKU range

  Customer segmentation show many had higher education and income

  Paddock to plate concept in meat
- Bi Lo had 180 stores
- Purchased in 1987
- Known as the cheapest supermarket in Australia

  Mainly in poorer states and regions

  Separate culture, buying team

  Well known for fair grade cheap meat through abattoir arbitrage

The Coles Myer Group History and Context

- In 2006, Revenue AUD$36B, PAT AUD$1B
- In addition to the supermarkets the businesses include Target, Kmart, Liquorland, Shell retail stores and Officeworks. Myer is sold separately to TPG
- Market Cap AUD$11B at $10 per share
- Aug 2006 KKR offered $14.50 followed by $15.25 per share circa AUD$16B and AUD$17B Market Capitalization
- Coles Myer Directors reject offer and announce a new strategic driver with the creation of Food Liquor and Fuel Group with Bi Lo converting into Coles Supermarkets as a key profit driver combined with the Shell retail outlets

Consequence

- The strategy unravels in 6 months

  Bi Lo experiences negative sales growth

  Consumers regularly record grievances on talkback radio and the papers. Thankfully, social media was only a fledgling idea

- May 2007 Coles announces the slowest sales growth in 7 years and a profit warning
- The company is put back onto the market
- Oct 2007 Wesfarmers buys the Coles Group for AUD$19B at AUD$17.25 per share

What went wrong?

- The wrong objectives

  Done as a counter measure rather than a methodical M&A strategic objective. Strategy on the fly. Why the sudden change when for 19 years they were kept as distinct brands.

  Looking for instantaneous P & L results to stave off the predator. No long-term integration plan

- Culture and consumers

  Bi Lo had different demographics and consumers. They have different needs. The meat example

- Leadership in turmoil

  The lack of debate and measurement. The lack of buy-in

  What was the implementation plan?

- Mick McMahon COO

  "A strategy you cannot execute is probably not the right strategy." A quote for journalists and the public

Chongqing Brewery Limited:

The long road of integration of a public listed company

Chongqing Brewery: History and context

- Chongqing Brewery first opened in 1958
- Publicly listed in 1993
- Culture of production driven rather than consumer driven dynamics.
- Expanded from Chongqing into the Eastern seaboard (Zhejiang, Jiangsu, Anhui) which resulted in devastating losses. Expansion included moving into speculative bio-technology
- Culture of expansion at all costs. In 2011 profits fell 50%. EBIT was circa 200m RMB
- Carlsberg first nibble of Chongqing Brewery was in 2008 with a 30% stake. 60% ownership was achieved in Dec 2013 but it required the purchase of the poisonous Eastern Assets.
- 23 breweries and 2 malting plants throughout China (SW, NE and Eastern Provinces)

Chongqing Brewery: A 7 Year Integration Plan

- Agreement in buying Chongqing Brewery included a non-compete status by 2020. Galvinised the need to create a One China beer business
- A 3 phase plan. The classical stop the bleeding, stabilize and regrow plan
- Phase 1: Downsizing, reorganisation and rebranding 2013 to 2016

  Including removal of risks (tax and previous historical errors)
- Phase 2: Introduce premium brands and focus on financial performance 2017 ~ 2018
- Phase 3: Growth momentum, expansion into new markets and Material Asset Restructure 2018 ~2020

Chongqing Phase 1: Downsize, reorganize and rebrand

- Phase 1
- Clear DD issues:

  tax, environmental law failures (36m rmb fine) and a need to rebuild relationships with authorities
- Over 3,000 redundancies that had to be negotiated with the provincial and local government
- Focus on cash and not revenue or P&L

  Closure of 15 breweries and 2 malting plants

  300m bottles writen off

  All painful on the P&L (>1B rmb) but are mostly non cash
- Culture and People

  Parachuting skilled finance, marketing and management from Europe and Eastern seaboard China personnel

Chongqing Phase 1: Downsize, reorganize and rebrand

- Revised distribution model

  Fewer distributors but higher incentives

- Systems and processes

  Carlsberg Chart of Accounts

  New ERP systems for production, finance and sales focusing on 6 key breweries first

  Bottle asset management to increase turnover

  New financial, procurement, supply chain and sales management system including sales person incentives based on agreed metrics

- Cash generation

  Sales of superfluous breweries

Chongqing Phase 1
Downsize, reorganize and rebrand

Premium
高档

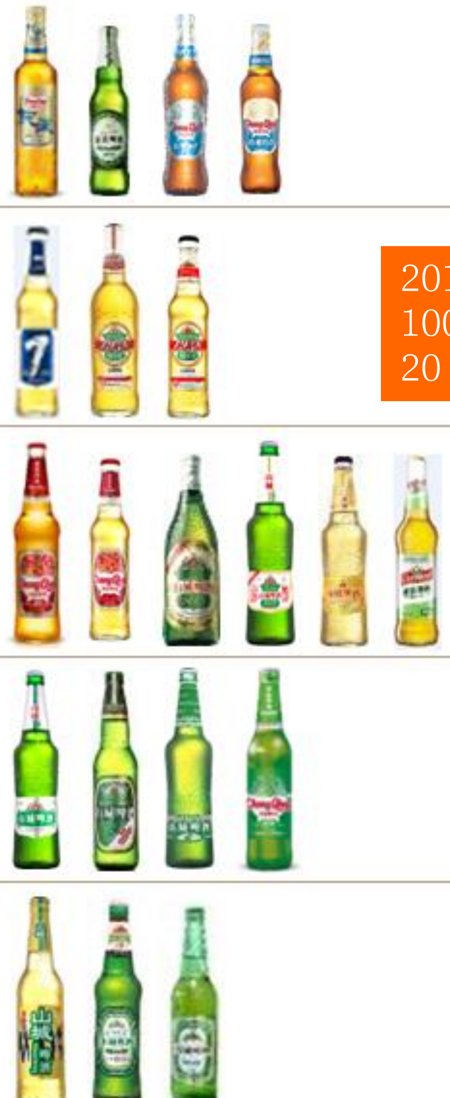
Sub-Premium
中高档

Mainstream+
主流高

Main-stream
主流

Discount
低档

2013
500+ SKU
100 bottle types



2017
100 SKU
20 bottle types

Chongqing Phase 2: Premiumize and focus on financial performance

- Phase 2
- Introduction of K1664 premium wheat beer
- New geographic reach securing Sichuan and Guizhou

  the immediate neighboring provinces: a concentric ring growth strategy

- Financial performance focused on cash generation and profitability and limited revenue focus in line with strategic integration plan

  Free Cash Flow generated was circa US$200m per annum from 2016 onwards

  Building on credit worthiness with payables and reduced capital needs for bottles

Chongqing Phase 3:
Expand and creation of One Carlsberg China entity

- Phase 3
- The big picture: Restructure of the entire Carlsberg China business into one entity in 2020
- Yibin 6m HL brewery commissioned
- Tiandao expansion and Tianmahu recommissioned
- All executives are fluent mandarin speakers

Chongqing Brewery Ltd results

Chongqing Brewery 5 year financials 2017 -2021

Rmb (M)	2017	2018	2019	2020	2021
Net sales[1]	3 176	3 467	3 582	**10 942**	**13 119**
EBITDA[1]	496	654	832	**2 378**	**3 375**
Operating profit (EBIT)[1]	334	480	658	**1 964**	**2 948**
Pre-Tax Profit (EBT)[1]	345	482	827	**2 131**	**2 941**
EPS[2]	0,68	0,83	1,36	**2,23**	**2,41**

Chongqing Brewery Share Price 2012 -2022

5. Prepare to handle underperformance

- More than 50% of M&A fail
- As directors you need to ensure that the executives continue to extract as much value out of the deal
- It is human nature to want to focus on success or the next story rather than deal with persistent, dogged and slow responding situations
- Again, focus on the cash generation and ROIC

Demand and review the revised the plan with a baleful eye from your years of experience

To paraphrase Gresham's law "Bad money drives out good." Be aware of pouring more cash to rescue an intractable situation

Be prepared to exit

A Final Takeaway:
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Terminal Value in DCF

Terminal Value #1 (Perpetual Growth Method)

$$TV = \frac{[FCFn \times (1 + g)]}{(WACC - g)}$$

Where:

TV = terminal value
FCF = free cash flow
n = year 1 of terminal period or final year
g = perpetual growth rate of FCF
WACC = weighted average cost of capital