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## Merchant Acquiring M&A in Europe A Legal Perspective

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# The Classic M&A Questions

- What am I buying and why?
- How should I buy it?
- At what price?
- What recourse will I have?

# What am I buying and Why?

## Key Business Issues

- Trade v Financial buyer
  - looking to add volume and/or territories; or
  - looking for a platform
- Banking v Non-banking target
  - who will actually own the client relationship and data?
  - referral/sales agency deal?
    - exclusive v non-exclusive
    - term and territory
    - change of control risk (Note: increasing bank consolidation)
    - is this the most important part of the deal?

# What am I buying and why?

## Key Business Issues

- Reliance on strategic partners and sponsors
  - banks for scheme memberships, BINs and ICAs and other regulatory requirements
  - referrers and sales agencies
  - processors
  - ability to replace or structure around
- Will processing be part of the deal?
  - increasing trend for processors to provide merchant acquiring

# What am I buying and why?

## The assets

- Merchant contracts
  - transferability and change of control
  - economics: term and pricing
  - quality:
    - of origination: merchant underwriting criteria
    - of documentation: reporting and monitoring requirements, POS requirements, hold backs and other reserves, ability to re-term merchants (including to introduce new products) etc
    - exposure to riskier sectors e.g. travel
    - “stickability”
- Other key contracts
  - processing and BIN/Scheme sponsorship
    - change of control or other discretionary rights that could impact on the deal

# What am I buying and why?

## The assets

- IT/IP
  - how big an issue: strategic v financial buyer
    - trade buyer may really only be concerned about transition BUT can be long time periods
    - financial buyer may be looking for a platform BUT obsolete tech is often one of the main drivers for sale
  - typical IT issues
    - adequacy – reliance on third party providers
    - PCI – DSS requirements
    - disaster recovery and redundancy
    - transition management

# What am I buying and why?

## The assets

- Employees
  - confirm who is transferring (Note: Acquired Rights Directive)
  - will any employees of suppliers and contractors be transferring?
  - pension exposures

# How am I buying?

## Key execution issues

- Outright Purchase
  - asset v share
- Joint venture structures
  - corporate or contractual
  - typically trade buyers where bank sellers wish to retain the customer relationship
  - bank contributes the customer contracts and supporting contracts and some IT and provides a referral/sales arrangement
  - “purchaser” will operate the acquiring business on their platform and indemnify the bank for all operating risks
  - economics: up front payment v profit share

# How am I buying?

## Key execution issues

- Regulation of purchaser
  - obtain PI licence and scheme membership, or
  - partner with a bank
- Providing deal certainty
  - crucial for Sellers and a key part of bidder selection
  - MAC: is it worth the effort?
  - competition: “reasonable efforts”, “best efforts”, “Hell or high water”
  - regulatory approvals: all v specified
  - bring down of warranties: carve-outs
  - break fees

# How am I buying?

## Key execution issues

- Financing
  - typically have to be unconditional as to financing
  - what security package can be offered?
    - important to maximise leverage
    - treatment of funds in settlement accounts and merchant holdbacks

# How much is it worth?

## Business valuation

- Not really for the lawyers
- BUT lawyers must understand :-
  - valuation basis e.g. balance sheet v EBITDA v DCF etc.
    - damages calculations
    - warranties v indemnities
  - and valuation assumptions e.g.
    - ownership of customer relationship
    - replacement of key suppliers or I.T.
    - longevity of contracts

# What recourse will I have?

## Managing risk

- Combination of diligence and documentation
- Diligence
  - legal
  - accounting
  - in an auction, may be prepared by the seller's advisors
  - not warranted
- Purchase Documentation
  - assets or shares
  - if assets, "exclusively used" v "used"

# What recourse will I have? Managing risk

- Warranties
  - subject to disclosure and caps and baskets
  - recourse for “unknown” issues
  - bring down to Closing
- Indemnities
  - typically not subject to disclosure and excluded from caps and baskets
  - recourse for “known” issues

# What recourse will I have? Managing risk

- Caps and baskets
  - “tipping” v “non-tipping”
  - typical basket is 1 - 2% of consideration
  - typical cap is 15 - 30% of consideration
  - exclusions for fundamental warranties (title, capacity, enforceability) and some indemnities
  - will not apply to fraud
- Price adjustments
  - against target working capital to pick up pre-closing liabilities
  - against portfolio to pick up attrition in the portfolio
  - not typical to have a full earn-out

# What recourse will I have?

## Managing risk

- Restrictive covenants
  - key part of protecting acquired goodwill
  - lock seller out the market and ring fence employees
  - typically no more than 3 years and existing territories
- Joint venture structures
  - will still need warranty and indemnity protection and restrictive covenants
  - should not come from JV
- Referral/sales agreement
  - consider liquidated damages and other penalty clauses
  - trade off warranty claims against referral relationship

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