Tesco Plc. acquired the wholesaler Booker Group for around £3.7bn

M.Sc. Corporate Financial Management

M&A Assessment, Element 1

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The number of words in the main part, from the introduction to conclusion, is 1753, being counted by MS-Office Word.

The summary, reference, and appendices are not included in this limitation.

Please refer to see more details and information that have been brought to the appendices.

Contents

Summary

As diving deeply into the M&A process in total is not possible not only in a report, but also even in a series of books, because of an extremely huge knowledge related to it, this assignment just by itself is kind of a summary of both sides of the deal between Tesco, an outstanding retailer, and Booker a huge wholesaler.

Tesco started the process in 2014 and finally in 2017 took the control of Booker, with £3.7bn, a price which socked the market at first. The initial strategy of the buyer was to expand its market out of retailing by gaining control of Booker. In addition to the expansion, making benefits from brands and market destination of the new subsidiary was kind of a final result of the deal. But the story of strategy is not done here because synergy, which is normally a goal of M&A activities, was the other major role of it.

Furthermore, with a high possibility, particularly from the view of opponents, Tesco had known that having hand in the biggest UK wholesaler was not only an expansion, but also it would dominate the market in its field, meaning a more diversity in terms of competition besides the competition itself. Despite the fact that both companies worked similarly in some areas, for example, food and beverages, it was not a horizontal deal, but mostly like a vertical one.

After about one year of the regulatory process with CMA, the Competition and Markets Authority, in January 2017, permitted the negotiation to get the final result, as it stated two enterprises were not competitors. Also, as their market was strong enough, there would be no high possibility of some drawbacks to harm the customers like a price increase.

On the other hand, Tesco succeeded to take the acceptance of the shareholders through its offers to them for their shares in the new combined business.

The opponents, which always are either directly or indirectly involved in every M&A agreement, had discussed that the final unique firm would be so strong to dominate completely the market and not allow the rivals to move forward.

Tesco in its reports had shown that it paid attention to the aspects of due diligence sufficiently, and reviewed many parts based on its strategy and objective.

Financially the deal was supposed to be beneficial for the parent company, which practically was in the first year after the deal. Tesco reported in 2018 an acceptable rise in its sales. All in all, it was not as successful as it seemed initially. However, it was not a failure in total.

Introduction

As the Oxford dictionary explains, a *merger* is a process of combining two or more companies, businesses, or corporations together, while the act of purchasing a property like land, building, or a company by another one, a person or a company, is the definition of acquisition. (Anon., 2015) One of the important points is to understand that all mergers are lawful because of the process of transactions that are happening based on statutes related to the country in which the buyer or major company exists. (Stanley Foster, et al., 2007)

As a retailer, Tesco's functional field contains clothing, financial and banking services, home appliances, food, and beverages. (Bedford, 2022) Tesco PLC, London based, from 1919 until now, has an interesting history when we get to know its start from stalls to be a leading international and multinational retailer, owning more than 360 thousand employees. The company claims to serve customers with healthy, sustainable, and affordable products in the food industry, daily and always. Following purchasing land and beginning development by Jack Cohen, the founder of the company in the 1930s, it had a great expansion in the 1950s, and then in the last decade of the last century arrived around the globe happened. (Tesco PLC, 2022)

Now Booker, a wholesale enterprise, is owned by Tesco since January 2017 and works as a subsidiary, while it is older, being founded in 1835 in London. (Booker, 2022)

This report is going to analyze the deal in terms of evaluation of the strategies, potential advantages from the buyer side, and rules applied to it.

The Evaluation of the Strategic Fit of the Deal

The Strategic Fit from Tesco View

Based on the fact that a deal is one of the methods to establish a strategy, in this case purchasing the Booker is one of options for Tesco to accomplish its strategy of expansion vertically. This was associated with the strong position of Tesco in the market share beforehand. (Appendix I, C)

The strategy that Tesco followed by having Booker, the biggest wholesaler in the food industry in the UK, was to access the shops, restaurants, and other stores owned by Booker or take service from it. Also, another key point was to unlock the possibility of synergy from this combination. (Vandevelde, 2017)

Risk or Hubristic Rationale View Point

It seems that the first potential offer was not sensible when it came to the price. Even though there was not found any obvious evidence about these issues, some of the involved individuals had stated their opinion about the offered price which had been unreasonably high.

But there were some disagreements and some doubts about firstly the possibility of being successful, secondly, the hidden costs, and thirdly the clarifying the ongoing strategy. Two of the main shareholders of Tesco had not been satisfied and had argued that the price of 3.7 billion pound had been really by far higher than essential. Some of the opponents, like Daniel O'Keefe, one of the fund managers at Artisan Partners, had argued that Tesco to come back to the normal operating margins needed worth maybe £11bn to shareholders, and this is a high risk to do for a £3.7bn deal. (Vandevelde, 2017) However, finally, on 28 Feb. 2018, Tesco took its shareholders' approval, based on the official documents recorded in the Tesco-Booker Group Merger Archive. (Griffith & Lawrie , 2018)

There can be hidden costs after completing the deal too. For instance, there was a question that how many of Tesco's 1,700 convenience stores must be sold to be able to afford the whole deal. (BBC News, 2017)

The Potential Benefits, Tesco Pursued

Market Power and Growth

From the aspect of market power and growth, Tesco could have been following the expansion of its share market and customer satisfaction simultaneously. In the CMA report of anticipation for Tesco and Booker, vertical effect; wholesale to retail in page 10 No. 32, the CMA stated that vertical merger is an acceptable alternative for both sides to do the deal for more profit instead of cutting the costs which cause the lower quality or increase in prices which worsens the situation for consumers. (Polito, et al., 2017)

Benefit from Different Core Capabilities

On the other hand, based on BBC News (BBC News, 2017), despite losing market share in the years before the deal, Tesco remained the top UK supermarket, having a share of about 28%. Nevertheless, as the retail industry was undergoing a period of consolidation, being threatened by competition from others like Aldi and Lidl, as well as Amazon had prompted Tesco to choose the strategy of acquiring Booker. As a result, it had the ability to both expand and compete.

Synergy as Major Strategy

Tesco had stated that its first and main strategy had been built on their core expertise of distributing after scouring and then selling food in the market of UK and so joining with Booker just helps them to grow faster in the food market at its end, food consumption. Following their key strategy, financially the deal was supposed to unlock a great number of synergies than Booker's operating profit, which happened in the 2016 financial year and provide the return more than the initial investment two years after the deal. (Tesco Archive, 2017) Which simply means a prosperous achievement contract.

Immediate Return

From the report of Morrison, (Morrison, 2018) in 2018 May, Tesco stated growth of 1.8% in group sales, as a sign of the successful deal with Booker.

Potentials in Booker

Economics reported that Booker had owned many brands and had supplied many businesses (EconomicsOnline, 2020), so these factors show a suitable target for Tesco to offer. (Details are in Appendix III, b)

The Regulatory and Due Diligence Issues

As usual, an M&A deal had its opponents; competitors, shareholders, and governmental organizations. However, the Board of Tesco announced on 28 Feb. 2018, that the resolution proposed for cash merger and recommended share by Tesco's General Meeting received the acceptance by shareholders from Booker Group PLC. (Griffith & Lawrie , 2018)

CMA Permission

Tesco-Booker Proposal of M&A, after about one year of review and in-depth look by the regulator, won the argument about the concern of competition and monopoly, because they had not directly competed with each other, so no remedies seemed to be needed. (Appendix IV, a)

BBC News reported that the CMA made the conclusion about the wholesale market that it would have remained competitive after the acquiring activity, because Booker's share of the food wholesale market in the UK, at less than 20%, had not been sufficient to bring up the concerns afterward. (BBC News, 2017)

Anti-Competitive Concerns

About the concern for the increase in prices for shoppers, CMA after a thorough investigation announced that market competition was sufficiently strong to defeat any attempt to profiteer. (Monaghan & Wood, 2017)

Tesco in addition to its stores would be able to supply its competitors' customers, causing the price-fixing and other anti-competitive practices. (EconomicsOnline, 2020)

Regulator Overview to Support Customers

As Simon Polito who was the chair of the inquiry group at the time, had suggested that based on their investigation the market was sufficiently strong in both the retail grocery section and the wholesale one to ensure the deal did not go to higher prices or lower quality in productions or services. (Monaghan & Wood, 2017)

Regulators' Opponents Ideas

Tesco after the agreement would probably dominate the market, John Mills, said, having reported by BBC, 2017. He explained the combination would be a power of £60bn of sales compared to the rest of the market by owning only £25bn.

The other one, Clive Black, found that the deal was an unconditional approval, which is not possible for the other deals. (Monaghan & Wood, 2017)

(Appendix IV, a)

Due Diligence Issues

This part is extremely crucial, important, and also critical, as every aspect of the deal for the post-acquisition period is dependent on the fact how much the whole process has been critically in detail reviewed.

A number of factors, such as the satisfaction of the Conditions had been evaluated, having issued in the report "Tesco and Booker Merger gains Tesco shareholder approval". (Griffith & Lawrie , 2018) (Appendix I, f) By reviewing the whole factors, refer to the appendix, we see that the contract had been checked and proofread thoroughly in many different aspects, but the risk or benefit from the side of suppliers and resources are not reported.

Tesco after the deal had explained to the Bookers shareholders that it would repurchase the shares even out of boundaries if needed. (Cazenove, et al., 2018)

Some of the Investors warned the risk of the deal was unpalatable. However, other experts usually did not agree, especially based on the powerful brands owned by Booker, see (See Appendix I, f). (Vandevelde, 2017)

The Foreign Regulations

There were concerns in the US regulatory about the future of the deal, in the case of having a complaint from the US shareholders against the directors in the UK. (Radford, et al., 2018) (See Appendix II, C)

Conclusion

From the view point of Patrick Gaughan, there are two main motives for M&A deals; faster growth and synergy. (Gaughan, 2017) Even though both reasons refer to be more powerful, like other activities and decisions in general, practically throughout the history and especially M&A waves these two played more roles.

Tesco as a huge retailer in the UK, gained control of Booker, the biggest wholesaler in the food market of the same country, in 2018, through acquiring process. Its motives and reasons were to expand its work to many opportunities like shops and restaurants and use the synergy of joining Booker.

At first, there were opposite sides from competitors and shareholders which had brought the process forward after the review and conclusion by CMA.

And following other steps of the whole process, in March 2018, the takeover of Booker by Tesco happened completely. As a result, after offering 0.861 of Tesco's share for each share of Booker by Tesco in London Stock Exchange, the Booker was removed from the LSE list. Therefore, at the time Tesco, with a market capitalization close to £20b, became bigger than all its other competitors, even if put together; Sainsbury's, Ocado, Morrisons, and Marks & Spencer. (Reuters, 2018)

To see if Tesco with the deal has been successful or not, we have many options of which the share price is usually used, in spite of the fact that other criteria are helpful too. Tesco's share price has been in total on growth way. (Lonfon Stock Exchange , 2022) (Appendix III, a.)

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Appendices

I. Different types of drivers

A summary of reasons, motives, drivers for M&A from the book of "Intelligent M&A: navigating the mergers and acquisitions minefield" written by Scott Moeller and Chris Brady.

a. Hidden Reasons Inside

Generally, what are stated in the public as reasons for merger and acquisition, are not the real ones happening inside the companies or between. The main Reasons are need to growth bigger or/and faster, competition, and synergy. However, we can take personal and financial causes, regardless of being typically hidden in the heart of the headquarters, as some key examples that are cleared by specialists. (Moeller & Brady, 2014)

b. Synergy as Major One

Talking about Providing synergy, it is essential to point out different types of that; synergies in revenue; synergy in expenses (operational synergy); synergy in finance. As expenses like tax, almost always, are very crucial, both sides might reduce them if they have a strategy to join either when efficiency matters or size is to allocate the expenses. On the other hand, not always collecting the capital from outside is simple or has efficiency, but the synergy in finance with an exact relevant strategy is possible and even stronger than raising capital from other resources. There are some affecting factors in this case like the credit or borrowing rate compared to all factors which have impact on the process of merger and acquisition. (Moeller & Brady, 2014)

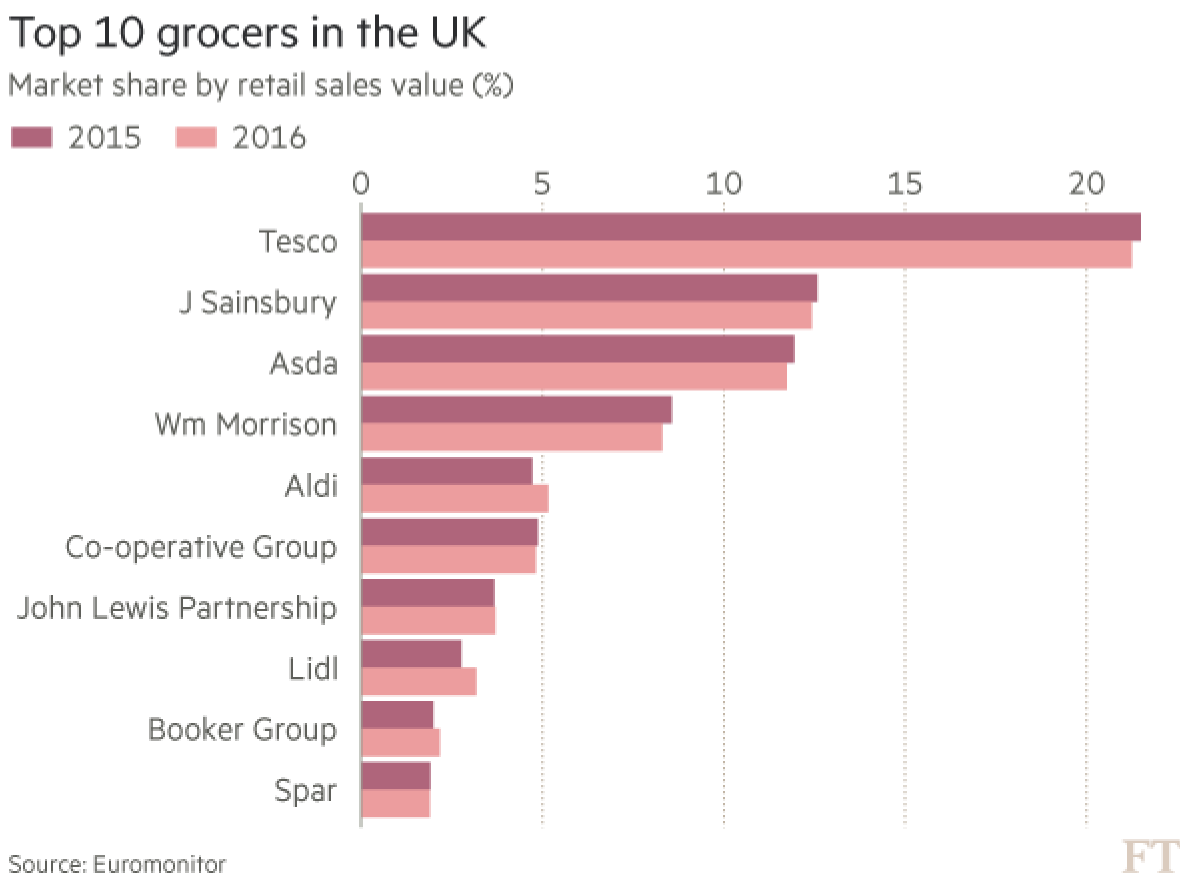
While synergy is considered as a main motive, it is also a strategy as long as the result of the NAV formula gets positive. NAV = V_{AB} - $[V_A + V_B]$ - P - E, V_{AB} is the value of the combination after the deal has completed, V_A and V_B are the values of parent and subsidiary respectively, P is the premium being paid to the subsidiary, and finally E is the total expenses through the process being paid by main company. (Gaughan, 2017)

Another resource for synergy in this deal came from the heart of reduction in running costs by 500 million Pound from the view of some specialists which was by far bigger than 200 million Pound, the prediction of Tesco boss Dave Lewis at the time of announcement, January 2014. (Monaghan & Wood, 2017)

c. Growth; another Major Motive

As being discussed above, growth is one of the major motives for M&A. Particularly, when it comes to going beyond the boundaries, preparation for a new market has its own difficulties and so another simpler and more likely way is shown up. Between the hardships, taking a license or permission from the other country government is one of the most problematic and time consuming ones. To expand the firm faster and stronger there are some different aspects of the whole activity as follows: faster in share price, revenue, market territory geographically, brand, operation and production scale, size, market power, efficiency, pure diversification, and last but not the least the target managerial efficiency, because of better managerial team or/and process, which usually are not mentioned but hidden. (Moeller & Brady, 2014)

Strong position in the market before and during the announcement was a reasonable cause to grow more rapidly by adding Booker into Tesco.



(Vandevelde, 2017)

d. Risk of Not Involving M&A Deals

Even if a company recognizes itself as being able to grow naturally and so without any form of merger and acquisition, as well as not looking for synergy, the competitors can be a huge threat when they join or acquire another one. This menacing possibility leads corporations to do M&A sooner than their competitors. (Moeller & Brady, 2014)

e. List of General Motives/Reasons

In General the list of motives and reasons are extremely broad and so it is not possible to contain all of them in this report. As a result here the name of more important are covered.

- Access to/using the opportunities:
    - Others competitive advantages, for instance
        - Technology
        - Name, logo, brand
    - Capital markets.
    - Resources of materials back to the suppliers.
    - other geographical markets because of
        - Seasonal restrictions
        - Cyclical fluctuations
    - information and signaling
    - Undervalued/not valued the market value of acquiring.
- Solve the
    - agency problems
    - Outside changes as a response.
- Decrease or remove:
    - Expenses
    - Taxes
    - Risks such as
        - Entering new market
        - Starting a new start up
        - Being dependent on a limited market, products, suppliers, country as a place of work.
    - The possibility of M&A by competitors
- Financial Motives:
    - Investment of Surplus Funds
    - Higher Market Capitalization

    - Reducing Costs
    - Tax Planning/Tax Benefits
    - Revival of Sick Units
    - Increasing Earning Per Share (EPS)
    - Creation of Shareholder Value
- Organizational Motives:
    - Managerialism and hubris (entrepreneur's Personal Compulsions) like
        - Enhance power or prestige
        - Acquire talents or experts
        - Even pressure from big shareholders
        - Hide internal problems
    - Retention of Management Talents
    - Removal of Inefficient Management
    - Quality of Management
    - Lobby Power
    - Emergence as Multinational Corporations (MNCs)
    - Emergence as a Conglomerate

(Hussein, 2022)

f. Due Diligence

The factors, such as the satisfaction of the Conditions, having evaluated and issued in the report of "Tesco and Booker Merger gains Tesco shareholder approval":

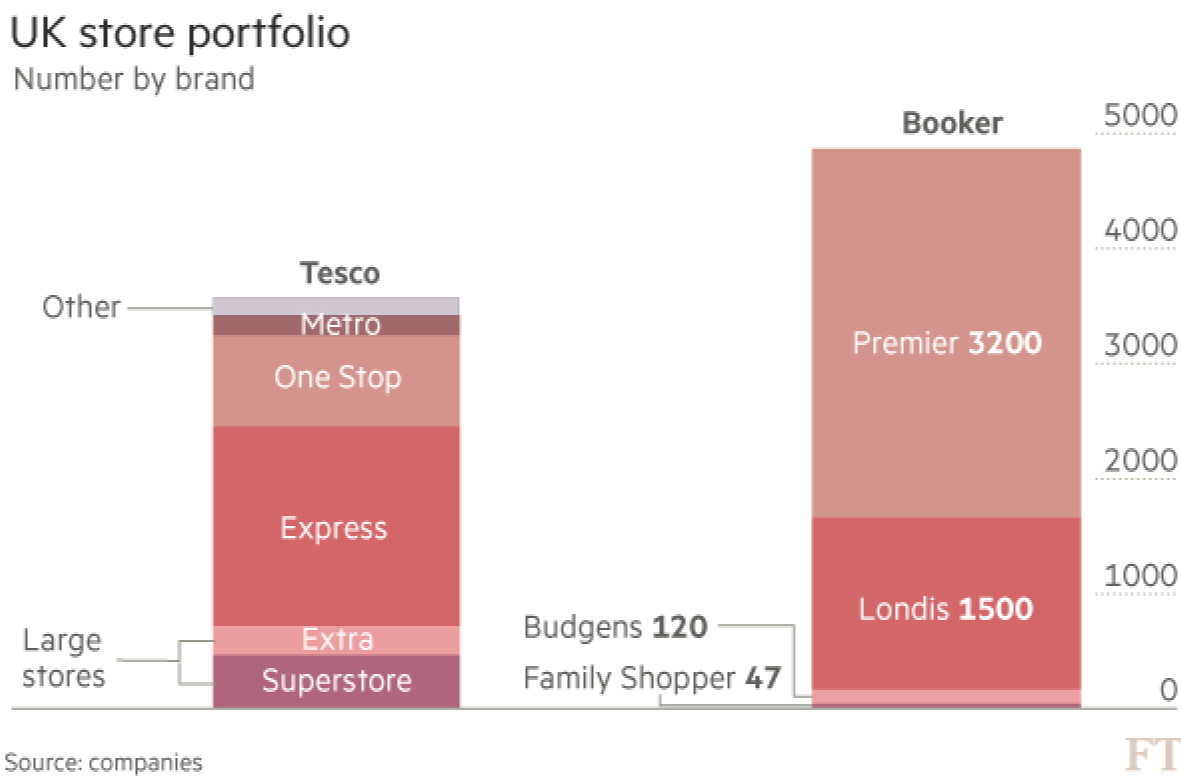
- Risks that are relevant to the Tesco Group's, in terms of credit rating
- Local, international, political issues, and economic situations which are including Brexit
- The economic model of Tesco and the Booker Group's
- The liquidity threats and risks, happening to both groups
- Financial overhaul, for both companies, services risks
- The risks applied to both of Tesco's and Booker's brands
- Reputation and trust
- Environmental risks
- Safety, technology, data security, and data privacy risks
- Modifications in customer preferences, predilections, and habits

- Law-based or regulatory modifications
- The outcome of any lawsuit
- The effects of any acquiring and similar transactions
- Competition and market threats
- Competitive goods, services, and pricing problems
- Business continuousness and crisis administration
- Pensions risks
- Joint venture contracts and partnerships
- Obedience accounting standards and the legislations beside failure to report precise financial results.

None of the relevant parties such as Tesco, Booker, or the respective partners or directors, officers or advisers, reports any kind of representation, guarantee, or assurance that the events indicated or implied in any type of future-looking statements would actually occur.

(Griffith & Lawrie , 2018)

The powerful brands owned by Booker, Premier and Londis, were two of the whole targets for Tesco.



(Vandevelde, 2017)

II. Cross-Border M&A

a. A Great Example of Overseas Acquirers: Johnson& Johnson

One of a very successful applied strategies is the one used by Johnson & Johnson. This company through 1994 to 2007 acquired many other companies, mostly in or related to the same industry as itself. The strategy that it uses is based on finding and owning or having the control of the firms who have been successful either in product or in functioning the whole process in the market. To analyze more this strategy, we can go further in details. (Gaughan, 2017)

Johnson & Johnson decided in some cases that instead of wasting the time and money to expand from inside and then try to surpass the competitors, it can more easily and likely to gain control of them only with money. Despite some failures happened like buying Cordis in 1996 for $1.8 billion, the whole strategy responded beneficially for the parent company. (Gaughan, 2017)

b. Risky Destinations

The other strategy which is outstanding when you think to go and cross the boundaries, is to join or gain control of others in another territory that you are not yet having space to work. Typically, this facilitate faster and simpler the process of expansion, particularly, when moving to another part of the world and seeking to tap the destination market is risky because of not being familiar with the rules, laws, culture, and economic situation. (Gaughan, 2017)

In addition of them, there are other advantageous to join globally, for instance when the buyer company has a more powerful currency compared to the target one. Sometimes in this condition, the acquiree accept the deal because of hardship in passing by the boundaries too. As an example, Hilton Hotels Corp purchased businesses out of the US, while US dollar appreciates relative to many other currencies. (Gaughan, 2017)

c. The US Shareholders Concerns

It might be difficult for the US shareholders to enforce any of their rights and any kind of claims that they probably would have arising under the US federal securities regulation in connection with the deal, since both Booker and Tesco are managed and organized under the laws of another country overseas other than the US. As some or all of the managers, officers, and directors with high possibility were residents of the other countries rather than the US. Also a lot of of the assets of both enterprises are located not in the US, but outside of it. (Gaughan, 2017)

As a result the US shareholders could not be able, in any case of need, to sue a non-US firm or even its employees, especially its directors, as they would have a trial in a non-US court, when it is a case for violations related to the US securities laws. Further, it may be problematic to compel a company out of the US and their affiliates to be subject to one of the US court's jurisdiction. (Radford, et al., 2018)

III. Acquisition's Details

a. Post-Acquisition Share Price

Tesco's share price has been in total on growth way.

(Lonfon Stock Exchange , 2022)

b. Booker's Detail

At the time Booker had owned Londis, the Premier, and Budgens brands. Additionally, it was the main cash and carry wholesaler who provided products to hundreds of grocery stores which were in fact independent convenience stores. Booker, also, was supplying several restaurant chains, like Carluccios, Wagamama, and Loch Fyne. (EconomicsOnline, 2020)

IV. Regulatory

a. CMA

(CMA) the Competition and Markets Authority stated that the process could even increase the competition in the market of wholesalers and also reduce the final prices for buyers. The CMA announced that either of Tesco or Booker had not competed directly in almost all their activities. A percentage of 30% and more of the sale of Booker had performed in the catering sector, which Tesco had not arrived in. (BBC News, 2017)

b. Opponents Opinions

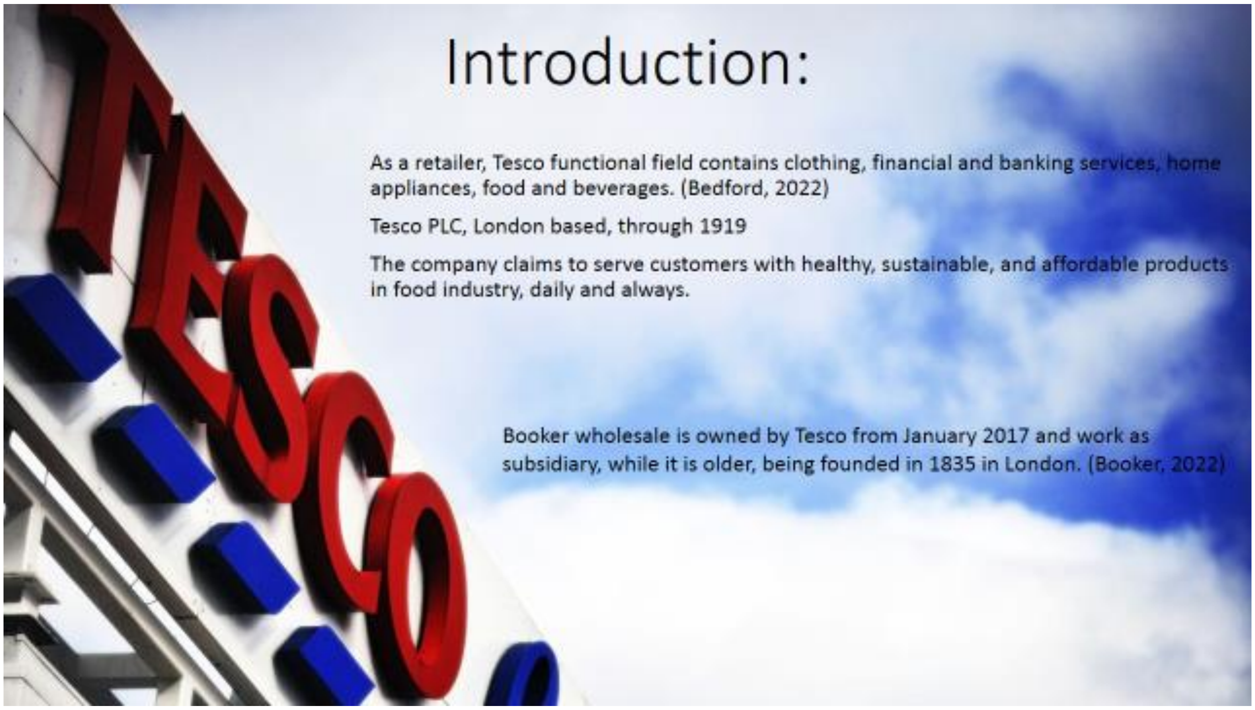
The CMA's permission were criticized by John Mills, the managing director of Landmark, a wholesale group. He said that this move not only would not increase competition, but also it would destroy it. The combined Tesco and Booker function had sales of £60bn, while the rest of the market of the UK wholesale industry remained with the amount of £25bn. As a result the other wholesalers could not be able, based on his idea, to compete with the combination process of buying and distribution network of Tesco& Booker. So Tesco, which had accounted for £1 in every £8 in the High Street would dominate the corner shop and convenience market. (BBC News, 2017)

The other opponent, Clive Black mentioned that If Tesco and Booker could join with unconditional approval, the scope for next large-scale consolidations had to be accepted afterward, unconditionally too. His reason was that Tesco had 3,200 UK stores and Booker supplies 117,000 self-standing retailers. So after the deal it would create a wholesale and retail giant with a turnover of about £60bn. (Monaghan & Wood, 2017)

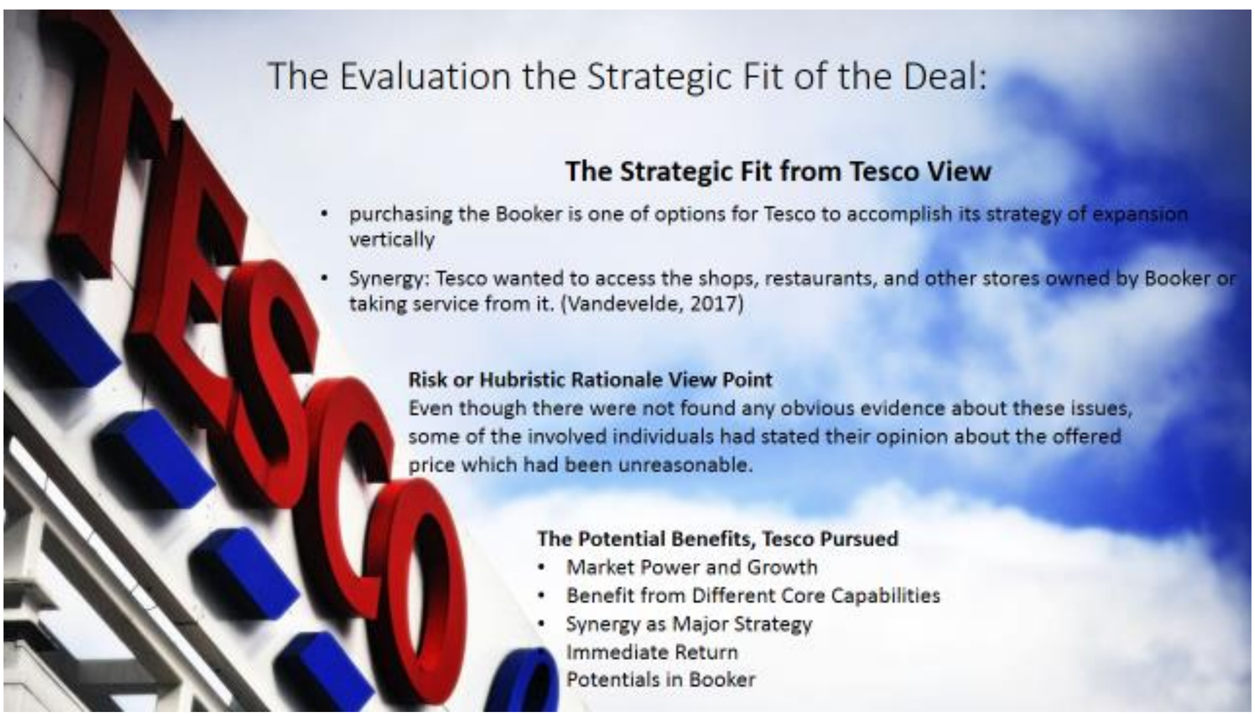
V. Slides for Presentation

(Vandevelde, et al., 2017)

(Onita, 2018)



(Talking, 2017)



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