

Tesco acquires Booker

Evaluation of the strategic fits, Regulatory & Due Diligence issues



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(Financial Times, (2017a))

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Table of Contents

Summary.....	1
1- Introduction.....	1
2- Strategic fit and potential benefits that Tesco pursue	2
2-1- Revenue and cost synergy.....	3
2-2- Market Power	3
2-3- Expanding sales	5
2-4- Customer Satisfaction	6
2-5- Expertise and Knowledge Synergy	6
2-6- ESG achievements	7
2-7- Share Information Technologies	7
3- The Regulatory & Due diligence issues faced by Tesco	7
3-1- CMA (Competition and Markets Authority) Approval.....	7
3-2- Scheme of arrangement & Shareholder Approval.....	8
3-3- Non-audit services (NAS) and Fee cap	8
3-4- Valuation	8
3-5- Market analysis (Formulate remedies).....	9
3-6- Some uncertainties around the deal.....	9
4- Conclusion	9
References.....	10
Appendix.....	11

List of Figures

Figure 1: UK Store portfolio	1
Figure 2: SWOT analysis of Tesco & Booker.....	2
Figure 3: Tesco and Booker Earnings before interest and Tax	3
Figure 4: Top grocers in the UK	4
Figure 5: Estimated market shares for larger wholesaler players	4
Figure 6: Tesco and Booker sales breakdown	5
Figure 7: Growth in the UK grocery market by channel	6
Figure 8: Booker Group Operational Profit Vs Customer Satisfaction	6

List of Tables

Table 1: Bookers Revenue & Customers	2
Table 2: Revenue & Cost synergies of £200 million per annum	3
Table 3: Valuation.....	8
Table 4: Market analysis	9

Summary

Tesco is going to create the “UK’s leading food business” and “increasing their presence in the out of home food segment” (Tesco annual report, 2017).

It has been observed that Tesco PLC has some important strategic fit with Booker, such as: expanding their operation in different markets by focusing on online services and the out-of-home sector, overcoming their rivals by controlling the market, and enhancing customer satisfaction. Through the deal and according to these strategic fits, it is going to gain revenue and cost benefits (table 1), expertise synergy, and ESG improvement. Except of regulatory issues including CMA and shareholder approval and NAS, Tesco PLC was struggling with some due diligence issues from target valuation to formulating remedies and the M&A activities that were happening at the same time.

1- Introduction

Considering Tesco as a retailer and Booker as a wholesaler, the deal is a vertical merger, in addition, both companies operate in retail sector (Booker on a very small scale as table 1) and it also is a horizontal merger.

Tesco PLC is a UK publicly listed company and the UK largest grocery retailer. It operates across “Europe and Asia”. “It owns approximately 3,500 supermarkets and convenience stores. In 2016/17 Tesco generated 55.9 billion of revenue worldwide, with 42.5 billion coming from the UK” (Piliot et al., 2017)

Booker is also a “UK publicly listed company” and the largest “wholesaler of food and non-food grocery items, particularly in the catering and retail sectors, with operations in the UK and India”. (Piliot et al., 2017).



Figure 1: UK Store portfolio (Vandeveldt, 2017)

Booker acquired convenience store chains Londis and grocery retailer Budgens in 2015. (Vandevelde et al., 2017). “In 2017 Booker generated £5.3 billion of revenue worldwide”. Booker serves three main types of customers as table 1:

Table 1: Bookers Revenue & Customers			
	Revenue	Percentage	Number of customers
Retailers	£3.36 bn	63%	117,000
Caterers	£1.68 bn	32%	441,000
Small business users	£290 million	5%	641,000

(Piliot et al., 2017)

2- Strategic fit and potential benefits that Tesco pursue

Figure 2 shows SWOT analysis of both Parties and in next sections I will evaluate their strategic fits according to the benefits that Tesco is looking for.

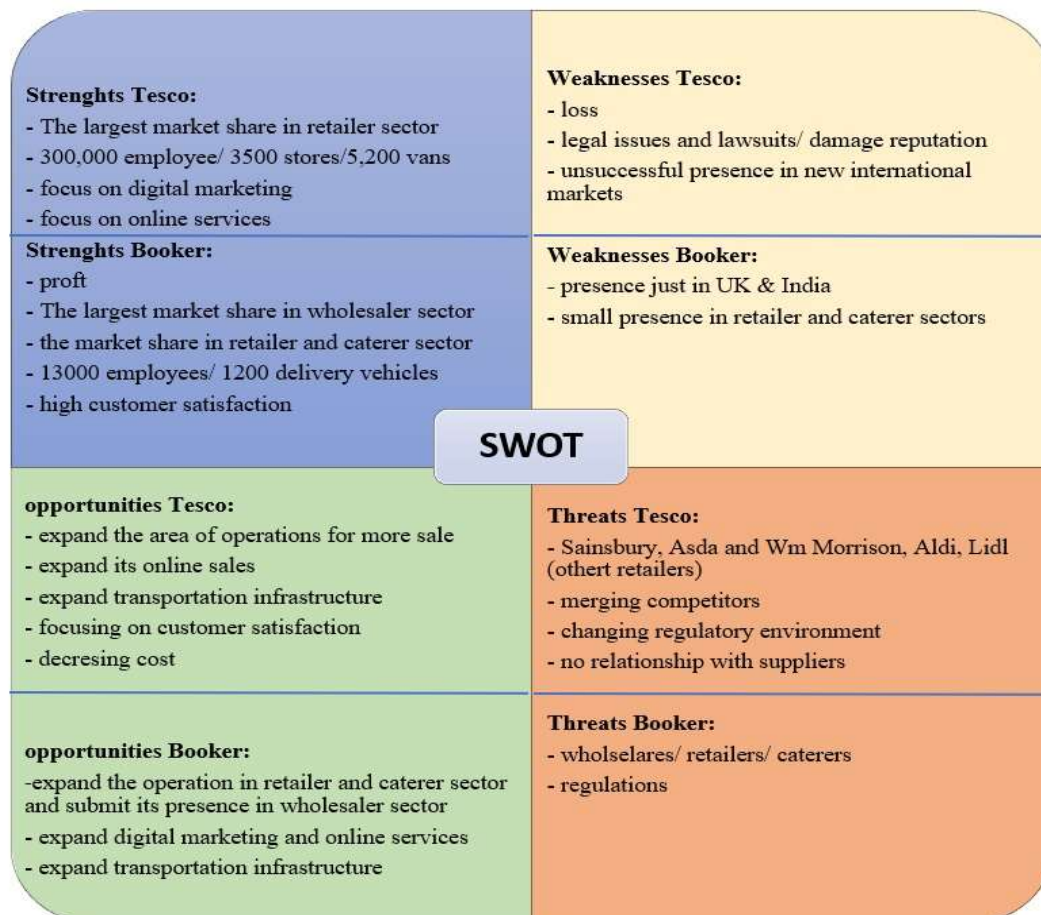


Figure 2: SWOT analysis of Tesco & Booker

2-1- Revenue and cost synergy

The Parties estimated the financial synergies and how they can achieve them, as table 1:

Table 2: Revenue & Cost synergies of £200 million per annum			
Revenue	Cost/Procurement	Cost/Distribution	Cost/Central Functions
£25 million	£96 million	£61 million	£18 million
Extending offering to caterers “within Tesco’s stores” “Booker’s stores being able to offer an enhanced product range”	“Reducing waste and optimizing/harmonizing supply terms between the Parties”	“By combining and optimizing the distribution networks of the Parties” save carbon, fuel, wastage	working smarter, working better

(Pilot et al., 2017) (Tesco PLC transcripts, 2017)



Figure 3: Tesco and Booker Earnings before interest and Tax

(Financial Times, (2017b))

As we see in figure 3, Booker’s earnings have increased continuously from 2008 to 2016, but Tesco has seen a significant decrease in its earnings. According to the financial situation of Booker, maybe we could consider it as a good target for Tesco that has encountered with a huge loss from 2012. In addition, HSBC Global Research “has announced that the synergies even could be as high as £500 million a year” (Pilot et al., 2017). I will explain in next sections, in detail that how synergies in table 2 will be achieved through operations.

2-2- Market Power

According to the figure 4, in retail market, there is close competition between the big four (Vandeveld, 2017). Tesco has 29% market share (Bounds, 2017) and can easily dictate its power

to consumers, other retailers and wholesalers in the UK. By achieving the market share of Booker in retail sector, can turn to an unrivaled leader.



Figure 4: Top grocers in the UK (Bounds, 2017)

Additionally, according to the figure 5, Booker has 11% of wholesaler market share, achieving the biggest wholesaler can help Tesco easily receive a variety of benefits from Booker and the other wholesalers and govern the wholesaler, retailer and caterer sector.

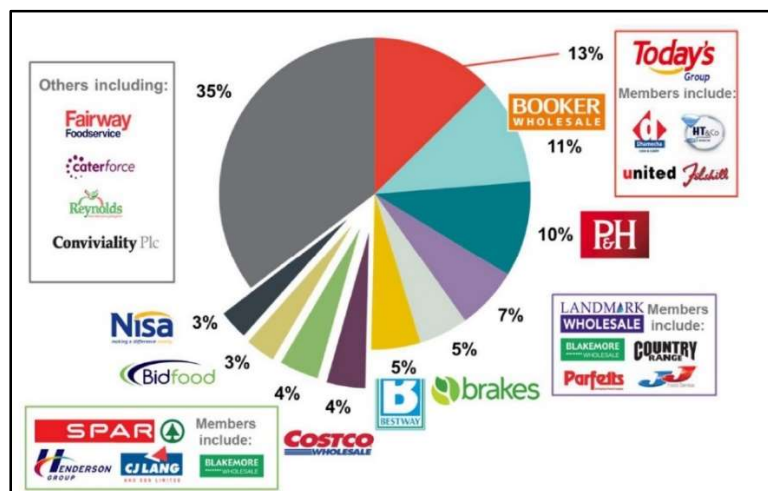


Figure 5: Estimated market shares for larger wholesaler players

(Tesco & Booker, 2017)

On the whole, Tesco would be a leader in both wholesaler and retailer sector, can be the number one in receiving the wholesaler services, specify prices, rules and managing the market and Booker can expand its market in retailers and caterers and submit its power in wholesaler market with being part of the largest retailer, Tesco.

2-3- Expanding sales

The growth forecasting of “out of home” segment “at 3.8% per annum between 2015 and 2018, and an expected growth of 2.4% for in home segment”, encouraged Tesco to plan to grow their presence in both markets: (Tesco PLC transcripts, 2017)

- **Market penetration:** Convenience is large and a fast-growing part of the market and continue to develop it (Tesco PLC transcripts, 2017) by accessing to wholesaler and improving the choice and the range of product for consumers (Tesco PLC transcripts, 2017)
- **Market Development:**
 - “Supplying a greater range of higher quality products” (Piliot et al., 2017) to Caterers (including Wagamama and Byron Burger), the retail sectors and small businesses of Booker and its own stores (Figure 6).
 - Improving online services to customers through “an expanded network of nearly 8,000 locations to pick up click and collect”. (Piliot et al., 2017). “£5 billion of turnover that is in the Booker business, £1 billion of that is already online”. (Tesco PLC transcripts, 2017)
 - Combining 5,200 vans of Tesco; 1,200 delivery vehicles of Booker (delivery operation with £1.8 billion of deliveries) (Tesco PLC transcripts, 2017) so it can increase the speed of transportation and provide better availability and fresh products to consumers.

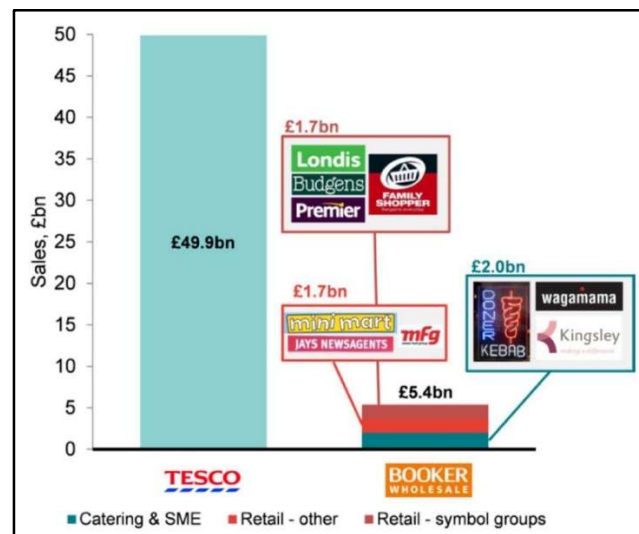


Figure 6: Tesco and Booker sales breakdown (Tesco & Booker, 2017)

According to figure 7 and predicting the changes in sales by different channels shows the willingness of consumers to buy online in the future. Tesco will access to more “click and collect” locations for online services and Booker can enhance its online presence and income. Further, in response to the significant presence of the Discounters, by merging with Booker, it can gain power

in Conveniences and large stores in comparison with Aldi and Lidle as Discounters. In a competitive environment, retailers focus on price, fresh products, and delivery services from wholesalers and will switch wholesalers to get them (Tesco & Booker,2017). Tesco will gain all of these benefits with this merger.

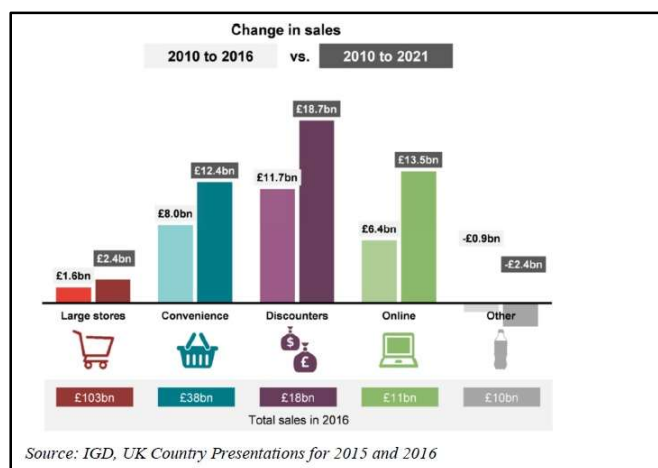


Figure 7: Growth in the UK grocery market by channel (Tesco & Booker,2017)

2-4- Customer Satisfaction

Figure 8 represent the customer satisfaction of Booker from 2008 to 2017, then it can help Tesco to gather its lost reputation after the big scandal of 2014 and increase customer satisfaction after starting the big competition with Amazon in “same-day delivery” (BBC News, 2017)

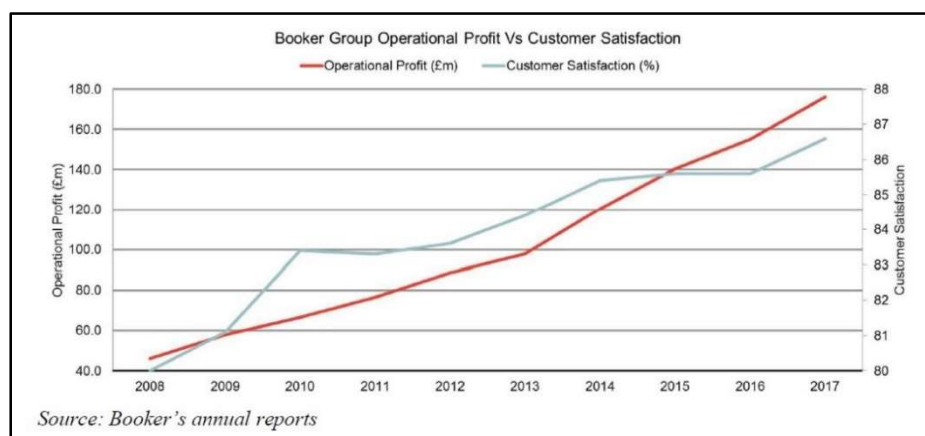


Figure 8: Booker Group Operational Profit Vs Customer Satisfaction (Tesco & Booker,2017)

2-5- Expertise and Knowledge Synergy

Keeping the retailing expertise in Tesco (300,000 employees) and the wholesaling expertise in Booker (13,000 colleagues), creates opportunities to grow in a diverse and leading business. Moreover, the combination of Bookers CEO with Tesco Plc board (Tesco PLC transcripts, 2017)

(Tesco & Booker,2017), plays an important role in keeping the business in a safe situation, from a managerial perspective for handling the all parts of the organization to psychological issues that happen during and after mergers.

2-6- ESG achievements

Carbon emission: By combining their routes to market, and decreasing the distances, increasing the proportion of the products and decreasing the transportation (Tesco & Booker,2017).

Food waste: With accessing to suppliers can delete the intermediaries and decrease the Food waste by retailers, caterers and consumers especially in fresh fruits, and vegetables. (Tesco PLC transcripts, 2017)

2-7- Share Information Technologies

Booker and Tesco have a very well-built digital infrastructure. By enhancing the online service, they will be able to serve their customers better through the digital operation. Importantly, it also gives Booker access to banking, digital solutions, mobile solutions, and pay equipment, making that available to all caterers and convenience stores (Tesco PLC transcripts, 2017).

3- The Regulatory & Due diligence issues faced by Tesco

3-1- CMA (Competition and Markets Authority) Approval

As “at least two-thirds of their EU turnover is in the UK, jurisdiction of the Merger lies with the CMA” rather than European Commission (Piliot et al., 2017), in 2 phases with considering both vertical and horizontal aspect of merger and how it would affect on “SLC (substantially lessen competition)” (Hussein, (2022a)). Phase Two lasted for 24-week (“FT Opening Quote,” 2017). Their competitors claimed that the tie-up would put smaller rivals out of market and put pressure on big competitors with raising prices and reducing service quality for the other retailers (Megaw, 2017).

CMA concluded that Tesco and Booker came from different businesses and cannot be harmful for their rivals (Rovnick & Odell, 2018) In addition, there is a strong competition in the market (wholesale and retail sectors) to select and switch between them (Megaw, 2017).

A decade ago the regulator decided according to market share numbers and said no or yes (Burgess, 2018). Now making a decision after understanding how the market would be affected by the deals negatively or positively, can control the negative outcomes in advance or can improve the competition and customer services by accepting the deal.

3-2- Scheme of arrangement ¹& Shareholder Approval

The deal needed 75 percent of Bookers shareholders' approval and at least 50 percent of Tesco's shareholders. The disagreement of Booker's shareholders was due to the deal valuation and dividend payment (Vandeveldt & Pooley, 2017). Tesco's shareholders criticized the logic of the deal just 3 years after the big scandal of Tesco and the 6.4bn loss (Rovnick & Odell, 2018) and the Tesco refusal of talking to them about their concerns over shareholders' value (Vincent, 2017). The disagreement of shareholders could have negative and positive effects in M&A, making delay in finalizing the merger is risky, especially from the valuation and market competition aspect, but sometimes it can prevent of wrongdoings by the managers.

3-3- Non-audit services (NAS) and Fee cap²

The new rule prohibited some non-audit services by external auditor and limited its fee. Therefore, Deloitte didn't provide any new non-audit services for the Group in 2016/17 to ensure compliance with the new regulations. It did the due diligence and reporting accountant services in respect of the Booker transaction (Annual report, 2017).

3-4- Valuation

The deal condition is: 0.861 shares and 42.6p in cash. Sandell Asset Management Corp., believed that:

Table 3: Valuation	
Issue	Reason
Fair Value for Bookers share	Between 255p and 265p per share
Tesco stock is inferior to Booker stock	Closing price of Tesco: 210.8p, Closing price of Booker: 221.5p
Premium is below average	Offer: 12%, average premium in UK: 25%

(Jahshan, 2018)

Finally, based on the Tesco closing price of 210.8p, a rise of 1.8 per cent on the day, the deal valued Booker at just over £4bn (Rovnick & Odell, 2018).

¹ Scheme of arrangement is an agreement between companies and its members "under section 26 of the Companies Act 2006". After confirmation by the CMA, at least 75% of each group member is needed for approval. (THOMSON REUTERS PRACTICAL LAW, 2022)

² The (EU) audit legislation entered into force with the effective date, June 17, 2016. "Fees for NAS should not exceed 70% of the average audit fees paid in the last three consecutive financial years" (Delloitte, 2015)

3-5- Market analysis (Formulate remedies)

The UK convenience sector had attracted the attention of companies, so all of these rivals should be considered as an important matter in external Due Diligence and how the acquirer and target would be affected by any of the below deals.

Table 4: Market analysis (Formulate remedies)		
Rivals	Market	Threat
Sainsbury made a bid for Nisa	Retailer & Wholesaler	Increasing presence in both market
Morrisons signed a wholesale supply agreement with McColl's	Retailer	Increasing presence in Retailer sector
Possibility of combination of J Sainsbury and Asda	Retailer	Increasing presence in Retailer sector, and the market share would be more than Tesco
Amazon in conjunction with Morrisons	Online Retailer "Same-day" Delivery Services	Increasing presence in online market and more customer satisfaction

(Bounds, 2017) (Butler & Wood, 2017) (Eley, 2018) (BBC News, 2017)

3-6- Some uncertainties around the deal

Richard Cousins, Tesco's senior non-executive director, resigned and he was against the deal. Believing that "Tesco needs to make the business simpler, not more complex." (Vandeveldt et al., 2017) "Advisory firms including Glass Lewis and ISS had also told Booker's investors to reject Tesco's bid" (Rovnick & Odell, 2018). Brexit (2016 -2020) can affect financial transactions, operations, contracts and regulatory issues that might depend on the EU or UK, relationships with customers, suppliers and even colleagues. Always there are uncertainties around the deal that can be predicted. The acquirer should pay more attention to internal and external risks during the deal. This can be recognized according to experience and existing evidence.

4- Conclusion

As a concluding statement, Tesco used "business strategy" for this merger and it can be a win-win deal under the same regulatory and cultural environment, and both Parties can acquire a variety of financial and operational benefits. Specifically, Tesco can overcome its rivals and gather its lost reputation and bring the difficulties that have been faced during these years under control. Considering the regulatory and due diligence issues, I believe the regulatory obstacles that Tesco and Booker encountered were logical and timely actions from the market, shareholders, and regulators. Such regulations, definitely help to control any future challenges beforehand. Due to high competition in the market, an exact analysis of rivals and a logical valuation to shorten the duration of the deal process should be considered in Due Diligence. (Hussein, (2022b))

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Appendix

- PowerPoint presentation



TESCO ACQUIRES BOOKER

C NUMBER: C2042409

INTRODUCTION

- Tesco PLC is a UK publicly listed company and the UK largest grocery retailer. It operates across “Europe and Asia”. “It owns approximately 3,500 supermarkets and convenience stores. In 2016/17 Tesco generated 55.9 billion of revenue worldwide, with 42.5 billion coming from the UK” (Piliot et al., 2017)
- Booker is also a “UK publicly listed company” and the largest “wholesaler of food and non-food grocery items, particularly in the catering and retail sectors, with operations in the UK and India”. (Piliot et al., 2017).
- The deal is vertical and horizontal merger.





INTRODUCTION

UK STORE PORTFOLIO (VANDEVELDE, 2017)

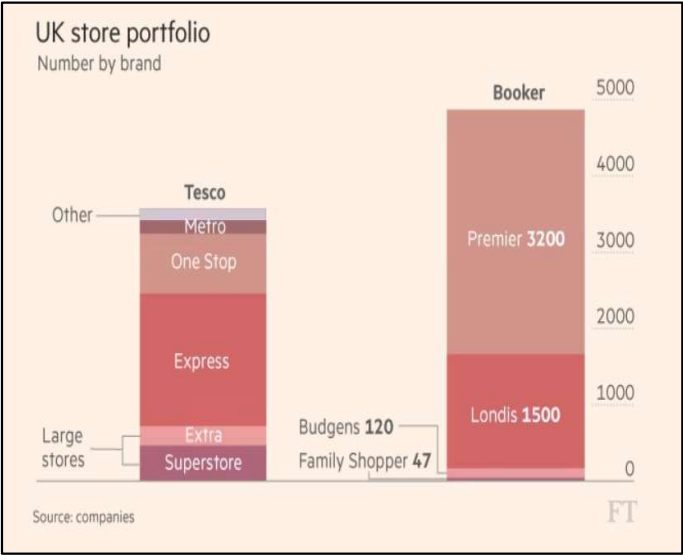


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BOOKERS REVENUE & CUSTOMER

(Piliot et al., 2017)



Strategic fit and potential benefits that Tesco pursue

SWOT ANALYSIS

Strenghts Tesco: <ul style="list-style-type: none"> - The largest market share in retailer sector - 300,000 employee/ 3500 stores/5,200 vans - focus on digital marketing - focus on online services 	Weaknesses Tesco: <ul style="list-style-type: none"> - loss - legal issues and lawsuits/ damage reputation - unsuccessful presence in new international markets
Strenghts Booker: <ul style="list-style-type: none"> - profit - The largest market share in wholesaler sector - the market share in retailer and caterer sector - 13000 employees/ 1200 delivery vehicles - high customer satisfaction 	Weaknesses Booker: <ul style="list-style-type: none"> - presence just in UK & India
opportunities Tesco: <ul style="list-style-type: none"> - expand the area of operations for more sale - expand its online sales - expand transportation infrastructure - focusing on customer satisfaction - decresing cost 	Threats Tesco: <ul style="list-style-type: none"> - Sainsbury, Asda and Wm Morrison, Aldi, Lidl (othert retailers) - merging competitors - changing regulatory environment - no relationship with suppliers
opportunities Booker: <ul style="list-style-type: none"> -expand the operation in retailer and caterer sector and submit its presence in wholesaler sector - expand digital marketing and online services - expand transportation infrastructure 	Threats Booker: <ul style="list-style-type: none"> - wholselares/ retailers/ caterers - regulations

SWOT



REVENUE AND COST SYNERGY

TESCO AND BOOKER EARNINGS BEFORE INTEREST AND TAX



(Financial Times, (2017b))

Table 2: Revenue & Cost synergies of £200 million per annum			
Revenue	Cost/Procurement	Cost/Distribution	Cost/Central Functions
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Extending offering to caterers “within Tesco’s stores” “Booker’s stores being able to offer an enhanced product range”	“Reducing waste and optimizing/harmonizing supply terms between the Parties”	“By combining and optimizing the distribution networks of the Parties” save carbon, fuel, wastage	working smarter, working better



BOOKERS REVENUE & CUSTOMER

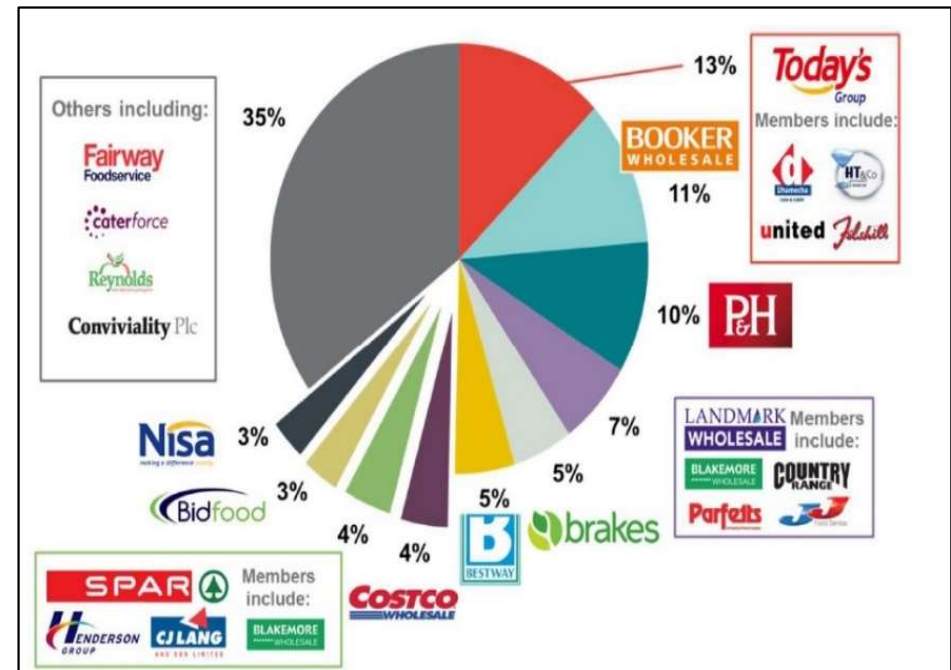
(Piliot et al., 2017) (Tesco PLC transcripts, 2017)

Market power



Top grocers in the UK (Bounds, 2017)

Estimated market shares for larger wholesaler players (Tesco & Booker, 2017)

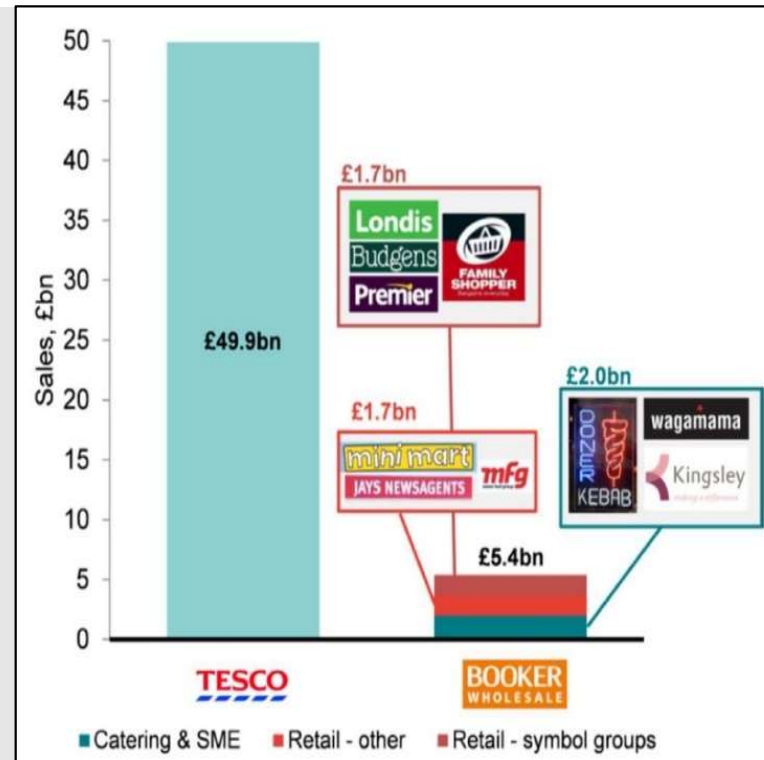


IMPROVING SALES



MARKET PENETRATION

“Supplying a greater range of higher quality products” (Pilot et al., 2017) to Caterers (including Wagamama and Byron Burger), the retail sectors and small businesses of Booker and its own stores



(Tesco & Booker, 2017)



MARKET DEVELOPMENT

- Improving online services to customers through “an expanded network of nearly 8,000 locations to pick up click and collect”. (Pilot et al., 2017).
- Combining 5,200 vans of Tesco; 1,200 delivery vehicles of Booker (delivery operation with £1.8 billion of deliveries) (Tesco PLC transcripts, 2017) so it can increase the speed of transportation and provide better availability and fresh products to consumers.

SOME OTHER BENEFITS



Customer Satisfaction

- can help Tesco to gather its lost reputation and customer satisfaction, after the big scandal of 2014.
- Competition with Amazon

Expertise and Knowledge Synergy

- Tesco (300,000 employees)
- Booker (13,000 colleagues),
- **Management merger**



Share Information Technologies

ESG achievements

- **Carbon emission**
- **Food waste**



The Regulatory & Due diligence issues faced by Tesco



Regulatory issues



▪CMA (Competition and Markets Authority) Approval

- CMA concluded that Tesco and Booker came from different businesses and cannot be harmful for their rivals (Rovnick & Odell, 2018) In addition, there is a strong competition in the market (wholesale and retail sectors) to select and switch between them (Megaw, 2017)

▪Non-audit services (NAS) and Fee cap

- The (EU) audit legislation entered into force with the effective date, June 17, 2016. “Fees for NAS should not exceed 70% of the average audit fees paid in the last three consecutive financial years” (Deloitte, 2015)

▪ Scheme of arrangement & Shareholder Approval

The deal needed 75 per cent of Bookers shareholders’ approval and at least 50 per cent of Tesco’s shareholders (Vandevelde & Pooley, 2017)

DUE DILIGENCE ISSUES

- **Valuation**

Table 3: Valuation	
Issue	Reason
Fair Value for Bookers share	Between 255p and 265p per share
Tesco stock is inferior to Booker stock	Closing price of Tesco: 210.8p, Closing price of Booker: 221.5p
Premium is below average	Offer: 12%, average premium in UK: 25%

- **Market analysis (Formulate remedies)**

Table 4: Market analysis (Formulate remedies)		
Rivals	Market	Threat
Sainsbury made a bid for <u>Nisa</u>	Retailer & Wholesaler	Increasing presence in both market
Morrisons signed a wholesale supply agreement with McColl's	Retailer	Increasing presence in Retailer sector
Possibility of combination of J Sainsbury and Asda	Retailer	Increasing presence in Retailer sector, and the market share would be more than Tesco
Amazon in conjunction with Morrisons	Online Retailer "Same-day" Delivery Services	Increasing presence in online market and more customer satisfaction

Some uncertainties around the deal

- **Tesco's senior non-executive director, resigned**
- **"Advisory firms including Glass Lewis and ISS had also told Booker's investors to reject Tesco's bid"**
- **Brexit (2016 -2020)**



CONCLUSION

As a concluding statement, this merger can be a win-win deal under the same regulatory and cultural environment, and both Parties can acquire a variety of financial and operational benefits. Specifically, Tesco can overcome its rivals and gather its lost reputation and bring the difficulties that have been faced during these years under control. Considering the regulatory and due diligence issues, I believe the regulatory obstacles that Tesco and Booker encountered were logical and timely actions from the market, shareholders, and regulators. Such regulations, definitely help to control any future challenges beforehand. Due to high competition in the market, an exact analysis of rivals and a logical valuation to shorten the duration of the deal process should be considered in Due Diligence.





THANK YOU

