J.P.Morgan

TREASURY AND PAYMENTS

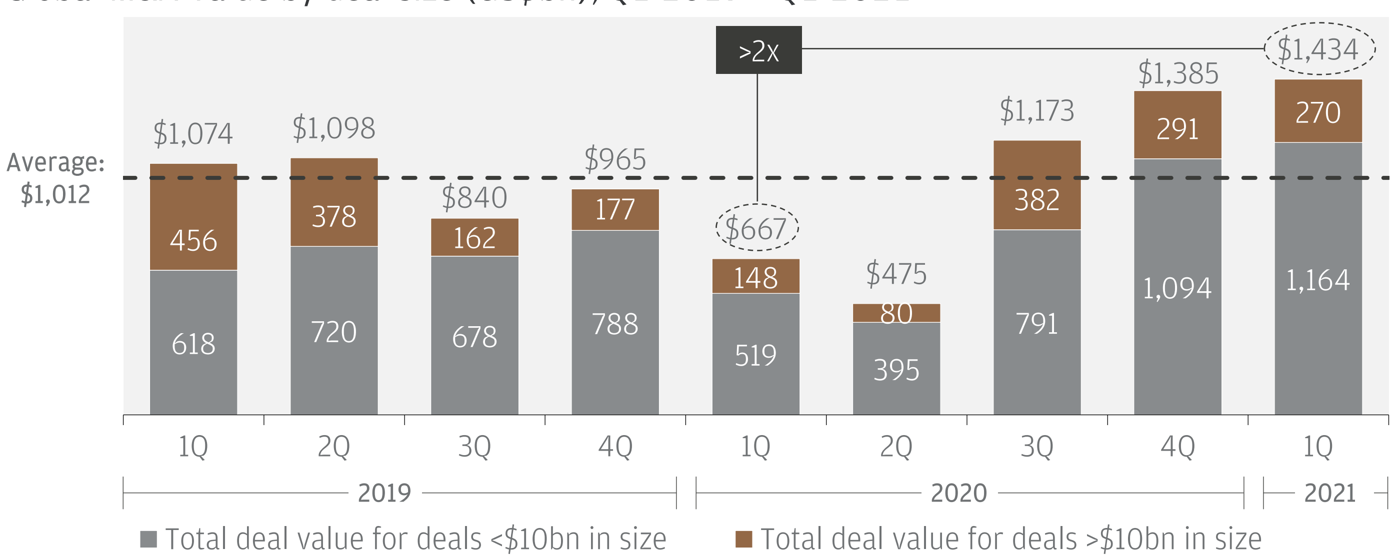
What does it really mean for Corporate Treasury?

The onset of the pandemic in 2020 had widespread implications across the business world, not least of which was a roller coaster ride for deal activity. Treasurers can play a pivotal role in a deal lifecycle by providing strategic support to the CFO's office.

The key to managing the deal lifecycle is the creation of a strategic and highly defined roadmap that ensures Treasury is fully supporting each vital step in the process. Below is a three-phase roadmap to execute a deal.

A low interest rate environment, excess liquidity, search for growth and a more positive economic recovery outlook can be some of the reasons attributed to the increase in Q1 2021 deal value, which was greater than two times that of Q1 2020 levels. Monthly deal activity in March 2021 was the highest since 2019. Much of the deal volume was powered by deals in the \$1bn - \$10bn range, of which, over half of deals originated in the US. It's critical that Treasury is engaged early in the process to ensure smooth settlement of the transaction on due date and to be prepared with an integration plan post deal settlement.

Global M&A Value by deal size (US$bn), Q1 2019 – Q1 2021[1]



M&A deal momentum expected to be strong in 2021[2]

M&A deal momentum is expected to continue in 2021 coupled with a low interest rate environment, stability of corporate liquidity buffers, and a positive economic outlook.

Bringing organizations together through mergers and acquisitions, or carving them out through separations and divestitures, are among the most complex business activities an organization can undertake.

How Treasury can provide Strategic Support to the CFO

Over time, Treasury's role has evolved from protecting the company's liquid assets and carrying out core functions to serving as a strategic advisor to the CFO's office. This means that Treasury needs to navigate shifting business priorities, while still managing company liquidity, funding, and risk management in a globally connected world. With Treasury's expanded responsibility has come the need to provide strategic support and build a sustainable operational infrastructure to execute the transaction, while delivering long-term shareholder value.

The key to managing the deal lifecycle is the creation of a strategic and highly defined roadmap that ensures Treasury is fully supporting each vital step in the process. Below is a three-phase roadmap to execute a deal.

Deal Announced

Plan and Prepare

- Plan for deal settlement on target date
- Start information gathering
- Set up a governance structure (e.g., IMO (Integration Management Office))

Deal Settled

Settle and Control

- Settle deal (Day 1)
- Gain Control & Visibility across Treasury
- Build a quantifiable business case for change
- Finalize organization structure (i.e., Legal Entity)
- Build a treasury operating model vision

Post Deal Integration

Transform and upgrade

- Rationalize bank accounts & Globally manage liquidity
- Upgrade treasury infrastructure
- Build efficient and automated processes
- Manage risk (e.g., FX, Interest Rate etc.)

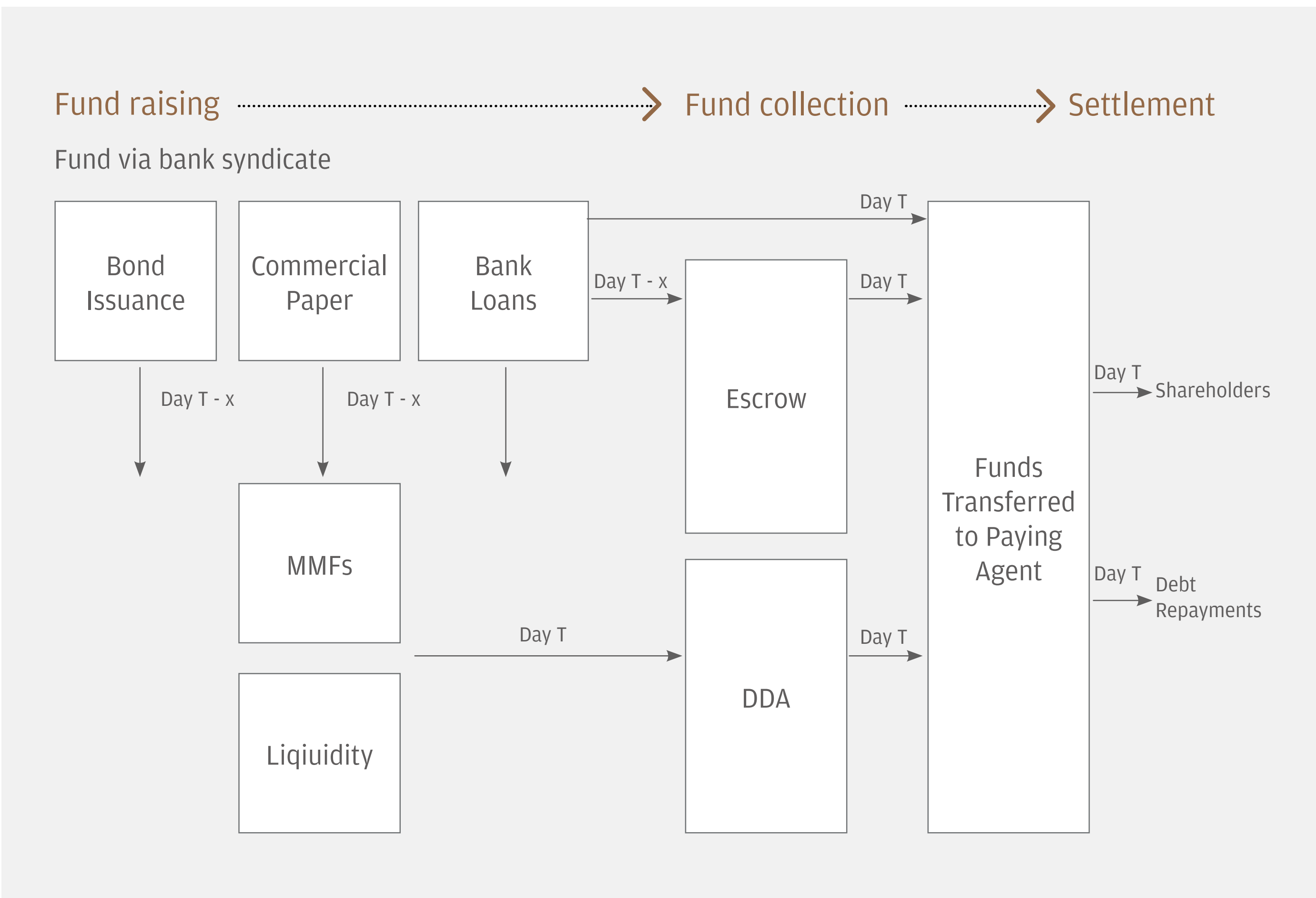
Plan and Prepare

Establish Governance and Gather Information[3]: Collaboration across functions (finance, legal, tax, compliance) and with third-party providers, such as banks, technology providers and consultants, is key to ensuring treasury integration success. Building an Integration Management Office (IMO), comprised of a cross-functional team, helps to avoid silos and identifies areas of interdependence. An IMO can identify issues and roadblocks that may arise. Additionally, IMO often centralize tracking initiatives used to prioritize activities and monitor organization, process, and technology dependencies. Treasury also needs to start gathering information needed not only to settle the transaction but also to gain visibility and control post the transaction.

Settle and Control

Successfully Settle the Transaction: As the deal closure date approaches, Treasury needs to manage competing priorities, including arranging the finances, consolidating funds, execution of funds movement and creating contingencies for executing the transaction. Treasury needs to communicate and plan with their banking partner(s) to establish an implementation plan, identify roles and responsibilities, complete documentary requirements and have adequate intraday limits to settle the transaction. Inadequate planning can result in funds not being available, which could negatively impact the deal timeline.

In a recent merger of two large pharmaceutical companies, it was important to have a clear understanding of where funds were to be centralized and how the transaction would be settled. It required detailed planning of how the funds would be collected into a set of accounts prior to settlement day along with a timely sensitive disbursement schedule to the paying agent to settle the deal. Scenario and contingency planning was required to ensure funds were cleared on settlement day and were supported with adequate intraday credit lines.



Gain Control and Visibility Across Treasury: The integration journey for Treasury begins immediately after deal execution. The top priority for Treasury is to gain visibility and control of accounts and liquidity. This allows the Treasury team to ensure cash is readily available and operating liquidity is maintained for the combined entity. Pre-planning and close coordination are required with your banking partners across the following areas:

Days 1 – 30

- Hierachy and account ownership changes of the acquired entity
- Online portal access, signature authority, security administration of acquired accounts
- Updates to banking and legal documentation to support corporate action changes
    - Core legal documentation with your bank provider(s)
    - KYC related documents and security administrator forms
- Manage onboarding for any new account openings and services

Days 30 – 120

- Rationalizing user entitlements, modules, and product features no longer required
- Reviewing combined Treasury operations to identify redundancies and inefficiencies
- Set up pre-formatted wire instructions for recurring treasury transactions
- Modifying and/or implementing host-to-host connectivity

By collaborating with banking partners across the planning process, Treasury can actively reduce friction in the integration journey while also identifying broader areas of synergy across the treasury organization. J.P. Morgan has worked with companies across a wide spectrum of industries to conduct pre-planning assessments and ensure sufficient control across bank accounts, liquidity and settlement activity deal situations.

Build a Business Case for Transformation: M&A is a good opportunity to drive change by reallocating resources and reprioritizing activities for treasury transformation. Recently J.P. Morgan partnered with a large delivery services company to quantify the impact of a recent merger on operating liquidity requirements, working capital management and cost efficiencies via bank account rationalization and streamlined settlements. For companies looking at treasury transformation, building a business case with both qualitative and quantitative benefits can help advocate for change at a corporate level:

Excess liquidity

- Identify the right amount of liquidity required for the combined company
- Understanding of the cash flows and J.P. Morgan's properietary statisical models can help quantify the operating cash requirement
- Total liquidity available with combined entity minus required opearting liquidity will determine excess liquidity which can be significant

Free up working capital

- Identify areas that can help improve working capital components (Days Sales Outstanding (DSO), Days Payables Outstanding (DPO) and Days Inventory Outstanding (DIO))
- Benchmarking across DSO, DPO, DIO can help size the opportunity for driving improvements

Reduction in short term funding cost

- Minimize the trapped cash left idle in operating countries or regions and provide more efficient funding for overdrawn positions with surplus cash from other entities
- This can be calculated by understanding the external short funding costs and identifying pockets where internal cash can be deployed

Operational cost reduction

- Cost reduction via automation in processing, organizational improvements and going electronic
- An analysis of such costs and identifying areas of improvements can be quanified

It is equally important to analyze the resources required to make changes including finance, IT, consultants, bank services, legal and tax specialists. Although this analysis can be quite complex, it can help create a comprehensive business case to help Treasurers act as strategic advisors throughout the deal process.

Finalize an Organization Structure: The newly formed company may require significant work to finalize an updated legal entity structure that matches the new footprint, navigates tax requirements across jurisdictions and aligns with objectives and the business model of the newly formed company. Changing legal entity structures is complex, time-consuming and requires assessment and buy-in from legal and tax partners within the company. From a treasury perspective it involves making changes to existing treasury structures (i.e., in-house bank, regional treasury centers, payment factories, etc.), as well as updating documentation with counterparties such as banks. Furthermore, it requires reassessing the impact the changes may have on country regulatory requirements, thin capitalization rules, cross-border fund restrictions and repatriation limits.

Build a Visionary Treasury Operating Model Strategy: Reviewing and rethinking Treasury's operating model in light of key business changes is a recommended practice. A company's footprint, expansion plans, and operational philosophy will determine the level of centralization required across liquidity, funding, risk and settlements. For example, one multinational technology provider that was being divested worked in collaboration with J.P. Morgan to rethink the Treasury Operating Model and identify areas that could be simplified, replicated or optimized. A review of both strategic areas, such as organization structure, governance and treasury infrastructure, as well as operational, such as cash visibility, liquidity management and transactional processes, resulted in the company designing a new visionary treasury model. This vision has established the roadmap for the company as it transforms its treasury.

Select Transformation Steps

Rationalize Bank Accounts and Globally Manage Liquidity [4]: Amongst the early activities of building an integrated treasury function is bank account rationalization. This helps reduce costs associated with maintaining accounts across the finance function and simplifies the treasury structure. This in turn leads to more efficient liquidity management, enabling use of solutions such as pooling and virtual accounts , which can alleviate the challenges of an evolving organizational structure in global markets.

> J.P. Morgan recently worked with a large multinational industrial company post spin off to identify >$500,000 in annual cost savings by streamlining and rationalizing its banking accounts globally.

Upgrade and Modernize Your Treasury Infrastructure: At times, Treasury faces the challenge of integrating different technology infrastructures, including multiple ERP, TMS and connectivity environments. As part of integration, Treasury has an opportunity to select technology from the two infrastructures that best supports the future state treasury model and underlying processes. Building new technology infrastructure requires due diligence by the company in defining the long-term vision of real time treasury[5].

Build Efficient and Automated Processes: After settling the deal, Treasury should look to drive synergies across the combined company. This means setting targets for unlocking excess working capital and improving operational efficiency across order to cash and procure to pay processes. Streamlining, standardization, automation and real time information exchange via APIs[6] across treasury operations helps build scalability that can help the company be better prepared for the future.

Take a Deep Dive to Assess and Manage Risk: In addition to closing the deal, Treasury should also obtain a detailed picture of the target company's risk identification, measurement and management infrastructure, along with its effectiveness in stress situations. There is a need to carefully analyze potential synergies and areas of exposure. Once the company's needs are identified, your banking provider can partner across liquidity, FX services, and working capital financing for easy flow of funds to minimize business disruption.

Building a strategy that outlines improvement areas along with services provided by banking partners can help the combined company pivot to a more efficient treasury function.

Implementing Treasury Best Practices

Companies looking to execute transactions need to define a vision, collect pertinent data and conduct an internal assessment that factors in industry, geographical footprint, business objectives and future expansion plans. The efforts should be complemented with an Integration Management Office that identifies key teams and stakeholders, defines clear timelines with milestones and measures benefits to track progress on a periodic basis. Having executive buy-in through a well-thought out plan and business case can help manage change and ensure superior execution to build a sustainable treasury function. It is beneficial to proactively engage with your bank partners, especially in the case of complex deals, as global banks can act as an advisor on treasury best practices across various jurisdictions and can guide in developing an effective action plan to execute a deal.

For more information, please contact the J.P. Morgan Wholesale Payments team.

Footnotes

1 Dealogic as of March 31, 2021; Deal value in US$bn
2 https://www.jpmorgan.com/solutions/cib/investment-banking/2021-global-ma-outlook
3 https://www.jpmorgan.com/commercial-banking/insights/treasury-ready-acquisition
4 https://www.jpmorgan.com/solutions/treasury-payments/insights/corporate-liquidity-centralization-imperative
5 https://www.jpmorgan.com/solutions/treasury-payments/insights/open-banking
6 https://www.jpmorgan.com/solutions/treasury-payments/insights/real-time-treasury-apis

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