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Contents

Editor
Oliver Clark
+44 (0)207 779 8597
oliver.clark@airfinancejournal.com

Asia finance editor
Dominic Lalk
+852 2842 6941
dominic.lalk@airfinancejournal.com

Greater China reporter
管沁雨 (GUAN Qinyu); Elsie Guan
+852 2842 6918
elsie.guan@airfinancejournal.com

Consulting editor
Geoff Hearn

Managing director
Laura Mueller
+44 (0)207 779 8278
laura.mueller@airfinancejournal.com

Managing editor
Olivier Bonnassies
+44 (0)207 779 8062
olivier.bonnassies@airfinancejournal.com

Group sub editor
Peter Styles Wilson

Managing director, The Airline Analyst
Mike Duff
+44 (0)207 779 8058
mduff@theairlineanalyst.com

Advertisement manager
Chris Gardner
+44 (0)207 779 8231
chris.gardner@euromoneyplc.com

Head of sales
George Wiliams
+44 (0)207 779 8274
george.wiliams@airfinancejournal.com

Head of Asia subscriptions
Harry Sakhrani
+65 6422 1482
hsakhrani@theairlineanalyst.com

Senior marketing executive
Alyssa Yang
+44 (0)207 779 8542
alyssa.yang@euromoneyplc.com

Divisional CEO
Jeffrey Davis

Production editor
Tim Huxford

Subscriptions / Conferences Hotline
+44 (0)207 779 8999 / +1 212 224 3570
hotline@euromoneyplc.com

Customer Services
+44 (0)207 779 8610.
8 Bouverie Street, London, EC4Y 8AX

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Navigating the M&A integration process

Managing risk has never been more imperative as aviation businesses are charting their paths toward recovery – and the eventual resumption of growth – while eyeing emergent investment opportunities amid the Covid-19-strained global operating environment. Zeevo Group discusses the resources, processes and commitments required to manage successfully enterprise risk during the M&A integration process.

With a constantly shifting business landscape compounded by the effects of the Covid-19 pandemic and the uncertainty surrounding the industry's nascent recovery, mergers and acquisitions (M&A) can be a crucial tool for the long-term strategic growth of businesses, particularly in the case of aircraft leasing platforms, which are poised to enter new markets or augment their fleet portfolios.

Joey Johnsen, Zeevo Group chief executive officer, stresses: "The success of the integration process lies in the business's ability to extract maximum value from an M&A transaction."

Transactions in the leasing space require long-term planning and strategic integration to optimise returns. M&A transactions alter the risk profile of the combined organisation as existing risks evolve and new risks emerge during the integration process.

"In fact, the ability to effectively manage operational and internal control risks can be a deciding factor for the combined company's survival," asserts Johnsen. "It is imperative to identify and mitigate risks related to people, processes and systems as a key component of the integration process."

While the immediate focus during an integration of two companies is on external customers, vendors and employees, the post-implementation challenge requires building an efficient infrastructure to capture synergies, particularly in finance, accounting, governance and compliance.

"The complexities of the integration process often result in companies being overwhelmed by the process, focusing solely on the technical aspects of the integration, while assuming the control environment will be properly addressed," warns Johnsen.

While lessors may be well-prepared with effective risk management and internal control structures, supported by strategic planning and analysis, and trading teams, these structures are not likely designed to meet the needs of the combined organisation.

Johnsen explains; "The lack of focus on integrating and right-sizing the control environment is among the most common reasons why lessors fail to achieve synergy goals during the integration and post-M&A implementation phase."

Solid PMO/IMO

Embedding a controls team within the overall project team and developing an integration strategy for risk and internal control transformation will ensure the combined organisation successfully captures synergies and builds for the future.

Figure 1: Balancing compliance with process improvements and risk assessments

Figure 2: Risk and internal controls strategy informing decisions at all stages of integration process

"The integration planning must run in parallel with deal negotiations," stresses Johnsen, pointing to the need for leadership to ensure functional representatives from finance are at the table from the get-go.

"Establishing a dedicated finance arm of the project/ programme management office (PMO) or integration management office (IMO) to track milestones and identify and address identified integration issues is key to a successful integration," he adds.

Internal controls work stream

The internal controls work stream should include key risk and internal control professionals, with each focused on specific business process and technical work streams. The risk and internal controls strategy must be anchored in proactively addressing critical areas during the integration process by considering its impact on people, systems and processes.

"An effective risk and internal controls strategy will provide a guideline to govern decision-making related to risk and controls for the combined organisation, making it less likely for leadership to overlook critical areas and for decisions to be ad-hoc," elaborates Johnsen.

People

The effectiveness of the resulting business process can be significantly affected by culture. The internal controls team must take into account the combined entity's different cultures, risk tolerances and working styles in considering the adoption of new processes and controls to adapt effectively to the new risk profile.

Johnsen emphasises that analysing these differences and clearly defining risk and control objectives will result in an approach that the internal control team can adopt to "eliminate the common cultural obstacles and define the necessary changes in the combined organisation" that will bring cultures together, drive better control execution and ensure the effectiveness of the resulting processes.

Systems

Designing and implementing interim and bridge controls while addressing the to-be processes are the requisite steps to leverage system functionality effectively during the integration process.

"Understanding technology risks and ways to mitigate and control IT system development projects and applications, data quality and integrity are key to an effective final system integration," declares Johnsen.

By granting the right access to systems while restricting it where necessary, the internal control team will eliminate conflicting duties during the integration process. The team must also be tasked with the design and development of user monitoring processes to address the risk of uncontrolled access and resolve existing issues as part of implementing the new process and system design.

"Key stakeholders from across the business, who understand the data and its importance to the user community, must be involved from the get-go in the design of the to-be environment," stresses Zeevo Group's chief technology officer, John McCartney.

Figure 3: IT management framework delineates the roles and capabilities of the information technology organisation in terms of processes, tools and performance measures

These stakeholders' understanding of differences affecting data integrity, as exemplified by work orders, a key input to the asset unitisation process where data elements are usually different among the entities, will help arm the combined organisation with appropriate controls for data cleansing, conversion and validation processes, ensuring there are no issues with asset unitisation in the to-be data model down the line.

Processes

The differences in various business processes, including external and management reporting, will affect the end-state operations of the combined organisation. The internal control team must evaluate these differences and determine the desired process and procedure for each relevant business process.

The internal controls team should collaborate with the finance organisation to develop an accounting policy playbook that evaluates differences and their impact on data conversion, transaction recording, and operational and financial reporting.

Some key questions the internal controls team should ask during design to understand these differences include:

- how are items classified when they are initially recorded – are they considered inventory, or are they capitalised on the balance sheet as financial assets?
- how are purchase requisitions (PRs) and orders (POs) maintained in each companies' respective system(s)?
- what PRs and POs need to be transferred to the combined company's system of record (eg, open PRs and POs only, how much historical data will be brought across)?
- what does the new signing authority/delegation/ grant of authority matrix look like, and at what level of detail must supporting documentation have to make purchasing decisions, investment decisions, etc?

The internal control team should clearly understand the differences between each entity and assist in the creation of routines that bridge these differences. In addition, the internal control team assists in enabling the development of to-be processes based on the combined entity's policies, procedures and external/internal reporting requirements.

Clearly, understanding and documenting the process differences and affirmatively making a decision about the end-state processes and procedures provides the foundation to achieve completeness and accuracy of information and reporting.

Finance, treasury and tax are central to a merger's success

The chief financial officer's (CFO) organisation, along with its finance, treasury and tax teams, are central to a merger's success and face numerous challenges during the integration process.

"While assisting the finance transformation efforts for a range of publicly listed, global organisations across industries, the first priority I always communicate to client teams is to determine the priority plan for things needing to change by arraying the integration responsibilities across the dimensions of size, risk and effort needed," reflects Johnsen.

Typically, the highest value, lowest risk, and the easiest to analyse responsibilities should be addressed first. Then, successive waves of responsibility should include those that are of lower value and need more time to analyse and implement to minimise risk.

However, the entire process can be altered depending on the type of entities merging and their individual sizes.

Governance, risk and compliance

An effective, internal control environment provides confidence to leaders that their organisations can meet the demands of changing environments. Lessors must comply with regulations, respond to events of non-compliance and improve processes around information systems that support governance, risk and compliance.

"An ounce of prevention is worth a pound of cure," explains Debbie Anderson, Zeevo Group chief accounting officer and internal controls expert. "Sound governance, internal controls and compliance practices demonstrate credibility to regulators, investors and analysts."

Moreover, sweeping regulatory mandates, such as Sarbanes-Oxley (US legislation from 2002 to combat corporate fraud), complicate the integration process by adding to the complexity already created by industry-specific and country-specific regulations.

Contract compliance

Strategic alliances are increasingly important in today's business environment. Extended business relationships, formed through partnerships, vendor relationships and outsourcing arrangements, are pervasive and have replaced the traditional closed-end business structure of yesteryear. This collection of relationships is often referred to as the "extended enterprise".

Aircraft lessors increasingly:

- rely on original equipment manufacturers to manufacture and source aircraft and engines;
- depend on advisers to market, sell and deliver on promises to lessees and prospective lessees; and
- use vendors to provide support services.

"Organisations must understand the complexities and nuances of a range of business contracts, processes and procedures while maintaining and improving relationships with clients and business partners throughout the integration and transition into the combined entity," stresses Anderson.

Accounting policies

Companies often underestimate the time and expertise required to standardise accounting policies for the merged organisation during the integration process.

A vital step in an integration of two companies is to reconcile accounting policy differences and identify short- and long-term plans to address any underlying issues.

Bringing in accounting policy experts to consult with the new entity's leadership usually helps to put in place a solid plan and timeline for the unification of the differing policies and processes:

- develop a new regulatory reporting calendar for the combined organisation; and
- recognise data strategy issues and accounting policy differences early to fix any underlying issues.

Cash management

During the integration process, the lack of controls around cash management often will lead to fraudulent activities, missed filing deadlines and improperly accounting for transfer pricing transactions. Treasury is primarily about liquidity and ensuring your company has enough cash to survive – cash is king! – it is the life/heart of any organisation, and treasury keeps the heart pumping.

It is critical to reconcile cash and bank account balances on day one while implementing proper cash management controls. Companies also need to integrate hedging and foreign exchange (FX) cash management strategies while addressing the cash flow needs of the newly combined business:

Figure 4: The extended enterprise

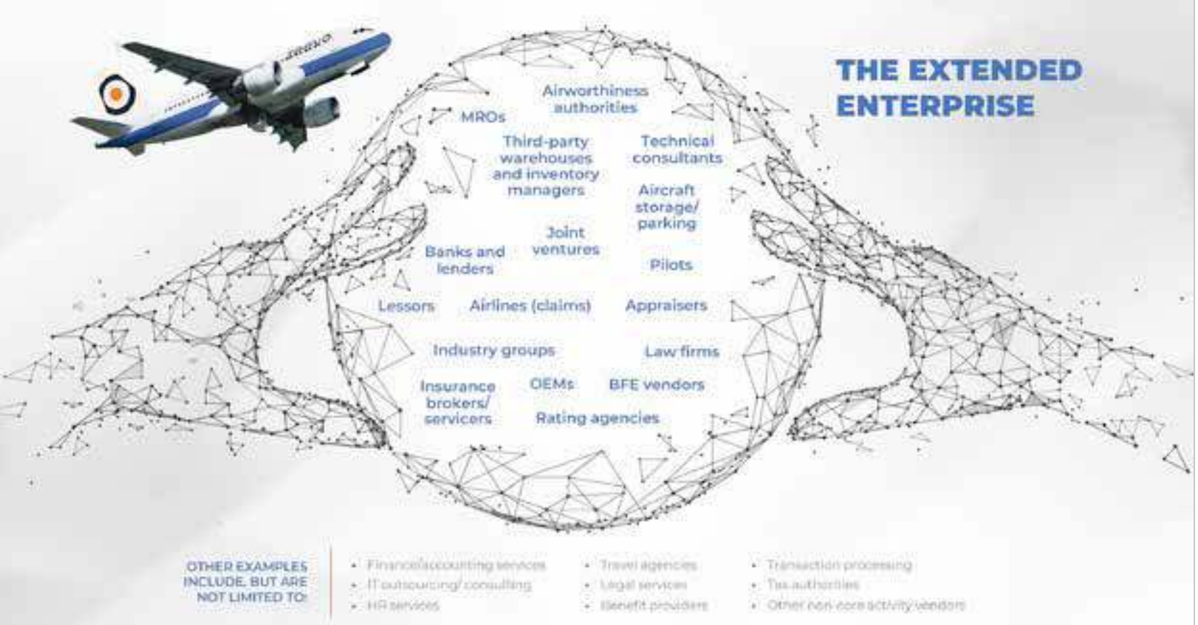

Figure 5: Controls around treasury, accounting and cash management

- determine who has cash management authority and reconcile cash and bank accounts on day one; and
- integrate hedging and FX cash strategies and develop transfer pricing accounting procedures.

Paul McDowell, Zeevo Group senior adviser, singles out contingent liabilities as an "all-too-often overlooked aspect of cash management". McDowell explains that there are usually several contingent liabilities that might be unnoticed.

"Even with smaller deals, you will find contingent liabilities with credit card programmes, certain contract obligations and operating leases. Since these liabilities are not recorded on the balance sheet, they get overlooked and are sometimes unaccounted for during due diligence," he says.

In addition, during the integration process, integration teams must account for bank accounts, bank relationships, potential rating agencies, venture capitalists, investors (debt and equity) and ongoing transaction execution – all within a well-controlled environment.

Reporting

It is critical for leadership to understand the limits of and adjust their expectations for reporting post-acquisition, while carefully planning for data migration and storage of historical financial information to allow for comparative and performance analyses:

- understand limits for reporting post-acquisition and plan for the first combined set of reports; and

Figure 6: Synergy analysis identifying the incremental flows that impact the valuation of the target company

Figure 7: Zeevo's comprehensive approach to integration execution

- communicate the expected synergy capture to the finance functions during budgeting and planning activities.

"Leadership must take early action to develop a regulatory reporting calendar and an interim approach to data strategy, bridging differences, and planning for a longer-term fix," adds Anderson.

Accounts receivable

Improperly monitoring accounts receivable (AR) during the integration process will result in increased enterprise risk and negatively impact the new combined entity's cash flows.

"Organisations must ensure a clean cut-off of lockbox and remittance guidelines to limit post-day one AR reconciliations," stresses Anderson.

Companies can successfully manage enterprise-wide risk with day one credit and receivables reporting until one customer, order management and AR data warehouse exists for all customers:

- manage enterprise-wide risk with day one credit and receivable reporting; and
- ensure a clean cutoff of lockbox/remittance guidelines to limit post-day one accounts receivable reconciliations.

Cost synergies

One of the key benefits of merging two companies into one entity is cost synergies. However, integration teams often fail to recognise the importance of unifying internal procurement policies and expense approval processes immediately post the merger. In turn, expenses and capital expenditures can run afoul and the combined leadership's ability to negotiate competitive contracts with vendors can be hampered.

The standardisation of purchase order, invoice and employee expense approval limits and processes for all levels across the new organisation should be top of mind for integration teams. In addition, it is critical to develop consistent capital expenditure approval process and

"Leadership must take early action to develop a regulatory reporting calendar and an interim approach to data strategy, bridging differences, and planning for a longer-term fix."

Debbie Anderson, chief accounting officer and internal controls expert, Zeevo Group

reporting for the merged organisation, and review vendor contracts to reflect the new merged legal entity:

- take advantage of the merger to renegotiate vendor discounts with terms which will improve cash flow; and
- standardise purchase order, invoice and employee expense approval limits and processes for all levels.

Zeevo Group can assist

An effective, internal control environment provides confidence to leaders that their organisations can meet the demands of their changing environments.

With extensive backgrounds in finance, technology, operations, risks, as well as all aspects of aircraft leasing and M&A transactions, our team of industry experienced professionals are well versed in assisting CFOs and executives across their enterprises in strengthening their internal control environments and risk-related decision-making processes.

Zeevo Group's multidisciplinary M&A service offerings can help unlock the value of an investment by touching all dimensions of shareholder value through our road-tested approach to executing the integration process.

We have assisted companies across industries in achieving success by ensuring the integration process is executed as needed against the different M&A strategies.

For more information, visit **zeevogroup.com**.

M&A INTEGRATION
THE CATALYST FOR FINANCE TRANSFORMATION

Mergers and acquisitions (M&A) present a valuable opportunity for companies to use the integration process as the catalyst for finance transformation.

Our experience shows the key to a successful integration is building the right control environment, which ensures the people, processes, and systems capture value from the transaction and generate the desired synergies.

Drawing on years of experience, Zeevo delivers expert opinion, insights, and guidance to empower clients' finance teams to successfully implement finance transformation initiatives along the M&A transaction lifecycle.

ZEEVOGROUP.COM / M&A