

The Actuarial Profession

making financial sense of the future

# Pensions in corporate transactions

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# Financial due diligence

- Price
- Cash flow
- Risk

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# Background

- Pensions Act
- Deficits
- Accounting
- Market

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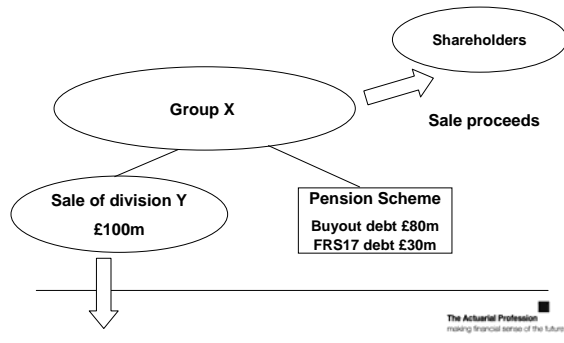
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## What is the Regulator Concerned About




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## Price

- Enterprise value (EV) = PV earnings
- Cost of capital
- Equity = EV - Debt
- Premium

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## Example

FRS 17 service cost = 100  
 Net FRS 17 pension deficit = 1000  
 P/E multiple = 10  
 Value of pensions =  $1000 + 10 \times 100 = 2000$

Expected contributions =  $90 + 900/15 = 150$   
 Value of pensions =  $150 \times 10 = 1500$

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## Pensions

- Debt
  - Investment returns
  - Mortality
  - FRS 17 or buy-out
- Operating cost

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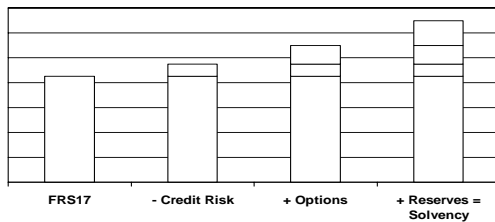
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## Best Estimate vs Prudent



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## Cash flow

- Pricing
- Business planning
- Debt repayment
- Effect of deal

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## Risk

- Event
- Impact
- Mitigation
- Residual

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## Mitigation

- Decline
- Reduce
- Absorb
- Transfer

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## Transaction risks

- Information
- Estimation
- Contract
- Third party

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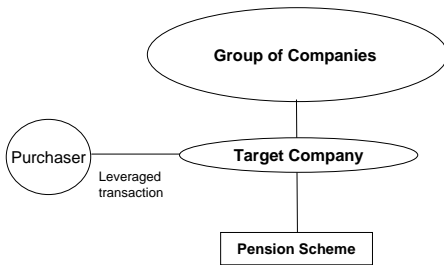
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## Example – A leveraged disposal



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## Example – Impact on target company

Prior to Sale	£m		Post Sale	£m
Value of assets	100		Value of assets	100
Charged assets	-		Charged assets	-
Preferential creditors	(10)		Preferential creditors	(70)
Available for unsecured creditors	90		Available for unsecured creditors	30
Section 75 debt	100		Section 75 debt	100
Other unsecured creditors	10		Other unsecured creditors	10
Total unsecured creditors	110		Total unsecured creditors	110
Recovery on insolvency	82%		Recovery on insolvency	27%

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## Example – Potential solutions

Pension Scheme	£m		Potential solutions
Value of assets	100		Review of investment strategy ➤ Reduction in equity exposure
Deficit on ongoing basis	10		Revised funding strategy ➤ One off payment of £10m ➤ Funding plan implemented to reduce remaining FRS17 deficit over 5 years
Deficit on FRS17 basis	20		Company shares business plans and detailed financial information
Deficit on wind up	100		Company agrees not to increase level of secured borrowing in future
Deficit contributions (based on amortisation period of 15 years)	1.0 pa		

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## Conclusions

- Big risks for deal makers and us
- Don't hide them
- Give constructive advice
- Don't make price decisions

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Any questions?

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