MAYER • BROWN
JSM

Hospitality and Leisure M&A

Disruption and Innovation Driving Deals in a Fragmented Industry

AUTHORS

Mark Uhrynuk
Partner, Hong Kong
+852 2843 4307
mark.uhrynuk@mayerbrownjsm.com

Rod Brown
Partner, Singapore
+65 6327 0636
roderick.brown@mayerbrownjsm.com

M&A Trends in the Hospitality & Leisure Sector

In recent years, M&A activity in the hospitality and leisure (H&L) industry has grown significantly. Even as global M&A deal values for the first half of this year fell below where they were 12 months ago, large-scale, cross-border M&A activity in the H&L sector has dominated the headlines with a number of high profile deals in 2016.

Certain trends are driving this activity:

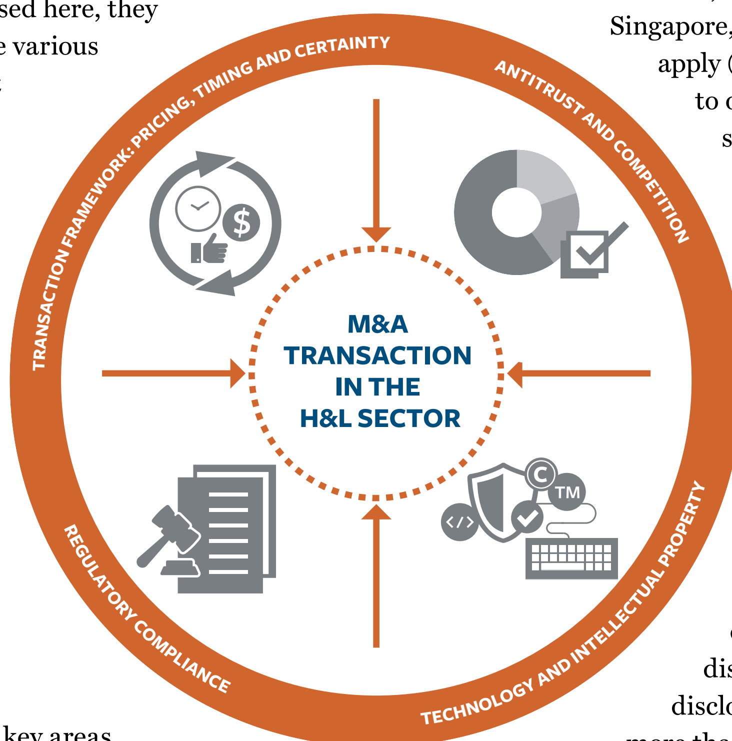
- A **fragmented industry** facing a number of challenges from new players forcing market consolidation and a race to scale up;
- A quest for **vertical integration** to fill product gaps across the value chain;
- The need for more efficient and effective **global platforms** to protect and increase market share and provide greater leverage (particularly in response to online travel agents);
- **New money** from both developing and mature economies in Asia; and
- **Innovative platforms**, such as airbnb, Travelmob and OneFineStay and the need for more traditional groups to develop a response to these new competitors.

These deal trends and the inherent disruption and consolidation impacting the H&L sector present opportunities for owners, operators and other market participants.

We highlight below some of the key issues that prospective participants should bear in mind when negotiating and executing cross-border M&A deals in the H&L sector.

The Cross-Border Context

Cross-border M&A transactions involve a number of challenges as political, cultural and economic landscapes shift and regulatory regimes develop and evolve. While the many "cultural" challenges encountered on a typical cross-border M&A deal will not be discussed here, they serve to complicate the various substantive issues that arise in a cross-border transaction. Although the specific risks will vary depending on the jurisdictions and parties involved, it is possible to mitigate exposure through proper preparation and planning, thoughtful and frequent communication, and disciplined execution.



We discuss below four key areas to focus on when executing an M&A transaction in the H&L sector.

1. TRANSACTION FRAMEWORK: PRICING, TIMING AND CERTAINTY

The pursuit of overarching strategic objectives typically motivates buyers and sellers to explore M&A opportunities. Once engaged, however, pricing (value), timing and a desire for certainty drive the parties throughout a deal. Each will attempt to maximise the value obtained from a transaction while minimising risk, but they will nearly always share a desire for certainty in completing the transaction within their desired timeline while maintaining their good reputations in their business, shareholder and industry communities.

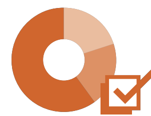
The ability of a party to control these factors, however, may be dictated by the transaction framework. If the transaction involves the acquisition of (or merger with) a publicly-listed entity, special rules will apply. For example:

- Acquisitions of public companies will be played out in public and typically to a tight timetable - with less opportunity for detailed due diligence (see further below) - and are more likely to attract rival bidders;
- In the UK, Hong Kong and Singapore, mandatory bid rules apply (requiring the acquirer to offer to purchase all shares of the target if a certain threshold percentage of shares are acquired);
- If the target is listed in the UK, proof of certain funds will be required at time of making the offer; when acquiring a public company in the US, there are detailed procedural and disclosure rules (including disclosure of purchases of more than 5% of a class of listed securities), but no mandatory bid provisions apply; if the target is a US public company, consider and understand in advance the realities of the US litigation climate; even in the context of friendly deals that offer the target shareholders a substantial premium, it is routine for professional plaintiffs' lawyers to bring shareholder class action lawsuits against both the target and the acquirer as soon as the deal is announced; litigation (initiated by the target and/or the target's shareholders) is even more likely in the context of a hostile deal.

The approach adopted in the Marriott-Starwood transaction as to pricing and certainty is not unusual in the context of a US public company merger. The transaction was structured as a share for share and cash merger in which the parties agreed to a fixed "exchange ratio" (i.e., Starwood shareholders received a fixed amount of cash and a fixed percentage of Marriott shares in the deal without adjustment for subsequent movement in the share price of either party's shares). In addition, the Marriott Starwood transaction included a "no shop" provision and mutual termination fees as deal protection. Starwood undertook not to solicit alternative transactions which would result in the acquisition or disposal of 25% or more of its (and its subsidiaries') consolidated revenues, net income or assets, subject to an exception for negotiating a proposal received which is deemed a potentially "superior proposal" after consultation with outside counsel and a financial advisor. The transaction also provides termination fees of US$450 million in the event that either party terminates the transaction and announces an intention to enter into an alternative transaction or either party fails to obtain its required shareholder approval for the transaction.

While buyers and sellers will generally continue to operate their businesses normally during an M&A transaction (and even obtain representations that they will do so until completion), the transaction, in particular if public disclosures are required, could garner additional public scrutiny. The consequences range from negative publicity, defensive board action to potential shareholder lawsuits. When Marriott announced its agreement to acquire Starwood, lawsuits were launched within days in both New York and Chicago by owners who claimed that the merger would breach radius restrictions in the management contracts. Also, following the announcement of HNA Group's acquisition of Carlson Hotels Group and its brands, one of HNA Group's joint venture partners removed HNA's appointed joint venture board members due to concerns that the acquisition created a conflict of interest. HNA Group subsequently filed suit against its joint venture partner in an attempt to reverse these board member removals. This has not distracted HNA Group from pursuing its ambitious growth program as it recently announced the acquisition from Blackstone Group of a 25% interest in Hilton Worldwide for US$6.5 billion.

If the target is a private entity but the transaction is structured as a competitive auction, buyers should be aware that the transaction is highly process driven – seller regulated and controlled – which can impact structuring flexibility. In such a scenario, a buyer must understand clearly its value and risk parameters early in the process. While pricing is important, speed and deal certainty are key criteria to a seller and its advisers. These transactions often favour nimble buyers.



2. ANTITRUST AND COMPETITION

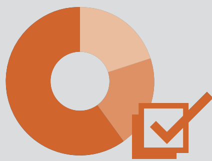
The continuing consolidation in the H&L sector and the increasing level of scrutiny placed on M&A deals by a growing number of competition authorities makes this an area of caution for market participants. Many transactions will have to be notified to competition authorities in multiple jurisdictions and often require specific clearances before the transaction can proceed. Detailed information filings and disclosure may be required. Advance planning and regulatory advice is critical to avoid delays and potentially significant fines. In certain cases, transactions can be blocked or divestitures required. Competition regulators are constantly reassessing the relevant market and typically communicate with one another across jurisdictions.

In the H&L sector, threshold questions and considerations for potential M&A participants include:

- Are there obvious overlaps between your existing brands and the segments in which they operate and the brands/segments of the target?
- How will each national regulator view the brands and the segments in which they operate and how will the competition authorities view the different hotel categories in their assessment?
- If the merger or acquisition significantly increases market concentration (assessed in the light of the brands and segments referred to above), is there a risk of divestiture to obtain clearance?
- In the context of the industry consolidation trend, it will be especially important to consider the

nature of an overlap between the operations of the buyer and the target operations.

As there will likely be notice and regulatory filing requirements, parties should consider the timing requirements and whether covenants or undertakings should be included in the documentation to require these requirements to be met on a "best efforts" basis or as a condition precedent.



The Marriott-Starwood transaction required antitrust/merger control clearances in the United States, the European Union, China and a number of other jurisdictions. While both Marriott and Starwood provide similar hotels and related services amenities, as their combined market share was only 14% of hotel rooms in the United States and 7% globally, it did not raise obvious competition concerns and was cleared by the anti-trust regulatory authorities in each of the key jurisdictions referred to above. The merger agreement between Marriott and Starwood contained a typical provision requiring each party to use its reasonable best efforts to obtain all governmental and regulatory clearances and approvals but also provided that neither party would be required to make divestitures of greater than US$ 700 million in value as part of those efforts.

3. REGULATORY COMPLIANCE

In the increasingly complex and interconnected world of compliance, buyers (and sometimes sellers) have compliance matters high on the list of diligence and risk mitigation issues. This broad category covers activities such as bribery, fraud, sanction violations and money laundering as well as cyber security and data privacy matters. The ongoing and high profile enforcement of laws such as the U.S. Foreign Corrupt Practices Act (or FCPA) and the U.K. Bribery Act means buyers act at their peril if they ignore these potential areas of concern. It is not unusual for buyers to retain separate advisers to handle a forensic and integrity due diligence exercise on the target business and key individuals. If identified and addressed early it is possible that these issues will not kill the deal. Late discovery or disclosure, on the other hand, will inevitably impact deal value and certainty of execution.

Another important area to consider in the context of cross-border M&A is the application of foreign investment/national security laws and regulations. While the operation of a traditional H&L business may be an unlikely candidate to trigger national security concerns, depending on the location of the real estate involved and the nature of the buyer issues could arise. For example, Anbang's acquisition of the Waldorf Astoria New York was scrutinised by the Committee on Foreign Investment in the United States (or CFIUS) - the committee which reviews transactions which may raise national security concerns in the United States - as the hotel is located close to the United Nation's headquarters in Manhattan and was the official residence for the United States ambassador to the United Nations and a large number of diplomatic guests. More recently, CFIUS concerns apparently caused Blackstone to terminate the planned sale to Anbang of the Hotel del Coronado which is located near to the US Naval Base Coronado in San Diego.

Finally, sellers should be mindful and seek clarity on the regulations and political influences potentially impacting a buyers ability to complete a deal. With the wave of Chinese interest in H&L assets, sellers should consider if the buyer has or will receive in a timely manner any industry related or other consents and clearances required to complete the deal and pay the purchase price in a timely manner.

4. TECHNOLOGY AND INTELLECTUAL PROPERTY

Brands and innovative technology are at the heart of developing a loyal customer base in the H&L industry. How the business interacts with its customer community through online activities and with internet-based partners can be critical. These realities underscore the importance of intellectual property and technology matters in an M&A transaction in this sector. Issues to consider include:

- Are all of the trade marks, domain names and other IP rights that are used by the H&L business owned and registered by the relevant

target company being acquired? Are all of these IP rights that are used to operate the H&L businesses (e.g. bars and restaurants) registered in all jurisdictions in which the business currently operates?

- Has the target company licensed any of its intellectual property rights to a third party (including an affiliate)?
- Has the target company been granted any license from a third party for the use of intellectual property owned by that third party?
- Are there any existing or potential actions, claims or proceedings in relation to the target company, the trade marks, the domain names or any other IP rights owned, licensed or used by the target company?
- How robust in the technology and related infrastructure utilised by the target business?

Loyalty programmes are an important component of branding in the H&L sector. In this context:

- Are there any overlap issues with existing loyalty schemes buyer may own/operate; for example, are there competing car rental or airline partners?
- Have the relevant data privacy laws been complied with in respect of the use of the individuals' personal data for the purposes of the loyalty programme?
- Is the loyalty programme run by a third-party processor? If so, is the agreement with the third party processor adequate and compliant with relevant privacy laws? If a central database model is adopted have all relevant notifications and consents been obtained to ensure access to the database from multiple locations?

Concluding Remarks

The increasing competition for quality assets and scale in the H&L sector and the need to leverage technology to compete, present special M&A opportunities and challenges for market participants.

The matters discussed above highlight a few of the key considerations involved, and the importance of planning and process, in executing a cross-border M&A deal in the H&L sector.

Of course, there are many other areas that need to be considered especially in the context of due diligence on the management agreements entered into by the brands, employment issues, data privacy and cybersecurity issues, and other risks arising out of operational issues. There are also significant tax structuring and acquisition financing issues to consider.

The authors would like to acknowledge the support and input of Andrew MacGeoch, Partner and Head of Mayer Brown JSM's Asia Hospitality and Leisure group, and Ashley Chow, a Corporate Registered Foreign Lawyer (California, USA) in Mayer Brown JSM's Hong Kong office, in the preparation of this article.

Mayer Brown JSM is part of Mayer Brown, a global legal services organisation, advising many of the world's largest companies, including a significant proportion of the Fortune 100, FTSE 100, CAC 40, DAX, Hang Seng and Nikkei index companies and more than half of the world's largest banks. Our legal services include banking and finance; corporate and securities; litigation and dispute resolution; antitrust and competition; employment and benefits; environmental; financial services regulatory and enforcement; government and global trade; intellectual property; real estate; tax; restructuring, bankruptcy and insolvency; and wealth management.

Please visit www.mayerbrownjsm.com for comprehensive contact information for all our offices.

This publication provides information and comments on legal issues and developments of interest to our clients and friends. The foregoing is intended to provide a general guide to the subject matter and is not intended to provide legal advice or be a substitute for specific advice concerning individual situations. Readers should seek legal advice before taking any action with respect to the matters discussed herein.

Mayer Brown is a global legal services provider comprising legal practices that are separate entities (the "Mayer Brown Practices"). The Mayer Brown Practices are: Mayer Brown LLP and Mayer Brown Europe-Brussels LLP, both limited liability partnerships established in Illinois USA; Mayer Brown International LLP, a limited liability partnership incorporated in England and Wales (authorized and regulated by the Solicitors Regulation Authority and registered in England and Wales number OC 303359); Mayer Brown, a SELAS established in France; Mayer Brown Mexico, S.C., a sociedad civil formed under the laws of the State of Durango, Mexico; Mayer Brown JSM, a Hong Kong partnership and its associated legal practices in Asia; and Tauil & Chequer Advogados, a Brazilian law partnership with which Mayer Brown is associated. Mayer Brown Consulting (Singapore) Pte. Ltd and its subsidiary, which are affiliated with Mayer Brown, provide customs and trade advisory and consultancy services, not legal services.

"Mayer Brown" and the Mayer Brown logo are the trademarks of the Mayer Brown Practices in their respective jurisdictions.

© 2016 The Mayer Brown Practices. All rights reserved.