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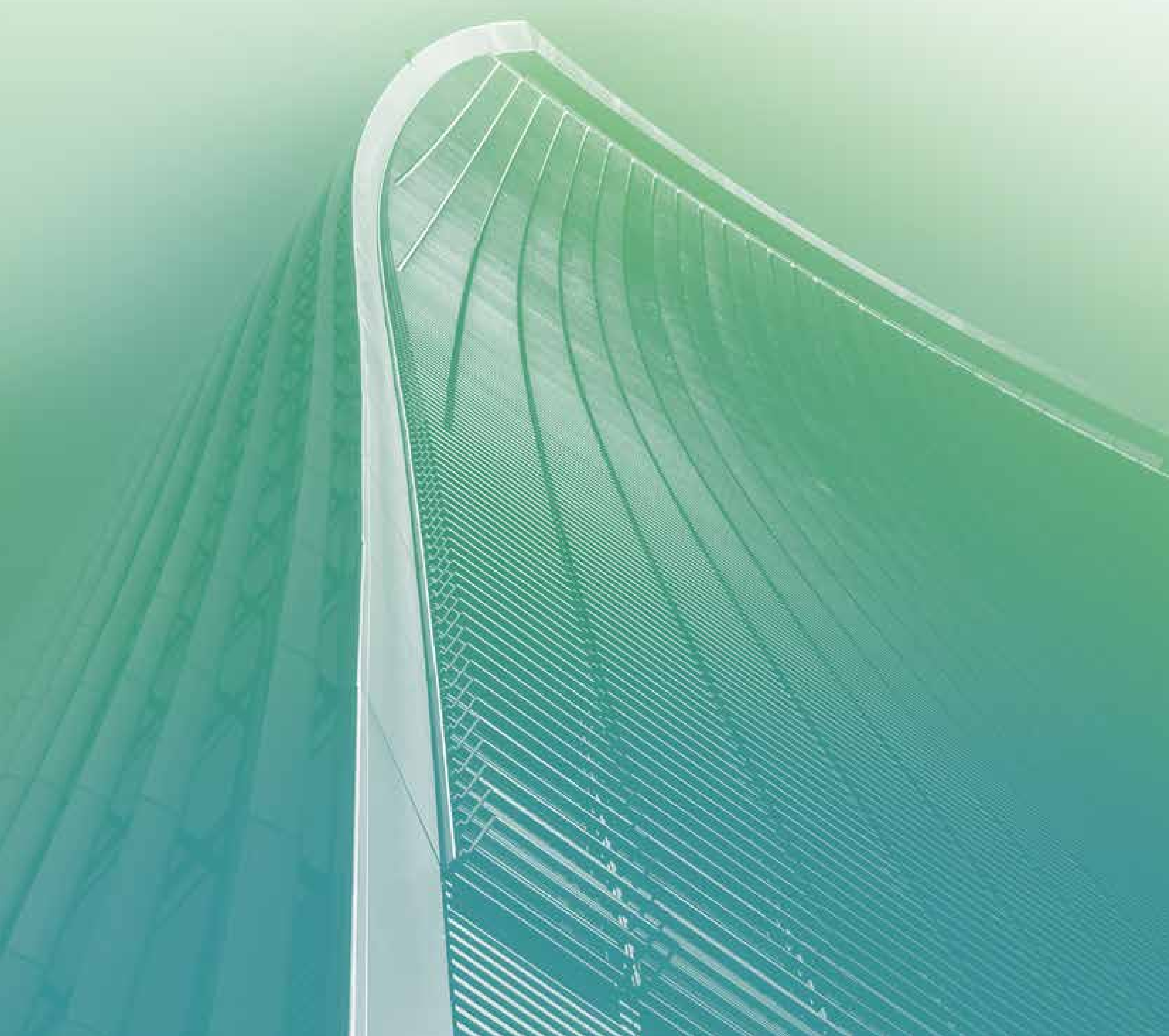
M&A Preparedness: How to Plan for Your Next Transaction



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Introduction

With target companies subject to more scrutiny than ever before, sellers are increasingly taking steps to ensure they are prepared for M&A deals – both to maximize valuations and to minimize logistical obstacles in the event of a sale. In this report, based on a survey of dealmakers from corporate entities, investment banks, private equity and venture capital firms, we examine the evolution of the deal preparation process and the challenges sellers face that threaten to stall deals or erode value.

On the whole, M&A preparations are becoming more time-consuming, due to factors such as longer due diligence on the part of buyers. And our survey pool indicates that these lengthier timelines are impacting target companies negatively – many note that time spent on completing a deal is time taken away from core business activities. Another key hurdle in the sale process is the increased time it takes to ready the necessary legal, financial and technical paperwork, the volume of which continues to grow as transactions become more complex and buyers demand increased transparency.

In addition to longer timelines, the number of people requiring access to deal information during the M&A process has also risen in recent years. And while this shift is generally viewed as positive, since it signals the inclusion of new perspectives and areas of expertise, respondents to our survey consistently identify challenges that result as more individuals and departments become involved. Maintaining transparency with employees while simultaneously protecting the confidential details of the sale, as well as managing timelines and deadlines across multiple departments, are just two of the issues respondents report in this vein.

In addition to the above findings, the results of *M&A Preparedness: How to Plan for Your Next Transaction* provide a detailed look at the challenges of sell-side deal preparation with commentary from those who know this changing landscape best. We hope you find this newsletter both informative and useful, and as always, we welcome your feedback.

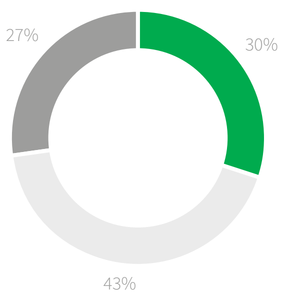
Methodology

IHS Markit commissioned Mergermarket to interview 30 senior executives in Q2 2019 to better understand their approach to decision-making related to preparedness for sell-side M&A transactions. The respondents were all based in North America and split between private equity and venture capital firms (33%), corporate entities (33%), and investment banks (33%). All responses are anonymous and the results are presented in aggregate.

Part 1: Preparation is Critical

The M&A sale process has evolved immensely in recent decades, as buyers have become increasingly sophisticated and demanding. As a result, the preparation process for deal targets has necessarily become more rigorous – posing ongoing challenges for the sell-side of a transaction.

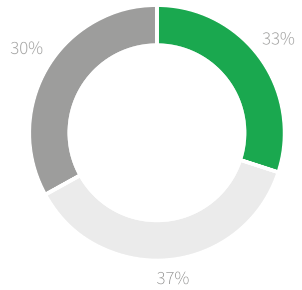
In recent deals on which you have worked, on average, how long has it taken to progress from initial conception of a sale to signing? (Select one)



- Between 4 and 6 months
- Between 6 and 9 months
- More than 9 months

Ultimately, there is no one-size-fits-all timeline for M&A – timing can vary from months to years depending on factors such as the size of the companies involved, the urgency of the transaction (e.g., in distressed situations), and the level of attention given to the details of M&A contracts. [1] In our dealmaker survey, when asked about the timeline of their own recent sell-side processes, respondents were divided: The largest percentage (43%) said between six and nine months typically elapsed between initial conception to signing, compared to 30% who said between four to six months and 27% who said it took more than nine months on average.

In your experience of recent sell-side M&A deals, how has the timeline changed for making sell-side deal preparations for a business or business unit?

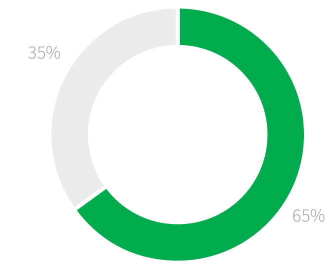


- Stayed about the same
- Lengthened somewhat
- Lengthened significantly

These differences notwithstanding, a majority (67%) agreed that the time required to make sell-side deal preparations has increased, either moderately (37%) or significantly (30%), in recent years. Critically, these lengthened deal timelines have had a mostly negative impact on the sell-side process, according to 65% of respondents. A longer deal process may entail delays in returning capital to investors in the case of an investment fund or in paying down debt at a corporate entity.

| [1]
M&A Contracts: Purposes, Types, Regulation, and Patterns of Practice
(Harvard DASH; 2015)

Do you think this change in the timeline for sell-side preparations has had a mostly negative or positive effect on the sell-side?



Another key factor for some sellers is the fact that extended preparations detract from the target's core business activities. One private equity (PE) respondent whose divestitures typically take more than nine months explained that time spent allaying the concerns of risk-averse buyers is time that can't be spent on the target's everyday operations: "It has taken more time to address the concerns of cautious buyers, and this extra time has influenced the business cycle negatively. Far more coordination efforts are being taken to ease buyer concerns, and detailed presentations further increase the time frame."

Buyers' conservatism is likely growing as the economy shows signs of reaching a cyclical peak – especially with memories of some ill-advised deals made just before the 2007-9 financial crisis fresh in dealmakers' memories.[2] Shareholders and management teams at buyer firms want to avoid overpaying as valuations continue to rise. And not only are decision-makers more apt to question the strategic rationale behind M&A decisions since the financial crisis – they are also likely to resist pouring resources into deals that could be derailed by political or regulatory uncertainty.

Going into 2020, the variables impacting M&A decisions will range from potential trade wars with China to uncertainty surrounding the power of activist investors [3], and the onus may fall on sellers to anticipate these concerns.

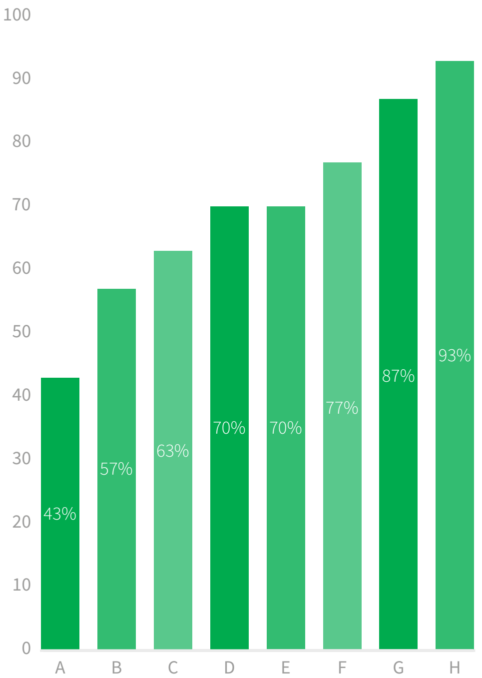
[2] *In The M&A Market, This Time Really Might Be Different* *(Financial Times; 2018)*

[3] *Can The Good Times Last? Four Factors Shaping M&A In The Second Half Of 2020* *(White & Case, US M&A H1 2019; p. 24)*

> *"It has taken more time to address the concerns of cautious buyers, and this extra time has influenced the business cycle negatively. Far more coordination efforts are being taken to ease buyer concerns, and detailed presentations further increase the time frame."*

Managing director at a US PE firm

In your experience of sell-side M&A transactions, which of the following issues have become increasingly prevalent? (Select all that apply)



A More concerns around environmental, government and social (ESG) issues

B Lack of clarity about IP/technology ownership

C More complex ownership structures

D Growing financing difficulties

E Growing valuation gaps between buyers and sellers

F More concerns over digital and technology issues

G Difficulties with agreeing on warranties/indemnities

H Longer due diligence processes

Digging deep

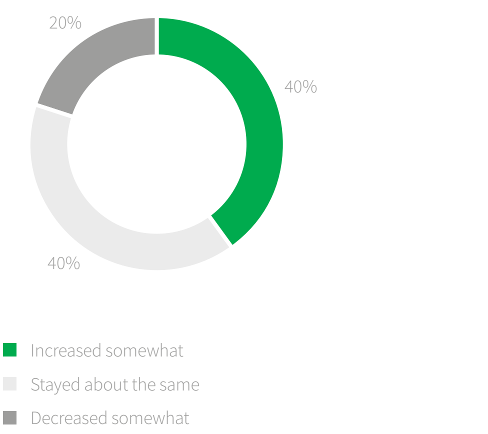
In addition to showing more sensitivity to buyers' concerns, sellers are facing a broad spectrum of technical challenges during the M&A process. The most pressing of these include longer due diligence processes (93%), difficulties agreeing on warranties and indemnities (87%), and digital or technological issues (77%). A managing director at a US-based PE firm argued that extended due diligence has been especially detrimental to sellers: "The challenges that occur during the due diligence process have increased significantly since the financial crisis some years back. Risk assessments are taking longer, which can stall the process unnecessarily at times."

Given that appetite for new technology or intellectual property is an increasingly common M&A driver, it should be no surprise that buyers are eager to understand the details of what they're buying in advance of an acquisition. A US-based corporate respondent explained that "ensuring all the required paperwork is available and organized for systematic review by the buy-side" is critical if sellers want to pre-emptively address buyer concerns. "Identifying problems, such as those involving the intellectual property of the organization, is tricky, especially with increased research and development activities across industries."

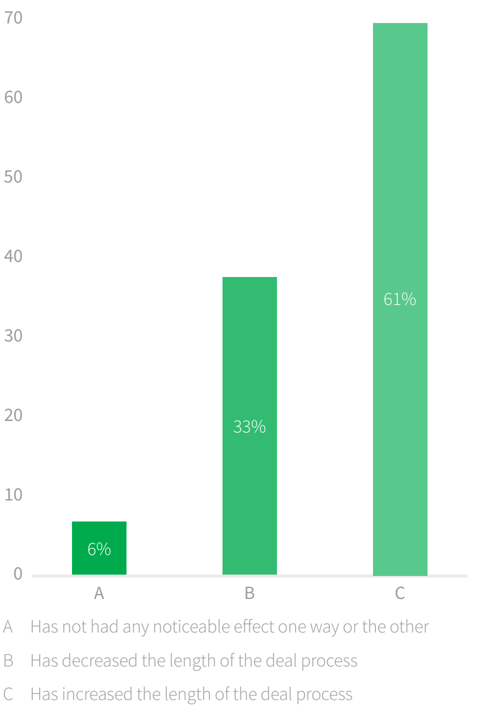
"The challenges that occur during the due diligence process have increased significantly since the financial crisis some years back."

Managing director at a Canadian PE firm

How has the number of people that require access to deal information during the M&A process across your organization changed over the last five years, if at all? (Select one)



What effect, if any, has this change had on the length of the deal process? (Select one)



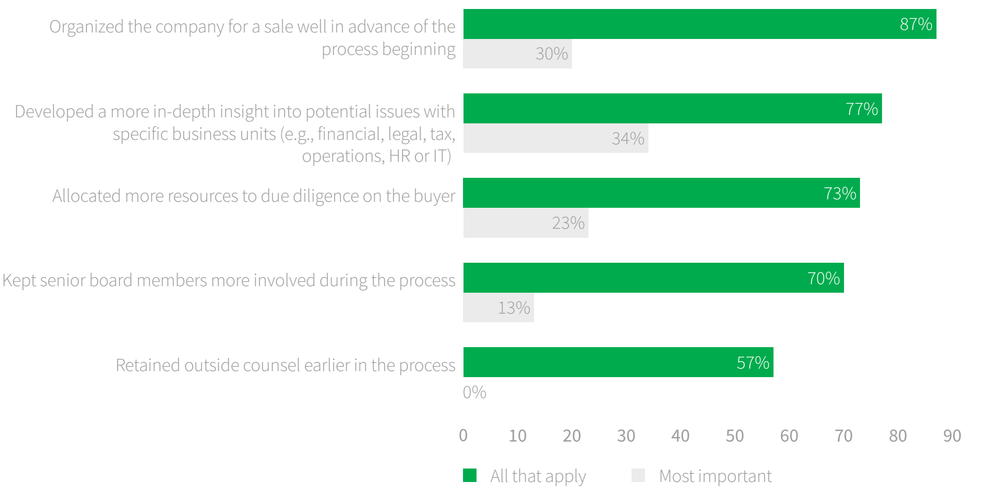
With sale processes becoming more time-consuming and challenging, it is also logical that the number of people involved in transactions is increasing – though it is unclear which trend is causing the other. For 40% of respondents, the number of people requiring access to deal information during the M&A process has increased over the past five years – and for 61% of respondents, this has led to a direct increase in the length of deal timelines.

"In my opinion, the involvement of more units and personnel on the sell-side is not always productive."

US-based investment banker

Although having more hands on deck should in theory expedite the sale process, the reality is that the introduction of more personnel often leads to delays and complications. A US-based investment banker describes this as a multifaceted and often paradoxical problem: "In my opinion, the involvement of more units and personnel on the sell-side is not always productive. But the level of preparedness expected of sellers these days calls for such expertise and experience. [Sellers] are trying to rise above the traditional methods in order to showcase potential. It has become essential to market the company in the best light, even if it incurs additional costs and time."

Looking back on your most recent sell-side deal, what, if anything, would you have done differently to make the transaction go more smoothly?



Planning ahead

Looking back on their most recent deals, the main things respondents said they would do differently relate to timing and more proactive preparation. Almost nine in 10 respondents (87%) said they would have organized the company for a sale well in advance of the process beginning, while 77% said they would have developed more targeted insights into specific functionalities, such as financial, legal, tax or HR issues. (About a third of respondents identified these last two as the single most important changes they would have made, respectively.)

In addition to these top two concerns, 73% said they would have allocated more resources to due diligence on the buyer while 70% would have involved more senior board members throughout the process.

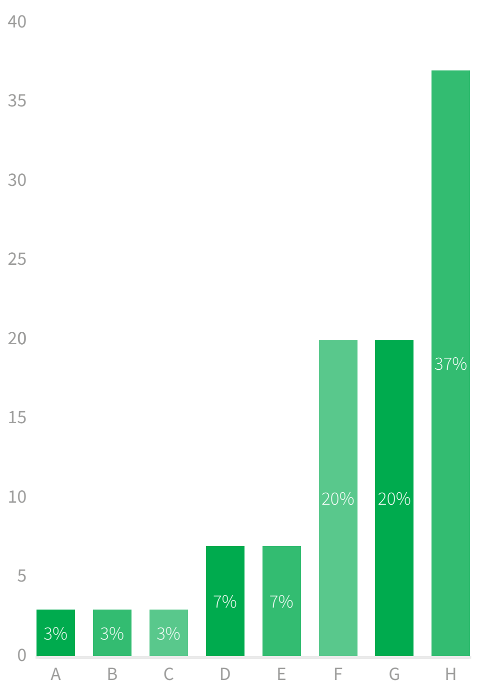
Speaking from his experience at a Canada-based private equity firm, one respondent said sellers must anticipate problems well in advance to ensure that a business can run smoothly throughout the sale.

"Apt organization of resources and managing departments with precision is important, even before the sale has been initiated," he explained. "Mainly, what we would have done differently is more in-depth analysis of potential issues that could come up during the process, such as employee concerns and productivity issues."

A US-based corporate respondent likewise wishes his firm had been "more adept at predicting" potential challenges and more focused on "defining the growth perspective of the company."

Part 2: Overcoming the New Sell-Side Challenges

In your experience, which of the following are typically the biggest logistical challenges when it comes to preparing a sell-side deal? (Select the most important)



A Ensuring all records, contracts, etc. can stand up to rigorous due diligence

B Ensuring that the deal is kept confidential

C Retaining the appropriate outside counsel

D Understanding staff issues and retaining key personnel

E Identifying key intellectual property issues

F Communicating and negotiating with key clients / customers about the sale

G Maintaining company operations and avoiding overburdening company personnel with deal preparations

H Preparing the legal, financial and technical paperwork

Clearly, the sell-side deal process has been getting longer, the result of trends such as more in-depth due diligence on the part of buyers, prolonged negotiations around warranties and indemnities, and the inclusion of a larger number of personnel in the deal process at the seller organization. But what specific challenges do sellers face during the sale process itself, and how can these difficulties be addressed?

When asked to identify the single greatest logistical challenge of sell-side deal preparation, 37% of respondents cited readying the necessary legal, financial and technical paperwork as the biggest hurdle. One investment banker described the organization of such paperwork as a critical defense against value erosion down the line: “The absence of paperwork, records of meetings, or unsigned documents by necessary parties is a threat that will ultimately reduce the value of the seller. Buyer due diligence is concentrated mostly on concrete data and paperwork for previous transactions and references. Handling these is especially difficult if the sell-side is not organized.”

Two additional issues – each cited by 20% of respondents as a top concern – include communicating with key clients and customers about the sale and maintaining regular operations amid deal preparations. Yet respondents from both the corporate and private equity worlds say it can prove difficult to maintain transparency and confidentiality at the same time.

“One of the main challenges is ensuring that regular activities proceed smoothly.”

Managing director at a Canadian PE firm

As a managing director at a Canadian private equity firm explained: "One of the main challenges is ensuring that regular activities proceed smoothly. This is easier said than done, given the mounting concerns of employees with the terms of the deal. The second biggest challenge is checking and rechecking available information. Any breach or failure to disclose essential information can prove costly to the sell-side."

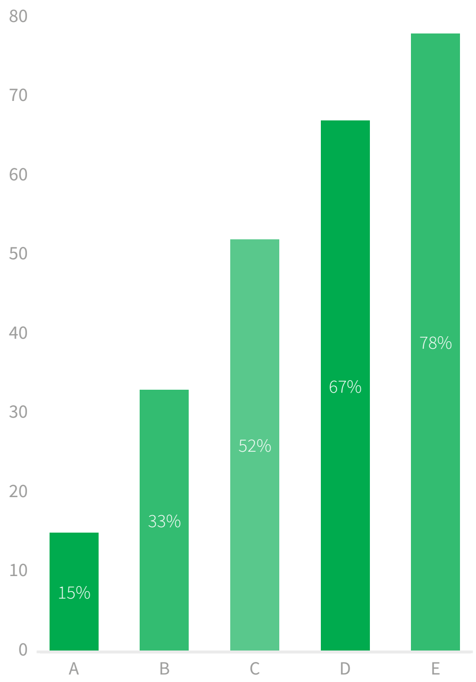
Likewise, an investment banker based in the US described the dual concerns of maintaining a dialogue with clients on the outside while also managing the sensitive details of the deal with those directly involved: "Proper communication with key clients is important, given the role they play in future prospects at the time of presentation. The facts that need to be disclosed in relation to clients should be discussed in advance, creating an atmosphere of trust. Paperwork is another essential part of the deal equation. Coordinating approvals is difficult considering their confidential nature."

Attention to detail

While the burden of M&A due diligence is typically thought to fall on the buyer, pressure is increasing on sellers to ensure that there are no vulnerabilities for the buy-side to uncover in the first place. A significant 78% of respondents said bidders had discovered missing contract agreements during a due diligence process, and 67% said bidders had found issues with employee-related documents such as incomplete or unsigned agreements.

The head of corporate development at a US-based company said sellers should pay particular attention to paperwork issues, not only to avoid potential liabilities but also to allocate resources and individuals more effectively. Using intellectual property paperwork as an example, he explained, "It takes extra time to sort through the registrations and agreements to make sure

In your organization's experience in sell-side transactions during the past three years, have there been any incidences of the bidder uncovering any of the following during the due diligence process? (Select all that apply)



A Issues with Stockholder minutes or resolutions (such as missing or unsigned minutes)

B Issues with Board minutes or resolutions (such as missing or unsigned minutes)

C Contract issues such as missing signatures or amendments that have not been signed off

D Issues with employee-related documents, such as incomplete or unsigned agreements

E Missing contract agreements

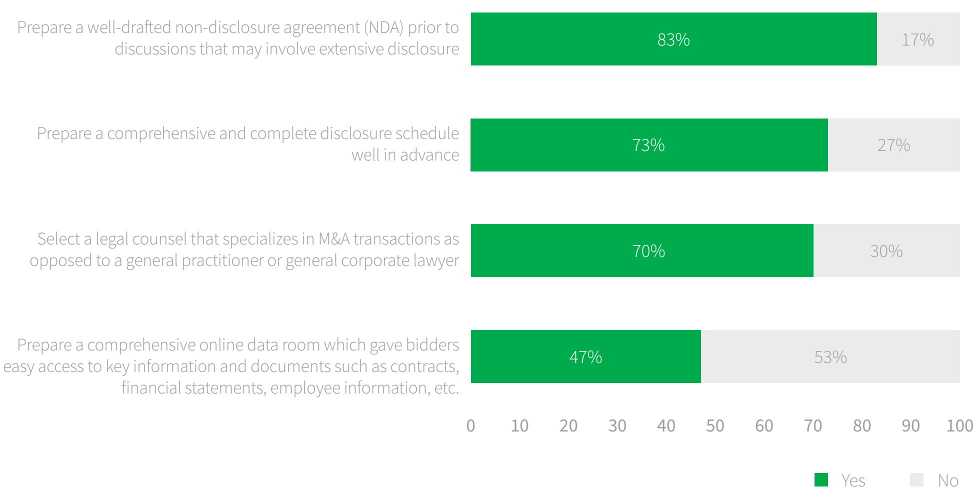
buy-side due diligence does not find any discrepancies. Simultaneously, operations need to continue at the usual pace. Designing proper schedules and targets to keep things on track is vital."

Despite the range of new challenges facing the sell-side, there are specific measures that dealmakers can take to minimize risk during increasingly complex sale processes.

More than eight in 10 respondents (83%) said they drafted non-disclosure agreements (NDA) prior to sensitive discussions in their last sale, and 54% said that having well-drafted NDAs helped deals run smoothly for the target. Most respondents also prepared comprehensive disclosure schedules well in advance (73%) and hired specialist M&A legal counsel (70%), while close to half (47%) prepared a comprehensive data room to give bidders access to key information and documents.

As the managing director of a private equity firm based in the US pointed out, all of these factors play important roles in a successful sale: "There were some issues during the various stages [of the deal], such as lack of compilation of essential data that was being expected from the buyer side. Having a counsel would have prompted a complete online data room without delaying the proceedings.... It would have certainly enhanced presentation and coordination among departments to have quality information."

During your most recent sell-side transaction, which of the following actions did your organization take?

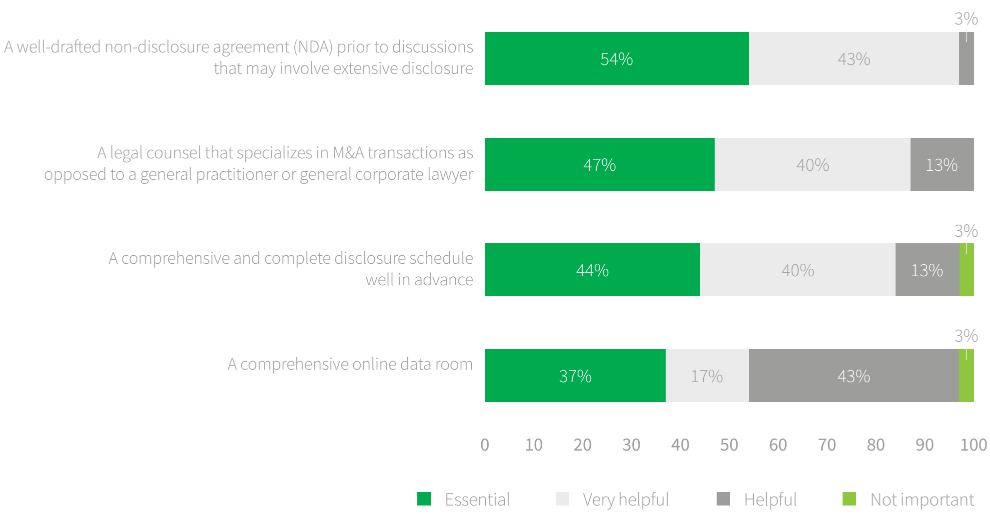


Maintaining secrecy

It is not surprising that confidentiality concerns are intensifying given the increased number of people involved with sale preparations. Two private equity respondents emphasized the importance of not only drafting strong NDAs but also verifying their enforcement at every phase of the deal. A respondent at a US-based buyout firm said, “Confidentiality is a challenge. Even though NDAs are signed prior to any discussions, ensuring they are followed is the main concern. It is important to reiterate the confidentiality of data to all personnel involved.”

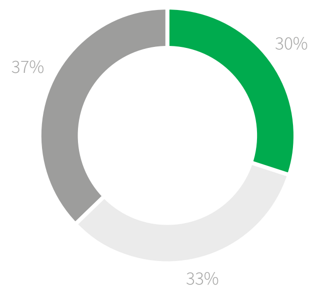
A Canada-based private equity respondent also highlighted the vital relationship between the disclosure schedule and NDAs: "It is important to have the disclosure schedule ready well in advance to avoid delays. It takes a good amount of time to go through the meticulous details and prepare the schedule to present to the buyers. Moreover, a well-drafted NDA with the help of legal counsel helps a lot in determining boundaries and protecting sellers in every way."

In your opinion, how helpful do you see the following in helping a deal to run smoothly and in line with the seller’s best interests?



Looking Ahead

In your estimation, what is the current sentiment regarding M&A heading into H2 2019 and 2020? (Select one)



Neutral sentiment

Somewhat negative sentiment – practitioners are somewhat pessimistic about deal activity

Very negative sentiment – practitioners are very pessimistic

The M&A market has experienced a remarkable run of growth since the financial crisis, taking deal value and volume to new heights. Amid global trade conflicts and geopolitical turmoil in many major economies, however, the cycle may finally be reaching its peak.

As a result, it may come as little surprise that respondents' near-term predictions for M&A are trending toward pessimism. A majority in our survey said that sentiment regarding the M&A environment is either somewhat negative (33%) or very negative (37%) for the second half of 2019 and going into 2020, while the remaining 30% said sentiment is neutral.

Some evidence of a weakening M&A market can be seen in recent deal data. For instance, the number of lapsed or withdrawn bids increased from 31 deals worth $20.1bn in H1 2018 to 42 worth $77.7bn in H1 2019, according to Mergermarket figures, implying greater caution on the part of buyers.

At the same time, in the US and Canada, deal activity remained robust in the first half of 2019: the value of announced deals increased from $885bn to $980.5bn year-over-year in the period, though the number of deals declined from 3,377 to 2,880.

Against this backdrop, potential sellers should prepare themselves for what may quickly turn into a buyers' market. A US-based respondent from an investment bank emphasized the shifting nature of the market going into 2020: "The negotiation dynamics have changed due to the opportunities available to both buy- and sell-side companies in the market... The market perception of M&A has changed. Now, the reasons behind key decisions are better understood and accepted."

"The market perception of M&A has changed. Now, the reasons behind key decisions are better understood and accepted."

Managing director at a US-based investment bank

Conclusion

The burden is increasingly falling on sellers to prepare for M&A well in advance of the process beginning. In the months and years ahead, the speed and ultimate success of a transaction may hinge on sellers' ability to anticipate obstacles and organize materials proactively.

The results of our survey confirm that sell-side preparation processes have become more sophisticated, not only because buyers in the current market demand it, but also because sellers have learned to take control wherever they can. As a managing director at a US-based investment bank noted, more streamlined sell-side processes "can be attributed to allowing experts to intervene" as opposed to limiting discussions to a small group of executives.

"Legal, financial, human resources, and IT teams were involved closely in important decisions," he said about a recent deal.

Yet the addition of more departments will continue to require more juggling on the seller's part, since all parties must be "involved at precise times to avoid lagging in the usual business activities." Indeed, as respondents have noted throughout this report, the inclusion of more perspectives can either help or hinder the M&A process, depending on the sellers' ability to manage timelines and confidentiality.

Recent deal activity suggests the importance of timing will only become more critical. The second half of 2019 so far has seen the announcement of long-anticipated acquisitions preceded by protracted, high-pressure sale processes, including in the $2.7bn acquisition of Shutterfly by Apollo Global Management and the $16.1bn acquisition of distressed gambling and entertainment conglomerate Caesars Entertainment by strategic buyer Eldorado Resorts. In the case of Shutterfly, the seller spent ample time evaluating options before deciding the private equity route was best for shareholders. In the case of Caesars, a strategic deal was ironed out after months of intense pressure from activist investors.

The challenges outlined by dealmakers throughout this survey represent a new normal in sell-side M&A preparedness. From large-scale acquisitions to smaller, mid-market deals, the speed and success of M&A deals will increasingly depend on sellers' ability to manage the challenges of the process – from protecting sensitive information to managing timelines – in an adept and proactive way.

"More streamlined sell-side processes can be attributed to allowing experts to intervene. Legal, financial, human resources, and IT teams were involved closely in important decisions in a recent deal."

Managing director at a US-based investment bank

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