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IS IT THE NEW CORNERSTONE OF MERGERS AND ACQUISITIONS TRANSACTIONS?

INTRODUCTION

More than ever, IT is driving M&A deal value delivery.

In addition to being a central topic and a key enabler for business convergence and synergies achievement, the increasing digitalization of all businesses and the growing acquisition of technology and software companies are bringing new challenges for IT.

On top of that, COVID-19 had a disruptive effect, creating a real paradigm shift in many areas, and accelerating digital trends, such as:

> A post-COVID-19 M&A context driving towards acquisition price, divestment, and run costs optimization.
>
> A strong need to accelerate the M&A transactions journey, driven by pandemic economic uncertainty, increasing sector disruption threats, and IT's ability to increase and accelerate synergies.
>
> "New Normal" working models enabled by an enriched digital workplace, expose companies to increasing Cybersecurity threats during M&A operations.
>
> Continuous digitalization of all businesses, leading to growing volumes of disruptive M&A and technology-driven transactions, requires stronger IT and cybersecurity due diligence.

This raises key questions: Why IT will play a central role in M&A in the post COVID world? What will be different from the role IT was playing until now?

THE PLACE OF IT IN M&A TRANSACTIONS HAS SIGNIFICANTLY EVOLVED OVER RECENT YEARS

Traditionally, IT topics were not considered as key structuring pre-deal topics. IT considerations were mainly addressed post-closing, and only for necessary IT areas that were part of the business continuity and post-merger integration activities.

In recent years, there has been an increasing awareness about the role of IT in M&A, both by corporate and private equities. IT topics have been increasingly prevalent in pre-deal phases, and recognized as a key enabler to secure deal value and synergies. Structured IT workstreams are set up alongside M&A transactions and IT integration budgets are increased. However, IT is still not being systematically addressed after due diligence phases. Besides, awareness on cybersecurity topics has increased – they are addressed more and more but still on a case-by-case basis, and mainly in post-signing phases.

WHAT ABOUT TOMORROW?

1 - A post-COVID-19 M&A context driving towards acquisition price, divestment and run costs optimization

One of the first effects of COVID-19 was to create a disrupted M&A environment, with higher bankruptcy figures and costs optimization stakes.

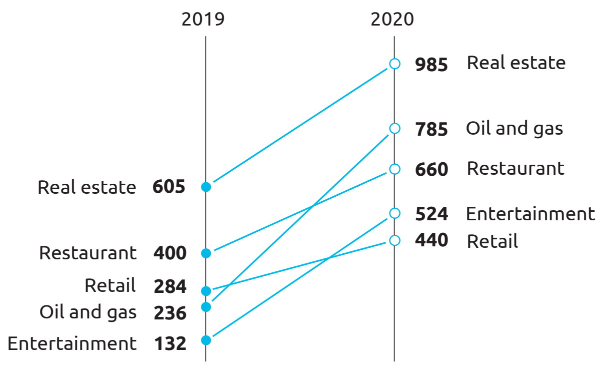
In the US, the number of bankruptcies increased by 105% from 2019 to 2020 due to COVID-19.

Also, in 2020, 39% of M&A deals included earn-outs, representing more than double the previous year (19% in 2019)[1], reflecting the market uncertainty.

The pandemic significantly increased distressed M&A deals, leading to more cautious transactions with the need of a better evaluation of the target, paying the right price, minimizing transition and run costs, with an early anticipation of operational performance and run cost reduction levers.

THE BUSINESSES HIT HARDEST BY THE PANDEMIC

NUMBER OF BANKRUPTCIES IN THE U.S. IN EACH INDUSTRY



Source: New Generation Research, Inc. Kevin Schaul/The Washington Post

Assessing technology capabilities can help better evaluate target value and identify innovative opportunities to recover and thrive in the post-COVID economy:

> IT due diligence can contribute to shaping a more accurate target valuation.
>
> It can also better evaluate how technology can support business plan and equity story, related one off costs and transition pace.
>
> Enterprise turnaround needs to identify early in the M&A process quick operational and cost-effective solutions, leveraging digital capabilities.

1 - SRS Acquiom's 2021 M&A DEAL Terms Study

2 - A strong need to accelerate the M&A transactions journey, driven by economic uncertainty and increasing sector disruption threats

The second trend emphasized by the pandemic is the need to accelerate M&A transactions.

33%	One-third of dealmakers are using M&A to face structural sector disruption, by accelerating long-term transformation of their business models in response to Covid-19.
35%	of dealmakers reported that digital tools significantly increased their speed to close.
US$15-45M	In average, for a US$1 billion revenue business sold at the median industry EBITDA multiple, being able to complete a transaction three months earlier can generate significant value: up to US$15–30 million for the buyer and US$15–45 million for the seller.

M&A and transformation acceleration is a key lever for cost reduction and quicker business value generation. For transactions where transition periods were traditionally around 18 to 24 months, dealmakers are more and more seeking for shortened transitions lasting between 6 and 12 months.

In addition to reducing TSA duration and related liabilities, this contracted transition period accelerates synergies delivery, as the transformation into the target state is performed during transaction, and not after (transforming while transacting).

Technology can significantly reduce the M&A transition period, and speed up integrations and divestments:

- Digitalization of M&A processes through dedicated tools is accelerating analysis, data processing, and decision making.
- Strengthened IT due diligences with a better understanding of IT constraints and opportunities, leads to an early shaping of effective transitioning strategy and budget.
- Cloud-based platforms and COTS* applications allow quicker systems integration and transformation, and more predictable integration costs.

(*) COTS: Commercial-off-the-shelf

3 - "New Normal" working models enabled by an enriched digital workplace, expose companies to increasing Cybersecurity threats during M&A operations

Another direct implication of COVID-19 are the new and remote working modes.

68%	A Gartner study revealed that 68% of responding C-Level executives have expressed more involvement in the digital workplace since COVID-19[2].
62%	of the business decision makers surveyed agreed their company faces significant cybersecurity risks acquiring new companies, and cyber risk is their biggest concern post-acquisition[2].
IT 1st	Technology integration appears to be the biggest hurdle to effectively manage the integration phase of a deal in a purely virtual environment.

COVID-19 has significantly accelerated the digitalization of M&A process by many years. Corporate M&A and private equity (PE) teams found themselves quickly adapting to the world of virtual due diligence, deal closing, and integration. Moreover, companies which have developed capabilities in virtual diligence and virtual integration have accelerated their M&A process.

However, cybersecurity threats and attacks particularly increased, especially during M&A transactions.

Technology is becoming a must-have asset to "stay in the game" and run M&A operations, securing against new threats, and taking advantage of new opportunities:

- Seamlessly running cross border transactions by setting up cross-company remote collaboration tools.
- Technology integration workstreams must be anticipated and organized accordingly, as it appears to be the biggest obstacle to effectively managing the integration phase of a deal in a virtual environment.
- The cybersecurity threat is higher than ever, from the earliest stages of the transaction. Cybersecurity aspects must be considered since due diligence phases and thoroughly managed along the M&A process.

2 - Gartner_2020_6 Trends on the Gartner Hyper Cycle for the Digital Workplace

4 - Increasing digitalization of all businesses leads to growing volumes of disruptive M&A and technology driven transactions, requiring stronger IT and cybersecurity due diligence

Disruptive M&A transactions were also boosted, especially non-tech companies acquiring tech companies to prevent business disruption.

77%	of businesses in the panel expect to **compete in a new sector within three years, leveraging on Technology and Innovation**.
55%	of **all technology assets** were **sold to non-tech companies**, that are willing to acquire new tech capabilities and **prevent market disruption** (2018 figures).
x25	For those technology-driven acquisitions, EBITDA multiple records are paid by non-tech companies for their disruptive M&A, reaching more than 25 EBITDA multiples, where the average for "conventional M&A" is between 4 to 7 times the EBITDA of the target.

Disruptive M&A helps companies to compete with their advanced competitors and/or create new markets.

Non-technology companies are targeting technology companies to accelerate their transformation and avoid market disruption. They are also willing to pay record EBITDA multiples.

Technology companies' acquisition by non-technology companies are booming, whereas non-technology companies are lacking the digital capabilities to properly evaluate their targets' technology:

- IT is the key asset of targeted technology companies.
- The value of the IT is directly driving the rational of the deal and the value of the targeted technology company.
- A proper IT and cybersecurity due diligence are crucial to evaluate a targeted technology company scalability and ability to support the business plan.

A NEW AGE FOR IT M&A

Considering all these trends, we anticipate a paradigm shift in which IT will play a central role in M&A.

IT will be positioned as an integral part of M&A processes and included 'By Design' from the earliest phases of a transaction.

IT will also be recognized as a major dimension of deal value creation and securing, enabling acceleration, costs reduction, transforming while transacting and providing plenty of turnaround opportunities for businesses.

Finally, cybersecurity considerations will be more essential and structuring, starting from the earliest phases of the deal, with strengthened due diligence and enriched clauses within the SPA/APA.

So, what about your next deal? How do you leverage digital to maximize deal value? How to make sure you address the right IT and cybersecurity topics, early enough in the process? How do you mobilize the relevant IT resources without jeopardizing your BAU?

About the author

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Youssef SBAI has more than 15 years of M&A and CIO Advisory professional experience, including IT Strategy, transformation programs management, and Business shared services setup.

He supported many M&A transactions in pre-deal and post-deal for Private Equities and Corporates (Due Diligence, Day1 preparation, Post Merger Integration, Carve-Out).

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