EVALUESERVE

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From Handshakes to Signatures: Navigating M&A Closure Dynamics

The closure of an M&A transaction never goes as smoothly as expected. Hence it becomes extremely crucial to follow certain procedures to avoid the risks and doubts for all the parties involved.

Successful closing of an M&A transaction requires a delicate balance of multiple factors including negotiations, finalizing purchase price adjustments, seamless integration and effective communication for a smooth transition.

Introduction

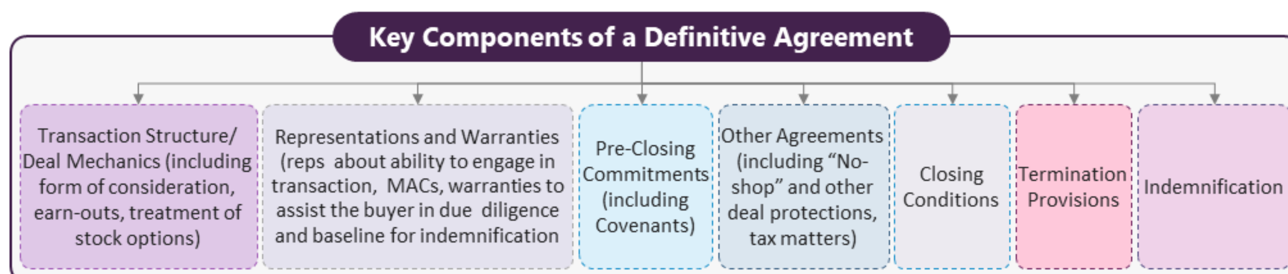
In the intricate landscape of mergers and acquisitions, navigating the path to successful deal closure stands as a pivotal moment. The critical stage signifies not just the finalization of the transaction and the exchange of ownership but also serves as a strategic turning point in shaping the future trajectory of the merged/acquired entities. Therefore, it becomes extremely important to take certain precautions during the entire procedure of M&A deal closure.

In this blog, we take a closer look at the M&A deal closure process, its challenges and discuss some of the key considerations that parties involved should keep in mind when working towards this critical milestone and in achieving the "Deal Toy"[1].

From Bids to Setting the Terms in Stone: The Definitive Journey

The stage of deal closure is deemed to initiate once the final bids from the participating bidders have been received and evaluated. Negotiations ensue among the sellers and the preferred bidders, and the buyer is finalized. This is followed by execution of the definitive agreement.

Definitive Agreement, sometimes referred as DA, is the primary legal document that transfers the ownership of a business. It is the "end all, be all" of all agreements. It contains everything agreed upon in the term sheet or Letter of Intent (LOI), among other things, and is definitive, Final and is set in stone. Failing to follow any of the agreed upon terms, can trigger huge legal costs and the waste of countless hours trying to negotiate and resolve what will seems like complex legal issues.



Once a DA is signed, sealed, and delivered, both the buyers and sellers embark on a journey to secure all the necessary approvals (board's, shareholders, and regulatory) as per the agreement.

In case of public companies and when the transactions are material and significant, another key step that is added to the list is obtaining a fairness opinion (after the DA and prior to the board's approval), to ensure transparency and fairness for all stakeholders involved. Historically, the investment bank serving as the sell side advisor were expected to provide the fairness opinion due to their extensive involvement in the process. However, recent scrutiny has questioned their objectivity due to potential bias linked to advisory fees and other factors including stapled financing. Therefore, some sellers today opt to engage a separate investment bank/firm to render the fairness opinion from an "independent" perspective.

Concurrently, amidst securing approvals, the buyer embarks on its own journey of sourcing the requisite capital that is essential to fund and finalize the transaction. This financing process timing may range from instantaneous (if the buyer has cash on hand/revolver availability in case of relatively small deals) to several weeks or months for funding that requires access to the capital markets.

Once the financing is received and conditions to closing in the definitive agreement are met, the transaction is funded and closed. However, this is easier said than done.

[1] A customary toy, presented by the deal team to commemorate the transaction, to the client's management team at a closing dinner event.

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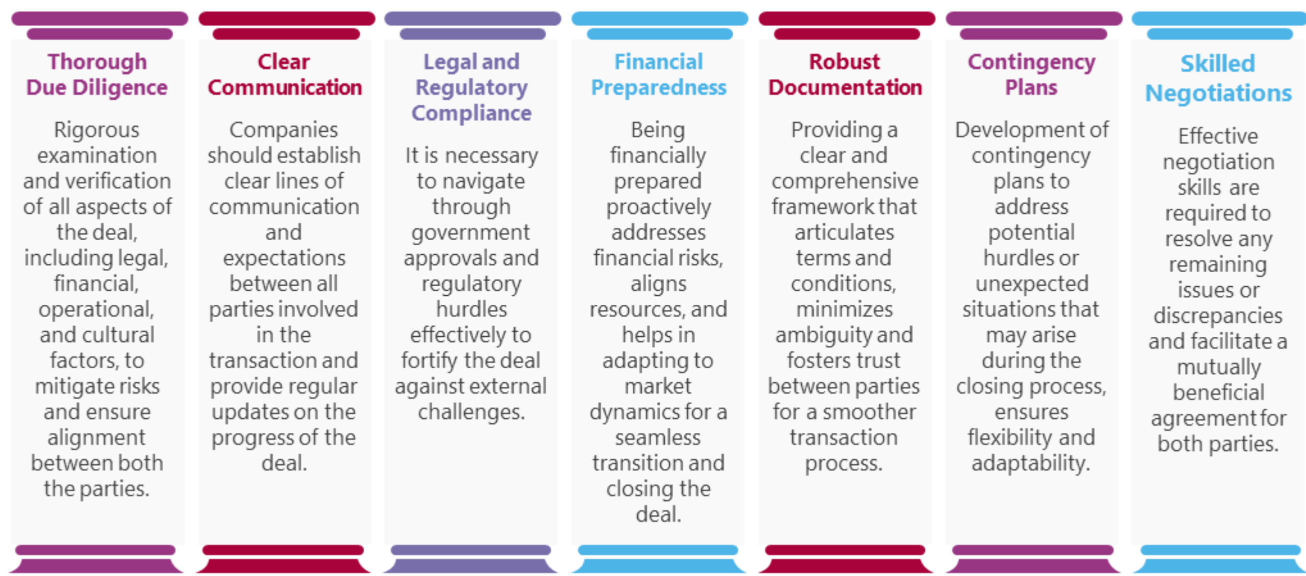
Pillars of Smooth M&A Closure



Challenges and Reasons for Delays:

1. **Economic Uncertainties:** Economic uncertainties create ambiguity around future market conditions, affecting valuation assessments and financing terms. This has led many companies to delay or cancel M&A transactions to await clearer economic outlooks.

2. **Regulatory Scrutiny:** In recent years, regulators around the world have become more active in scrutinizing M&A transactions. This has led to increased scrutiny and longer approval timelines, particularly for cross-border deals. For large-cap public transactions, deal timelines have materially increased and key regulatory bottlenecks have begun to form around competition approval and foreign investment approval.

3. **Geopolitical Tensions:** Geopolitical tensions, such as trade disputes and political instability, have also contributed to the slowdown in M&A deal closure. These tensions can create uncertainty and increase the perceived risk of transactions, leading to delays and cancellations.

4. **Valuation Challenges:** Valuation challenges have become a significant obstacle for M&A transactions, particularly in industries that have been impacted by technological disruption or changing market dynamics. This has led to greater caution among buyers, who may be reluctant to pay a premium for companies that face significant challenges in the current market.

5. **Increased Competition:** Increased competition in the M&A market has contributed to the slowdown in deal closure. As more companies seek to acquire attractive targets, the competition for deals has intensified, leading to higher valuations and longer negotiation timelines.

6. **Closing Time Dynamics:** The relative speed of the closure depends partly on the industry, the target size, and the deal environment at a given time. As a rule of thumb, venture investor Fred Wilson has suggested that completing a transaction within six weeks is a good goal, while “anything longer that three months is likely to be problematic.” Statistics show that the longer a deal takes to close, the less likely it is to close. According to Gartner in 2019, the average time to close an M&A deal has risen more than 30% in the past 10 years — now taking around 38 days. For mid-size deals, the average duration is 106 days, while large deals average 279 days.

7. **Inadequate Technology:** Lastly, inadequate technology supporting the due diligence process can slow down M&A deal closure because of manual data collection, inefficient data analysis, lack of collaboration tools, and security concerns.

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Case Study: Impact of unexpected disruptions on M&A transactions

The case study of Verizon depicts the technological and security challenges faced in an M&A deal. Verizon announced that it would acquire troubled Yahoo! for $4.8 billion, a deal that many considered a victory for the seller. But just two months later, the offer came into question when Yahoo! admitted that over 500 million of its user accounts had been breached. The fortuitous sale to Verizon seemed to be in jeopardy. The hacking scandal faced by Yahoo! is just one example of a disruption that can take place before a proposed transaction closes. Sellers have tools at their disposal to make it through to closing. However, in the case of Yahoo!, the two sides agreed to a discount of around $350 million because of the data breaches. Indeed, lowering the valuation is one of the main ways a seller can rescue a deal that comes under threat.

Source: NY Times

Tactical Approach: Navigating Buyer & Seller Dynamics

To avoid such complexities of M&A deal closures, a strategic and tactical approach is required. Both buyers and sellers benefit from adopting a collaborative mindset. A shared commitment to addressing challenges and adapting strategies enhances the likelihood of a successful deal closure. Here are some methods to consider:

1. **Demonstrating Certainty and Seriousness:** Buyers can distinguish themselves by showcasing a well-defined deal rationale to the target's management. Actively participating in due diligence, posing relevant questions, and addressing integration concerns proactively. This establishes the buyer as a reliable and committed partner in the process.
2. **Tolerating a Higher Break-up Fee:** Acknowledging the buyer's concerns and uncertainties, sellers may choose to tolerate a higher break-up fee. This financial concession acts as a safeguard for the buyer, providing them with an exit strategy if unforeseen challenges arise post-deal. While this approach may seem counterintuitive, it often instills confidence in the buyer and accelerate the decision-making process.
3. **Accepting a Discount to the Valuation:** In certain situations, sellers might consider accepting a discounted valuation to sweeten the deal for the buyer. This approach recognizes market conditions, potential risks, or other factors that may impact the perceived value of the target company. By demonstrating flexibility on the valuation, sellers can signal their commitment to the deal and foster a more cooperative negotiation environment.
4. **Clear Communication of Intentions:** Transparent communication about the buyer's strategic goals can build trust with the seller. Clearly articulating how the acquisition aligns with the buyer's long-term vision helps create a collaborative approach. Tactfully communicating the buyer's knowledge about the target company's IT systems and data sources, such as ERP systems and data warehouses, may help to expedite the data-gathering process with the target's employees.
5. **Negotiating an Earn-out:** Introducing an earn-out arrangement can align the interests of both the buyer and the seller. By tying a portion of the purchase price to the future performance of the acquired business, sellers provide buyers with assurances regarding the target's post-acquisition success.
6. **Competitive Pressure and Exclusivity:** Leveraging competitive pressure can be a powerful tactic. Creating a sense of exclusivity and positioning the buyer as the frontrunner in the deal can expedite the decision-making process. Sellers can strategically play off multiple interested parties, emphasizing the unique advantages of the buyer in question. This perception of exclusivity can motivate the buyer to act swiftly to secure the deal before competitors gain traction.

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Conclusion

Closing an M&A deal quickly requires a combination of careful planning, effective communication, and streamlined processes. Despite the inevitable challenges, adherence to well-defined procedures is crucial for mitigating risks and addressing uncertainties that may arise during the process. By finalizing key terms upfront, conducting thorough due diligence, addressing regulatory requirements, establishing clear communication channels, prioritizing integration planning, and being prepared to move quickly, companies can increase the likelihood of a successful and timely outcome.

Evalueserve extends comprehensive assistance to clients, engaging in a wide array of activities that encompass due diligence procedures, thorough industry research, in-depth market intelligence and insights, as well as strategic planning across diverse industries. The support services further extend to conducting detailed valuation analysis, handling IOIs and LOIs, and adeptly creating marketing summary slides tailored for different deal stages. Additionally, Evalueserve plays a crucial role in the meticulous review of NDAs, ensuring a thorough understanding of contractual agreements. This multifaceted approach underscores Evalueserve's commitment to delivering tailored solutions across the spectrum of business challenges and opportunities.

Evalueserve caters to bulge bracket banks, large global banks, commercial banks and boutique advisory firms offering research, analytics and design services providing deal execution and investment banking support.

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