

## In the coming economy, M&A strategies emerging as a big deal

The global M&A market roared into this year with enough momentum to sustain its high-flying status, having logged six successive years when worldwide activity rocketed past the \$3 trillion mark.<sup>1</sup> While the pace of activity showed signs of slowing, it was difficult to see how it might take a precipitous plunge, short of an unforeseen and dramatic act of nature.

But when the COVID-19 pandemic swept into the US, it curbed deal-making significantly. Between February and March, the number of announced deals dropped from 2,349 to 1,984, with deal value decreasing from just over \$151 billion to about \$130 billion.<sup>2</sup> Instead of launching new deals, the urgent priority for many finance leaders was to resolve any in-progress

transactions, re-evaluating their strategic assumptions and taking appropriate actions to safeguard their financial positions.

Now, as finance leaders move past the recovery phase of the pandemic and conceive plans for thriving in a changed economic landscape, M&A is poised to play a central role. In April, Deloitte conducted a snap poll of 2,800 US companies, and 70% of the respondents indicated they will continue with M&A and, in some cases, accelerate their deal activities over the next 12 months.<sup>3</sup> In addition, 31% of the 156 CFOs who responded to Deloitte's Q2 2020 [North American CFO Signals™](#) survey said they expect to acquire distressed assets or businesses over the next year.

Indeed, unique times create unique opportunities. And in this issue of *CFO Insights*, we'll consider the role M&A could play in an emerging post-COVID-19 business strategy. How might M&A actually fit in as a response to the COVID-19 crisis? How will such deals be conducted—and structured—in the disruptive era of social distancing? Plus, what additional outbreak-related risks and uncertainties need to be factored into the processes, terms, or timing of any deal?

### Poised to transact

As the pandemic's toll on both the US economy and society becomes clearer, so too will the implications for different industries. It's safe to say that aviation, hospitality, and leisure have suffered damaging drops in demand. But others, ➤

such as grocery, technology, and health, will likely emerge energized, eager to accelerate growth by pursuing M&A opportunities. Still, most sectors will need to reinvent themselves to thrive, and to do so, companies will need to explore a range of inorganic growth strategies, de-risking their approach to M&A by broadening their activities to include partnerships with their peers, co-investments, and cross-sector alliances.

Many companies are loaded with the economic firepower to do just that. The S&P 1200 companies boast a record \$3.8 trillion stashed in cash reserves<sup>4</sup> and have the wherewithal to service debt in a dovish monetary environment. And while access to the public equity markets has narrowed, the opportunity exists for offerings that can fit through the window. (See sidebar, “Thinking IPO? There may still be good reasons to move forward.”) Moreover, private equity firms have amassed a war chest of \$2.4 trillion<sup>5</sup> ready to be deployed.

Meanwhile, there are already signs that the pandemic is driving down acquisition prices—reversing the trend of recent years. Yet, even as their company’s business model may be changing, finance leaders need to evaluate prospective deals based on their strategic fit, as opposed to their bargain pricing (see Figure 1).

That fit has to take into account the systemic changes occurring within and across industries that have reframed considerations in companies’ abilities to take action, defensively and offensively, on the investment front. All of this leads to a revised set of strategic choice options and scenario-planning tools that can be leveraged to help identify potential game board moves.

Leveraging those tools will help companies identify the new capabilities they require and prioritize the markets where they need to operate in order to safeguard their future and drive growth. Moreover, redefining M&A in terms of these scenarios and choices can help bring much needed clarity of purpose, while confronting uncertainties in a materially changed post-crisis M&A environment.

## Thinking IPO? There may still be good reasons to move forward

The window for initial public offerings (IPOs) slammed closed in March, shuttered by pandemic-fueled economic uncertainty and volatility. But for certain types of companies, there may still be good reasons to pursue an IPO—and not just as a means of securing capital to fund growth. Often the IPO preparation process can make companies more attractive targets for acquisition.

Companies that decide going public is an option can leverage this period accordingly. Well-managed companies with a long-term vision and plans for strategic growth generally attract investors. So does a management team that takes steps to establish the necessary governance and reporting structures.

There are some COVID-19-related hurdles to clear, however. Current volatility and economic conditions could make it difficult to forecast performance metrics and establish pricing, important precursors to an offering. Timing is often a critical element of a successful IPO, perhaps more so in times when market activity is difficult to anticipate. Still, timing considerations may provide even more reason why well-suited companies with an eye toward capital formation may want to begin or resume carefully preparing for an IPO.

To assess whether a company is on track for going public, management may also need to address other pandemic-related concerns.

As a result of COVID-19, for example, companies may face significant questions regarding **supply chain resilience**. While efficiency has been an important indicator of supply chain performance historically, questions may shift to focus on factors, such as flexibility and geographic diversity.

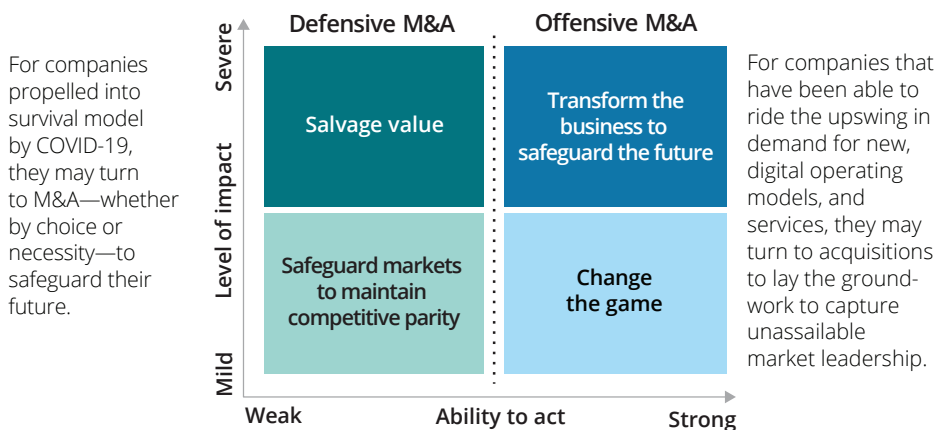
Investors also often look for a **strong leadership team** supported by a solid employee base. Questions may focus on the composition and qualifications of the board of directors and senior leaders. Investors may look for evidence of stability, integrity, and a positive culture. This may include probing into the HR strategy, compensation, stock options, benefits, relationships with labor unions, and retention plans.

Moreover, investors will also have extensive questions about the company’s **financial position**, earnings history and potential, and tax position. In addition to asset management, leverage, working capital, audit results, and accounting policies, cash flow effects resulting from COVID-19 may be important to address. Investors may have questions about the terms and conditions of loans or assistance the company may have leveraged, such as government loans that require repayment or grants where repayment is not required.

Public companies operate in a more formal, transparent manner, so management may also want to meet some public company requirements ahead of time, including establishing an effective investor relations department to communicate with the investor community. Increased visibility may attract the attention of potential acquirers; it’s not uncommon for companies preparing to go public to simultaneously entertain offers to sell the company. Depending on an owner’s needs, and other factors, this may become an appropriate exit strategy.

— by **Michael Dzikowski** and **Jeff Bergner**, both partners in the Merger and Acquisition Transaction Services practice of Deloitte & Touche LLP

**Figure 1. M&A strategy framework:** A combination of defensive and offensive M&A strategies should emerge as companies strive to safeguard existing markets, accelerate recovery, and position themselves to capture unassailable market leadership.



**Level of impact assessment:** Consider the impact of the pandemic on economic recovery and market supply/demand dynamics, employees, customers, and the competitive environment.

**Ability to act assessment:** Consider your liquidity position, balance sheet strengths, and ability to raise capital from the markets in relation to the resilience of your company's operating model and those of your suppliers and partners.

Source: [M&A and COVID-19: Charting new horizons](#), DCTL, ©2020

### M&A as self-preservation

For some companies, preservation is now paramount. Having sustained deep wounds during the pandemic, these companies may use M&A strategies in self-defense, protecting and strengthening value in different ways, such as:

- **Portfolio optimization and divestment of non-core assets.** Portfolio optimization is essential in crisis times to increase capital efficiency and identify assets that drain scarce resources. Real estate footprints will be under particular scrutiny, as some of the health and safety interventions, such as remote working become an integral part of business models. Companies will likely identify assets that lack strategic fit and will lead to divestment of non-core assets. A Deloitte analysis of divestment activities during times of crisis and recovery found in most instances, divestments create greater shareholder returns for both buyers and sellers.<sup>6</sup>
- **Disposal of underperforming businesses.** Some companies may need to consider radical actions, including

distressed asset sales, to salvage value from loss-making divisions and preserve the viable core business. In crisis situations, disposal of distressed assets at maximum value requires utmost speed in execution.

- **Extraction of deep synergies and preparation for predators.** Building financial resilience is a key imperative for all businesses, but more so for companies that have recently completed acquisitions and face pressure from shareholders to deliver value under decidedly difficult conditions. Taking decisive measures to integrate these acquisitions and capture deep synergies in an accelerated manner will help these companies free up valuable working capital to safeguard their markets and maintain parity with competitors.
- **Exploration of deals and alliances to safeguard the core business.** Companies that have capital constraints should consider alliances and pursue co-investment opportunities to reduce risk and capital outlay. Companies should also explore opportunities with private equity and other pools of private capital,



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accessing their significant funds to deploy in opportunities that enhance value and align with strategic priorities (see Figure 2).

**Using M&A to play offense**

Companies that have demonstrated resilience throughout the pandemic will be positioned to pursue acquisitions that enable them to lay the groundwork for capturing unassailable market leadership. Opportunities resulting from changes in ecosystems, supply chains, and geographical manufacturing concentration present new choices. And active pursuit of transformative acquisitions through disruptive M&A to unlock innovation-fueled growth is rooted in companies' need to rapidly adapt business and operating models. Overall, offensive M&A is fitting to achieve ambitious aims, such as:

- **To transform the business and safeguard the future.** Companies expecting a significant degree of structural disruption will use M&A to shield their customer base; to restore, protect, and diversify supply chain links; and to accelerate business and operating model transformation.

- **To accelerate the adoption of digital.** Companies, especially those from the non-tech sector, will seek technology acquisitions to build agile operations and expand customer channels.
- **To explore acquisitions and alliances and close gaps in the portfolio.** Growth-oriented CFOs should actively scan the market in search of underperforming peers, as well as high-growth startups that may be facing financial constraints. Dropping valuations may create unique acquisition opportunities.
- **To orchestrate a web of alliances to capture cross-sector convergence opportunities.** For companies that are strategically and financially well-placed, the post-pandemic acceleration of sector convergence and the establishment of new ecosystems will create opportunities to enter new markets and, in some instances, supplant entrenched incumbents. Capturing such opportunities means forging alliances with large specialist partners, as well as innovative startups, to collaborate on shaping new market offerings.

The global effort to contain COVID-19 will result in a materially changed environment for M&A. While the traditional pillars of commercial success—from market share to competitive positioning—will remain vital to evaluating targets and acquirers, transactions will also be viewed through the wider lens of social purpose and integrated sustainability practices. The measure of industry leadership will expand to include longer-range criteria such as societal impact, resilience, and the capacity to inspire trust across a wide coalition of stakeholders including governments, who will focus on deals that promise to aid recovery.

**How your next deal may differ**

No matter the context for a deal, it seems likely that the procedural aspects of deal-making—including the processes and timelines governing transactions—will also have to adjust to the changed landscape. On-site visits for the purposes of conducting operational due diligence, as well as face-to-face conference-room marathons, may no longer be standard. What follows are some changes prospective dealmakers can anticipate encountering:

**Figure 2. Aligning priorities with options**

	Priority	Potential responses	M&A deal archetypes
Defensive M&A	Salvage value	Identify ways to raise capital	<ul style="list-style-type: none"> <li>• Divest non-core or distressed assets</li> <li>• Wind down underperforming businesses</li> </ul>
	Safeguard markets to maintain competitive parity	Improve operational efficiency or increase business flexibility	<ul style="list-style-type: none"> <li>• Identify rapid turnaround situations to optimize portfolio</li> <li>• Explore JVs and alliances with suppliers and partners</li> </ul>
		Adjust operating models in response to competitive dynamics	<ul style="list-style-type: none"> <li>• Pursue deep synergies from recent acquisitions</li> <li>• Develop partnerships for non-core capabilities</li> </ul>
Offensive M&A	Transform the business to safeguard the future	Prepare the business for the "new world order"	<ul style="list-style-type: none"> <li>• Pursue co-investment opportunities for capital intensive projects</li> <li>• Pursue opportunistic deals to safeguard core markets</li> </ul>
		Rebalance your portfolio	<ul style="list-style-type: none"> <li>• Pursue acquisitions to facilitate vertical integration</li> <li>• Close gaps in portfolio through strategic acquisitions</li> </ul>
	Change the game	Capture additional revenue in adjacencies	<ul style="list-style-type: none"> <li>• Acquire distressed under-performing peers and early stage companies</li> <li>• Acquire capabilities to accelerate digital transformation</li> </ul>
		Define the "new world order" through the power of networks	<ul style="list-style-type: none"> <li>• Orchestrate a web of multilateral partnerships and alliances</li> <li>• Capture new opportunities resulting from sector convergence</li> </ul>
		Invest to scale at the "edge"	<ul style="list-style-type: none"> <li>• Acquire high-growth businesses from the innovation ecosystem</li> <li>• Curate a portfolio of investments on the "edge" of your core business</li> </ul>

Source: [M&A and COVID-19: Charting new horizons](#), DTTL, ©2020

1. **Building relationships will require overcoming virtual barriers.**

Traditionally, developing meaningful relationships between buyers, sellers, and advisors has relied heavily on an underlying element of trust built through a series of vital physical interactions. In the absence of these in-person meetings, alternative ways to build trust in virtual settings and mirror the human element must be found. Conscious effort must be made to “read” the virtual room, so that information and touchpoints are better tailored to address individual needs, expectations, and circumstances.

2. **Broadening due diligence.** In response to COVID-19, acquirers may want to take more time and focus on areas where vulnerabilities have been exposed—and could be again, should the pandemic worsen. Such hotspots include supply chains, IT infrastructure, cyber security effectiveness, and relevant clauses in contracts. Diligence should also expand to include integration options, a critical consideration given the systemic changes occurring. The underlying capabilities of a target asset, for example, may not align with the strategic opportunity of the deal thesis—which should be uncovered during the due diligence process.

3. **Accelerating digital tool adoption.** With the increased use of data and predictive tools throughout the life cycle of the deal, there will be an increase in the information that vendors share digitally in the new deal environment. That dissemination will provide an even greater opportunity to identify pockets of opportunity and risk through the overlay of existing benchmarks and other aligned data lakes, providing a differentiated view on the possible and likely outcomes of the future trading of targets. Effective and consistent use of analytics and artificial intelligence (AI) can also help companies transform their post-deal value-creation programs by making better decisions when the stakes are high, time frames are compressed, and social distancing continues.

4. **Forecasting with the new math.** Given the one-two punch of pandemic and recession—neither of which shows



signs of fading—historical financial data cannot be used for forecasting purposes. As a result, many companies may want to focus their scenarios on a range of pandemic/recession durations—from 18 to 48 months—to better understand their options. As events unfold and circumstances change, finance leaders will need to take a flexible approach to forecasting, reassigning probabilities.

5. **Building confidence in leadership amid uncertainty.** Virtual ways of working present unique opportunities for leaders in preparing and executing deals. Previously, leaders could not be everywhere at the same time, but the virtual environment has enabled greater outreach, connectivity, and opportunities to communicate more regularly and transparently. Leaders need to go over and above usual measures to build trust. By showing empathy toward the financial, well-being, and safety considerations of their teams; helping them navigate through uncertainty and disruption; and trusting them to do their jobs, leaders with a virtual presence can concretely inspire confidence.

6. **Closings may be hindered by unforeseen circumstances.** The complexity of the closing process has only increased with the inadvisability of travel, closed offices, and the possibility of key players (such as regulators) suffering from illness. Given all the approvals required, the logistical challenges alone can fuel delays. As always, be ready with contingency plans.

For a time, in fact, multiple contingency plans may constitute the most practical overall business strategy. But, as the new economic day dawns, companies will wake up to the role they need M&A to play, which is much broader than traditional buy-side and sell-side transactions. By being deliberate and strategic about the deals they take on—whether out of a need to acquire innovative technology, optimize their portfolios, or divest of non-core assets—companies may discover 2020 to be an excellent year for M&A, after all. ◀

## End notes

1. Deloitte analysis based on data from Thomson.
2. [“Global M&A activity started plummeting as Q1 2020 approached the end,”](#) GlobalData, April 27, 2020.
3. Deloitte analysis based on snap poll conducted on April 20, 2020.
4. Deloitte analysis based on data from Thomson.
5. Data sourced from Pitchbook.
6. Sriram Prakash, Lily Chen, and Russell Shoult, [“Divestments: Creating shareholder value,”](#) Upfront, Deloitte UK, Deloitte LLP, 2013.

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