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Sell-side success

Virtual data rooms and vendor due diligence have given sellers more control in the M&A process. But with an economic cooldown on the horizon, how can sellers continue to maximise their chances of success?

Over the past 15 to 20 years, tools and processes like virtual data rooms (VDRs) and vendor due diligence (VDD) have allowed sellers to take greater control of M&A processes

The availability of financing and buoyant M&A markets of the past few years have pushed competition for assets – and therefore deal valuations – higher, allowing the sell-side to gain further control over the process. The continuing growth of private equity has also contributed to the increasing professionalisation and formalisation of the M&A process, resulting in assets being prepped for sale earlier and earlier.

In fact, some firms are looking at the vendor due diligence process and identifying ways it can be useful not just in M&A, but day-to-day. As Gary McKeown, CEO of Imprima puts it, "From a compliance and general housekeeping perspective, you want to make sure that all your information contracts are updated. Why make that a separate process? Is this information you need only for a sale? You should really have that information to hand at all times."

On the one hand, thanks to the trend towards preparing vendor due diligence far earlier, sellers are better placed than ever before. On the other, they face a host of challenges, including managing longer and potentially more complex DD processes, concern from some on the buy-side about VDD, and a potential correction in valuation multiples on the cards.

With this in mind, we asked five experts in M&A from the fields of investment banking, technology and academia to weigh in on challenges facing the sell-side and trends in vendor due diligence.

The state of M&A for sellers

Expert speakers

Gary McKeown
CEO, Imprima

Timothy Galpin
Senior Lecturer, Saïd Business School, Oxford University

Ed Waldron
Partner, Taylor Wessing

Rob Donaldson
Head of Corporate Finance, RSM UK

Florian Bauer
Professor, Lancaster University Management School

These days, sellers are quick to take advantage of virtual data rooms and vendor due diligence to prepare themselves for sale processes as early they can. At the same time, beginning the early stages of preparing for a sale a year or more before a formal process kicks off can bring its own challenges

Mergermarket: Have you seen a shift in the balance between sellers and buyers in M&A processes? Are sellers more in control of sale processes than they were in the past?

Rob Donaldson, RSM: If you had a good advisor to run a good process, then sellers were always in control, because ultimately sellers have the ability to sell to someone else or decide not to sell at all. I think it's always the case that well-advised sellers have more control than anyone else. Virtual data rooms, vendor due diligence – these have definitely given sellers even more control over the process, as has a growth in the number of buyers.

Timothy Galpin, Saïd Business School: Well, it depends on what type of seller you're talking about and how familiar they are with the M&A process. If you're talking about a founder, or an entrepreneur selling a small-to-medium enterprise, they usually don't have a lot of experience in the deal process. That's something that has not changed over the last few years, although some entrepreneurs do build their enterprises for exit – that's typical in the tech world, for example.

Florian Bauer, Lancaster University: One shift that has emerged in the last few years is that while we have seen decades of consolidation-driven acquisitions, we are now seeing a lot of firms invest in start-ups, and this has changed the seller's role in the acquisition process. In these kinds of deals, acquirers often want the management of the seller to stay in the business.

Mergermarket: Are sellers preparing assets for sale earlier in the process than before?

Timothy Galpin, Saïd Business School: More sophisticated sellers, whether private equity or strategic sellers, have realised that a sale shouldn't be a last-minute decision or activity. They definitely do start earlier, getting advisors, attorneys, bankers, consultants, etc. involved.

Rob Donaldson, RSM: I agree. We are seeing sellers preparing assets earlier. I think this is linked to the increasing presence of private equity. Private equity firms are professional buyers and sellers of businesses. They have more experience with the process than private individuals or large corporates making divestments.

When private equity firms invest, they almost immediately begin thinking about the process of selling and making sure the business is ready if the moment comes. Sometimes they just maintain the discipline of having a data room in place and loading information into it in case they get an approach, so that when the time comes, the business is well prepared.

Gary McKeown, Imprima: We come at this from the perspective of providing technology solutions to the M&A market for the last two decades. Traditionally, a VDR was seen as a tool for securely storing and sharing information between the buy-side and the sell-side and providing workflow automation for the M&A process, such as Q&A and reporting to enhance & accelerate the process. In recent years, what's become of increasing importance is for sellers to be transaction ready. How do you do that? You make sure you have all the relevant documentation that you need, everything is up to date and ready to go, and well-structured in a folder structure. That's the first part of being prepared. The second part of being prepared, as best you can be, is actually knowing what's in the information that you're presenting to the other side. That's where vendor due diligence can play a key role. All of that has to be done before the buyer gets involved, so that you can identify risks and opportunities in the company that you're looking to sell.

Therefore, from our perspective, some sellers are taking a proactive approach to preparing assets for sale and that has meant our technology is being used a little earlier than we've traditionally experienced.

Sophisticated sellers have realised that a sale shouldn't be a last-minute decision or activity.

Timothy Galpin, Saïd Business School

Mergermarket: Does preparing assets for sale earlier bring its own challenges? For example, do sellers need to frequently re-evaluate the value of their assets over that period?

Timothy Galpin, Saïd Business School: Virtual data rooms have streamlined the due diligence process, but setting up a data room and getting it populated very early – say, a year or more before sale – means the seller ends up having to update information, whether it's financial or operational. A lot can change in a year's time in most industries – the external economic environment or the industry can shift, or internally, things can change: operations, new technology, customers coming and going, etc.

Ed Waldron, Taylor Wessing: Yes, timing can be key due to general economic circumstances or sector specific reasons, such as a potential change in the regulatory landscape in that sector. There is always the risk that the market might move. That is why you find that corporate finance advisors will sound out the market before too much money is spent on vendor due diligence and once a decision has been made move quickly.

Gary McKeown, Imprima: Our advice, as previously mentioned, is that preparation is key. The primary focus when you're not going through an M&A process is to run a business in the most successful way possible. However, with holding periods shortening – for real estate sometimes it is less than two years

between purchase and subsequent sale – that's a very short time to be stopping everything and preparing for a transaction.

Rather than have a stop-start nature towards the process, the more optimal situation is to maintain something similar to the data room structure on an ongoing basis. From a compliance and general housekeeping perspective, you want to make sure that all your information and all your contracts are updated. Why make that a separate process? Is this information you need only for a sale? You should really have that information to hand at all times. VDD is about identifying risks and pre-empting the bidders' discovery of those risks. We now experience sellers wanting to be aware of those risks at any stage of the holding period, not just when approaching a sale. So, being constantly prepared and transaction ready is the advice we give to our customers and utilising platforms such as our Imprima Asset Lifecycle Management (ALM) product.

Mergermarket: What are some of the common issues which prevent sellers from releasing as much value as they could, in your experience? How can sellers mitigate those issues?

Timothy Galpin, Saïd Business School: If the seller is a founder, they are not likely to be familiar with the sale process and therefore will need a good advisor. There are boutique advisories that focus on the sell-side, as some of the larger investment banks won't touch them, because it's too far down the chain for them. And it is not enough to get your accountant that does your books, or maybe an attorney that's done some work for you over the life of your business. It has to be somebody who really knows the exit process.

A look at vendor due diligence

The due diligence process has evolved over the years, from something the buy-side did just to make sure all the i's are dotted and the t's are crossed to a tool for the sell-side to not only identify any red flags while preparing for a sale and maximise value, but increasingly as part of the normal course of running a business optimally

Mergermarket: How common is vendor due diligence? Has this become something that was 'nice to have' to something that is seen as mandatory?

Rob Donaldson, RSM: I think with private equity, yes, it is now commonplace. With privately-owned businesses, whom we work with a lot as a firm, less so. Some vendors are less willing to invest in the process or struggle to perceive the value. Overall, however, it has definitely become more prevalent and has seeped down from very large deals originally to the upper mid-market and now it's common throughout the market.

Florian Bauer, Lancaster University: Vendor due diligence is becoming more and more common and should become a standard in the long run. At the moment, VDD is used for its original purpose in the process of a sale. But it can also be useful for other reasons, because it allows you to identify red flags, and helps you make your firm more stable. You can get a better understanding of your business. In the DACH region, there are hundreds and thousands of mid-sized family-owned firms that have no successors, that may be sold in the near future. For them it should absolutely become mandatory that they think about this.

Ed Waldron, Taylor Wessing: In relation to financial due diligence, including tax, I would say it is rare to run a process nowadays without doing financial and tax vendor due diligence, but we still don't see a huge amount of formal vendor legal due diligence being done prior to the data room being opened. Generally, sellers will ask their lawyers to do a health check of the data room, but it isn't a formal report, because it is rare for a legal issue to make an impact on the value. That said, some of my colleagues have reported an increase in demand for vendor legal due diligence of late, although even then buyers will more often than not do their own 'top up' work.

Mergermarket: How have virtual data rooms changed the VDD process over the years? Are processes more complex now than they used to be? How can this be mitigated?

Rob Donaldson, RSM: I was on a deal recently where we effectively made available the accounting system – every single entry – to the VDD provider. That is an enormous exercise that you could never have contemplated doing before VDRs and probably wouldn't have felt comfortable doing. But now, with data mining tools, it's no longer unusual.

VDD can also be useful for other reasons, because it allows you to identify red flags, and helps you make your firm more stable.

Florian Bauer, Lancaster University

The simplest way to prevent the process getting out of hand is saying no. Part of the job of a sell-side advisor is not just to try to sell the business, but it's to protect it through a process because it's perfectly conceivable the business or asset is not sold. Our job is to say "That's an unreasonable request," or "It's a disproportionate request," or "You need to focus your inquiries and explain why you need certain information." We don't and shouldn't just answer every question that's asked. To be honest, that's the simplest way of controlling the volume.

Gary McKeown, Imprima: If, let's say, the process is not very well-run by the sell-side, where – to use an extreme example – the seller has just uploaded lots of documents into a data room, and put the onus on the buyer to interrogate them and the data, then they are not making the most out of the process. If the process is not well-run, you end up with loads and loads of questions in the Q&A process in the data room. In a large deal, that may happen anyway, but what you want to avoid is lots and lots of questions that could have been answered through a VDD report or a well-prepared and organised process with a good communications flow.

Mergermarket: How is VDD regarded by the buy-side? Do they view it as too much in the control of sellers?

Rob Donaldson, RSM: That depends on who the buyer is. In our experience, corporate buyers don't particularly like it. That is because 1) they're not familiar with it, and 2) they won't necessarily have the same depth of relationship with the provider of VDD as private equity will. Private equity firms have the sanction of not giving them another deal if they do a bad job on one of them, whereas the corporate buyer won't necessarily have as many relationships.

Intuitively, VDD comes across as an odd process. When you first explain it to people who are not familiar with it, they struggle with the concept. But nowadays, certainly with the large upper middle market deals, buyers would be surprised if it doesn't have VDD.

Mergermarket: Is VDD often carried out by the same financial advisor that manages the whole transaction, and therefore have an interest in closing the sale? How is this viewed by potential buyers?

Rob Donaldson, RSM: I think that this is a very interesting question. As a firm, RSM will not do that, but we are one of the very few that will not do it. It does happen quite a lot that the M&A advisor is providing the VDD, and in my experience that is very uncomfortable. We don't do it because we don't think it's very credible. I think it's tolerated by some buyers, but you are starting to create lots of doubts about the veracity of the process. Contingency-driven advisors providing an assurance report to a buyer is difficult territory.

I think people have accepted it in the past, but they've never been that comfortable with it because it doesn't take a genius to work out the potential conflict. I think over time, it's becoming less and less acceptable.

Florian Bauer, Lancaster University: I think acquirers and sellers both are becoming more and more serious about conflicts of interest of other players in the market. These conflicts of interest were ignored for a while but are now a leading topic. Many firms don't want to work with specific consultancies or advisory firms because of conflicts of interest and I think this will become one of the greatest challenges for advisory firms in the next few years.

Part of the job of a sell-side advisor is not just to try to sell the business, but it's to protect it through a process.

Rob Donaldson, RSM

Future for sellers

Looking at the long- and short-term future of M&A, there are a range of challenges and changes coming for the sell-side. Longer term, technological changes are likely to change how sellers and their advisors work. Nearer term, conditions for the sell-side are likely to become less favourable, as M&A value and volume in 2019 fall compared to the previous year

Mergermarket: From the perspective of the sell-side, how is changing technology affecting the due diligence process specifically and the overall M&A process generally? Have you, for example, seen interest in adopting artificial intelligence (AI)?

Timothy Galpin, Saïd Business School: There is some discussion around parts of the due diligence process and the transaction process which could be automated through AI. For example, AI could flag potential issues in environmental due diligence, legal due diligence and financial due diligence, which would require more investigation from a human. But this is still in early stages at this point.

Gary McKeown, Imprima: Clearly, there's a lot of hype about artificial intelligence in general. Recently, M&A professionals, such as lawyers, have started to discover the potential of AI for contract review in due diligence. Most major law firms are investing significant resource in innovation, including AI & Machine Learning technologies designed to streamline the due diligence process. This summer Imprima has released a new product, Smart Review, to some select clients. This AI powered product can save lawyers as much as 90% of their time and increases reliability in due diligence contract review. We have a full market launch scheduled in Q1 2020.

In summary, we see technological advances increasing both the speed and accuracy of the due diligence process in M&A.

Mergermarket: While AI and other technology seem as if they will streamline and simplify work for humans, historically we have seen that technology sometimes creates more work. How do you see the nature of M&A advisory jobs evolving? What will this type of work look like for the next generation of professionals?

Ed Waldron, Taylor Wessing: I think it's important to give it some context and look at how things have changed over the last 20 years. I think it would be fair to say that, 20 years ago, buyers and their lawyers would get access to the data room and say, "Well, we've got to do a legal review. Let's just read everything in there and report on whatever is out of the ordinary," but may then not have been given enough time in the data room to do the whole job. Too little time was spent up front by buyers and their lawyers scoping the exercise, whereas, nowadays, notwithstanding the fact that you might have much more time in and access to the data room, lawyers are much better at agreeing on how to focus the review before making a start.

At Taylor Wessing, we are always very keen to ensure that our due diligence exercises are well scoped and focused to ensure that we are carry out an efficient review and quickly identify key issues. We spend time understanding the business's sector and legal framework beforehand. We don't just go into the data room and read everything before agreeing a scope with the client.

With that in mind, when we do use these software tools including AI tools, we deploy them sensibly and carefully as opposed to just thinking, "Well, now that we've got a machine, we can review absolutely everything and lose focus". We are using AI software to make legal due diligence processes shorter with enhanced value for money.

Timothy Galpin, Saïd Business School: Technology does streamline the due diligence process and makes it more efficient

but it can also remove the human element of the management teams getting to know each other. It is important to build rapport between the buyer and the seller before a deal closes. If there is very limited human interaction between management teams, you can end up with a lot of surprises that are not picked up from a data room around organisational culture, for example, and fit between the two companies. We need to get the balance right so that technology helps but does not replace human interaction during deals.

Generally, people look at deals from the financial side – price and valuation – and that's never going to go away. But for the most part, they ignore the organisational fit and especially in human capital-intensive industries, the cultural fit can really damage a deal after it's done if there is misalignment.

Mergermarket: How do you view the current M&A market? Is this still a sellers' market?

Ed Waldron, Taylor Wessing: It's important to put global M&A figures in context. Notwithstanding the fact that there are fewer deals happening right now as compare to last year, the first half of the year was still the third-highest half year for global M&A on record, thanks mainly to buoyant activity in the US. In the UK, M&A is down a bit compared to last year, but compared to the rest of Western Europe, we're actually doing OK.

Rob Donaldson, RSM: It has been a seller's market for some years now and it still is. The trouble with the global statistics is that they can be quite distorted by one or two large transactions. The part of the market that remains surprisingly buoyant is probably private equity transactions, and that is a function of how much dry powder there is and the pressure on those funds to deploy it.

Mergermarket: Do you expect M&A value and volume figures to continue falling? Will there be a correction in valuations?

Timothy Galpin, Saïd Business School: Are we looking at a correction on multiple? Probably. The M&A cycle typically follows economic cycles. As economies pick up, stock prices go up, valuations go up, and conversely as economies slow down, stock prices get depressed, valuations start getting depressed. Most people are predicting a recession, globally, over the next 12 months or so. Therefore, we are most likely looking at a correction. M&A is already slowing down, valuations are starting to come down a bit, and we will probably see an acceleration of that as the global economy starts to turn down.

Ed Waldron, Taylor Wessing: I think we are seeing a bit of softening in general terms, but let's keep in mind that we are comparing the state of the M&A market today to some very strong years. The market is still buoyant. Looking at different geographies, the US is actually up in terms of both value and volume of M&A, driven by a very strong domestic market. So, although in the UK there's been slowdown in private M&A in 2019 compared to 2018, it's less concerning when you look at how resistant activity and pricing still is.

Mergermarket: Given that an economic cooldown globally is likely, how can sellers make the best out of a more difficult market?

Florian Bauer, Lancaster University: I think, if you're really desperate to sell, you should do it in the next six months. That might be still a quite good period to sell. Afterwards, I am pretty sure we will see a strong decrease.

If you want to sell, there are of course periods where you can make more money and ones where you can make less. What is important, however, is to keep in mind the strategic rationale behind selling and start preparing the business. If, for example, you plan to stay on for five more years as CEO after a sale, you might do a different type of deal than if you just wanted to get rid of it. And that's something you should always keep in mind.

Timothy Galpin, Saïd Business School: One thing they can do is conduct an auction process. The typical valuation premium right now is around 35-38% on average across all industries, from what I've seen. But if you look at the data for the auction process, it's about 8-10% higher than that on average.

Another thing is what we've discussed: conducting due diligence on yourself – not just on financials, but also on operations and technology, so that you can make sure your operations are as efficient and effective as possible. That way, you can take the synergies yourself, rather than giving them to the buyer. It's not just that you will be much more ready for a sale, you are also much more valuable when you do sell.

Despite the drop in M&A activity, H1 2019 is still the third highest half-year from when records began.

Ed Waldron, Taylor Wessing

About Imprima

Imprima is a leading Virtual Data Room provider, handling over $1 trillion-worth of transactions in over 160 countries.

Our clients include high-profile corporations, financial institutions, and advisors.

Whether it's a complex M&A transaction, managing portfolios of assets or completing a time-sensitive restructure, our innovative products enable secure and fast deal execution.

- **Imprima Virtual Data Room (VDR)** is a highly secure, fast and intuitive virtual data room that preserves the confidentiality of mission-critical documents and communications during any transaction.
- **Imprima Asset Lifecycle Management (ALM)** empowers you to organise, manage and track your assets in an efficient and cost-effective way, ensuring they are sale-ready at any given time.
- **Imprima AI** is our new Artificial Intelligence (Machine Learning) tool that increases the accuracy of contract review, whilst reducing both the time it takes to complete and human error.

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