A CHIEF EXECUTIVE / TATA CONSULTANCY SERVICES RESEARCH REPORT

Deal-Making in the Digital Era

Purpose, Planning and Commitment

Chief Executive / tcs TATA CONSULTANCY SERVICES

The quagmire of the 2020 global health pandemic, social unrest and politically charged events created a perfect storm of uncertainty that touched nearly every organization across the globe. As consumption dwindled in some sectors, new growth emerged in others. M&A activity dipped at the beginning of the pandemic due to widespread uncertainty, but soon after, it soared once again, as organizations went hunting for bargains to support new market strategies and quick growth opportunities.

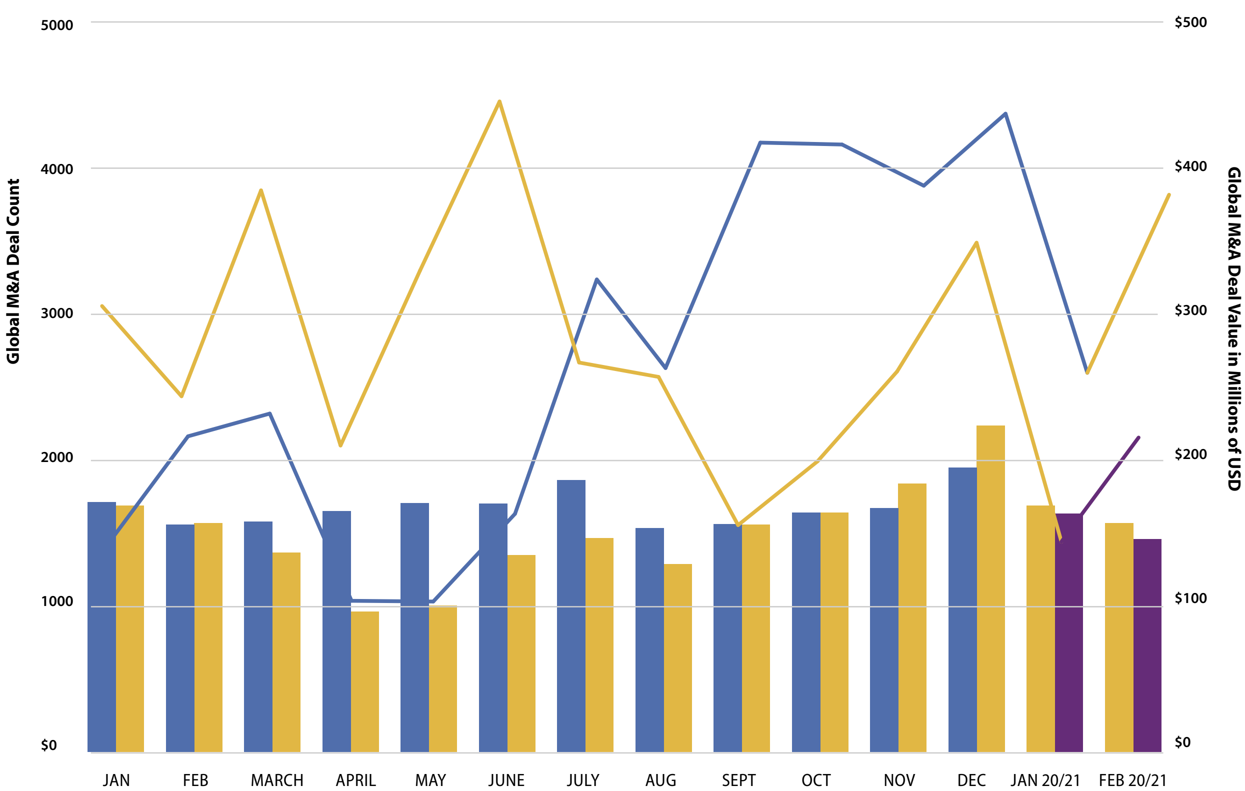
It's against this background that *Chief Executive* and Tata Consultancy Services partnered to survey some 500 business leaders over the course of two months to uncover their plans, challenges and successes with deal-making in this unique set of circumstances. This report presents our findings.

KEY FINDINGS:

- 60 percent of large companies ($1 billion+ in annual revenues) report having been undeterred in their M&A plans by the Covid-19 pandemic—with an additional 20 percent saying the pace had in fact picked up for them, instead of slowing down.
- Overall, the majority of companies considering M&A in 2021 are looking at alliances and acquisitions more than any other type of transaction.
- A full third of companies considering deals in 2021 say conducting due diligence in this environment is the greatest challenge they face.
- Strengthening their competitive position and capturing new markets are the two most important objectives for deals in 2021, ahead of financials and IP.

Mergers and acquisitions were severely curtailed during the first half of 2020, but as businesses came to grasp with the extent of the Covid-19 crisis, its impact on valuations and the transformational opportunities it created, there was a significant rebound in activity. From the trough of the crisis to the end of 2020, global M&A deal volume rose about 130 percent while deal value increased by more than 300 percent, according to data by Mergermarket.

Global M&A Deal Count and Value



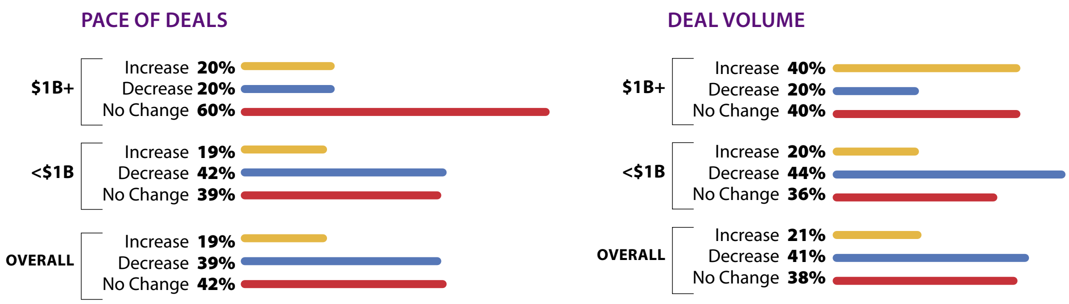
Source: Mergermarket

While many facets of deal-making were rendered more difficult because of the constraints of the crisis, including on-site due diligence and post-deal integration, valuation was by far the primary challenge for M&A activity in 2020. For example, companies in the life sciences space may have been led to believe their worth had multiplied overnight. Thermo Fisher Scientific's offer to purchase Qiagen, for instance, failed to receive the necessary buyer shareholder agreement because the target company twice requested an increase in price, which was raised once before the Thermo Fisher CEO confirmed that the upward revised bid "reflect(ed) the full and fair value of the business in the current environment, while generating strong returns for both sets of shareholders".[1]

Conversely—yet with the same outcome—certain sectors saw their value collapse entirely. In December 2019, DuPont was reported to be selling its transportation business. So far advanced were those talks that a buyer name had already been floated publicly by a major business publication. With the pandemic, however, the transportation market collapsed (demand for plastics plummeted), and the transaction did not materialize.

There is no doubt that regardless of what side of the equation companies were on, corporate development strategies were impacted by the crisis. Yet, research conducted by Chief Executive and Tata Consultancy Services shows that the majority of larger companies (those with at least $1 billion in annual revenues) experienced very little change in their M&A activity in 2020. Overall, only 20 percent of large company CEOs reported a decrease in deal volume and pace in 2020, compared to approximately 40 percent across all size groups. Instead, for the majority of large companies surveyed, data shows either an increase or steadiness in both the volume and pace of deals.

How has the Covid-19 pandemic affected your corporate development strategy?



While large companies are typically better positioned (e.g., access to capital, cash reserves) to be more opportunistic in disruptive environments, some transactions were already underway when the pandemic hit, and the momentum was enough to carry them to the end. DuPont's acquisition of Laird Performance Materials is a good example of an opportunistic tuck-in acquisition to broaden DuPont's technology portfolio in electronic-related films that was announced during the crisis.

If large companies tend to have stronger financials and be less impacted by market volatility, their smaller counterparts—particularly those in sectors not too hard-hit by the pandemic—can, too, seize a moment of crisis to be opportunistic. Growth projections drive strategic decisions, and M&A is a vehicle for growth when organic growth is insufficient.

This is, of course, dependent on the industry. Twenty-seven percent of CEOs at healthcare companies, for instance, say the pace of deal accelerated during the crisis, compared to 13 and 14 percent in manufacturing and financial services, respectively, according to the research. Consumption has been a primary driver of this activity across sectors. On one side, healthcare companies have, for the most part, done well during the pandemic due to both government and private sector spending on goods and services, which has put them in a great position to be opportunistic to deepen and broaden their portfolios—in addition to many attempting to gain control of the supply chain to capitalize on growth. On the other, M&A in manufacturing has been mostly distress-driven, as demand for manufactured goods dropped.

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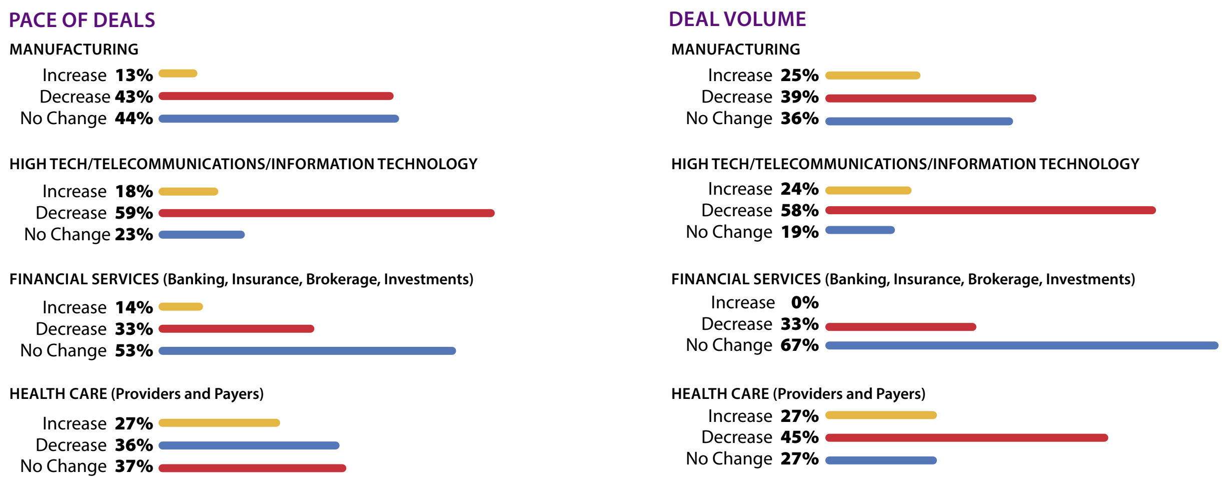


For financial services firms, low interest rates and defaulting loan books have put them in a less favorable position for M&A. Covid has brought the biggest downturn since World War II; nearly all banks had to go through refinancing in March 2020, but there is hope that the sector could rebound with President Biden's Recovery Package. As consumption adapts to a post-vaccine world, M&A trends across sectors are also expected to evolve and shift.

M&A Outlook

• Prepare for deal activity to ramp up, as the global economy unlocks during the second half of 2021. Sectors that may not have been in a position to participate in M&A activities during the pandemic may look to find opportunities as the light at the end of the tunnel becomes visible.

• Key sectors such as pharma are likely to experience a further uptick in M&A and joint venture activity.

• As deal activity picks up, many companies, particularly in sectors such as transportation, will begin to explore new technologies and opportunities in and outside of their current portfolios.

• As due diligence is better able to be carried out again, financing may also free up to underwrite M&A activity.

• Overall, rapid due diligence and valuation and "virtual integration" are expected to be prominent M&A trends over the coming months, with companies looking to operate faster and invest more to make themselves more agile and competitive. As the new work modes become normalized, technology will continue to be important for connectivity and acquisition integration.

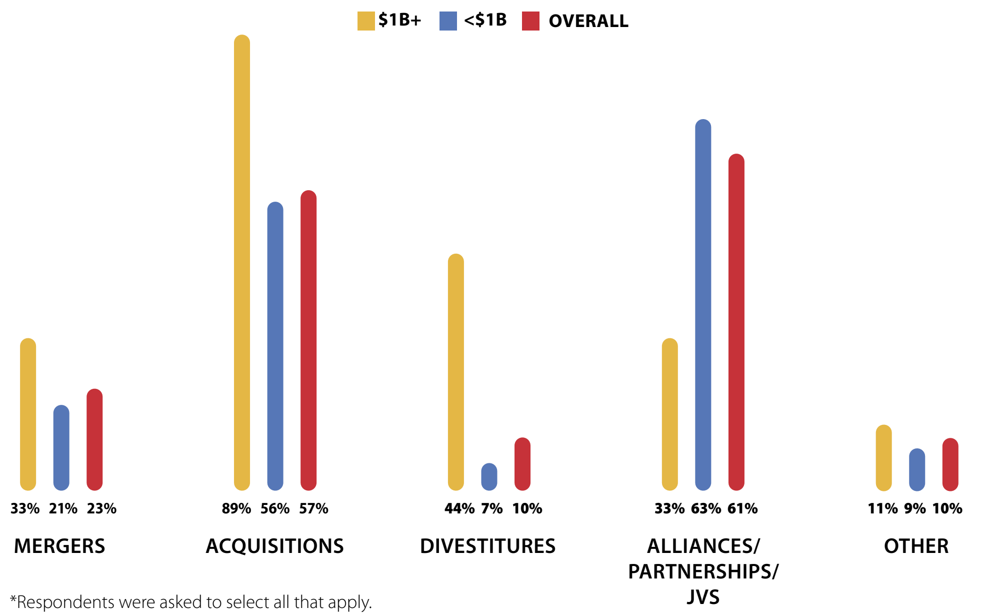
• Over the next 12-24 months, companies looking to gain a competitive edge should consider building on their strengths, ensure they have a clearly defined vision of where they want to go and look at adjacencies to broaden offering footprints and spread risk of downturns.

VIRTUAL DEAL-MAKING

Of the companies planning a transaction over the next six months, the majority are considering alliances (61 percent) and acquisitions (57 percent), well ahead of any other type of transaction. Less than a quarter of CEOs participating in the research said they were considering mergers at this time, and only 10 percent selected divestitures as a possible strategy to navigate the current environment.

Successful mergers require cash, capital and commitment to integrate—all of which are more challenging to find these days, especially for companies focused on cost containment to recover from the crisis. Those planning for growth are more likely to consider alliances as faster and more cost-effective means to access new markets.

Which of the following transactions (if any) are you exploring in the next 6 months?

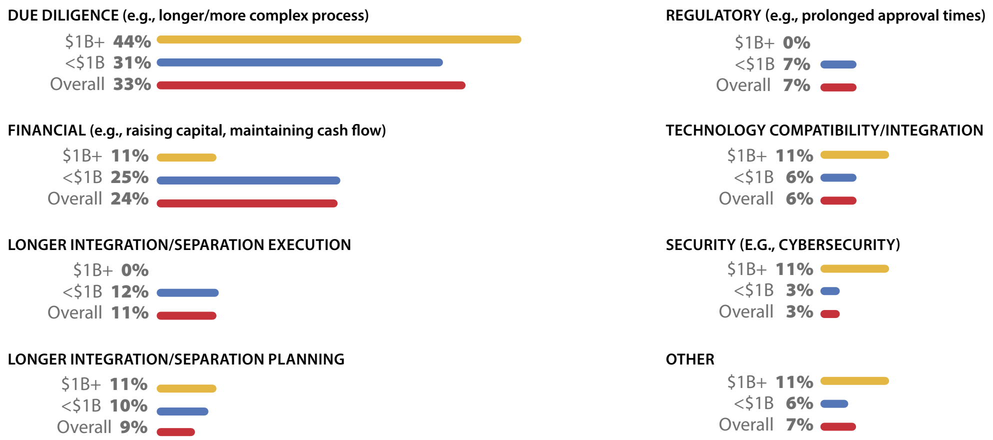


*Respondents were asked to select all that apply.

Company size once again plays an important role in these activities. Smaller companies can be hesitant to consider divestitures—only 7 percent of CEOs in the survey reported considering those transactions over the coming months, compared to 44 percent of large companies—since they don't typically have a lot of flexibility in what to divest. They often have more niche services and are therefore more likely to partner or combine with a complementary entity in order to achieve the right portfolio balance, diversify their market risk and support sales distribution.

Similarly, smaller enterprises are more often the target of a deal, whereas larger organizations pursue acquisitions. Mergers of sizable equals are rare, as they are typically global and transformational in nature, which magnifies the complexity as the NewCo works to rid itself of old-fashioned products and supply chains for new and differentiated digital capabilities.

What do you believe is your company's biggest challenge in successfully executing a deal in today's Covid-19 environment?



Regardless of size, there is no doubt that the Covid environment has placed additional burdens on the deal-making process. Overall, fully one third of the companies surveyed say due diligence is their biggest challenge in executing a deal successfully in today's environment—and the top challenge across all companies, large or small.

Accelerating and Enhancing Due Diligence

❶ Invest in strategic planning upfront to identify M&A targets and/or divestment areas for potential rapid deployment.

❷ Build a trusted M&A advisory team with the right industry, operational and technology knowledge to be engaged at the earliest stages of M&A exploration.

❸ Establish risk thresholds to address unknowns. Managing risk is a part of evaluating every M&A opportunity, especially when acquiring cutting-edge technologies or entering new markets. Defining likely risks and rapidly testing 'Go-No Go' tolerances will accelerate decision-making, ensuring the company is not out-flanked by more nimble competitors.

❹ Give the CIO a starring role. Business and supporting systems are no longer separate considerations. IT cannot make an M&A deal, but it certainly can break one. Engaged early, the CIO can drive the design of the target operating model by quickly assessing compatibility, identifying pitfalls and deal breakers, and determining ongoing operating environment costs.

❺ Formalize your playbook. Every company should have an M&A playbook that scripts the activities for every phase along the M&A lifecycle. A good playbook describes the roles to execute these scripts. For due diligence, pre-defined assessment and analysis frameworks can greatly accelerate the process.

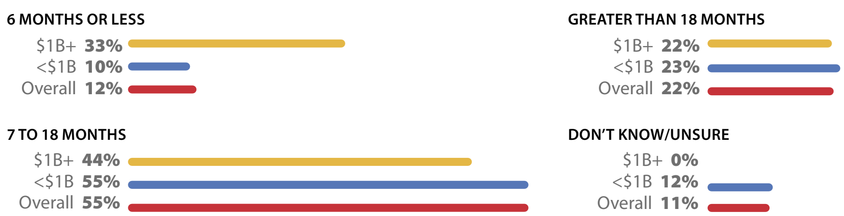
❻ Begin formulating the integration strategy as early as due diligence. Understanding the "secret sauce" from the target's customers' perspective and how it is made is the basis for ensuring none of the key ingredients are lost in the integration. Integration models range from modular to full absorption and can vary based on degree of transformation needed.

The challenges of conducting due diligence virtually were discussed in a recent webinar held in partnership between *Chief Executive* and Tata Consultancy Services: How do companies, particularly those in some of the more distressed industries and those in the earlier stages of a deal, embark on the critical path to discovering and evaluating the assets they are acquiring? Finite resources exist to do due diligence and in a market of valuation uncertainty, expertise and focus are needed more than ever.

Since the dawn of the internet in business, the proportion of intangibles in M&A deals has been rising. Historically, M&A was focused predominantly on evaluating tangible assets. Intangibles, which include talent and digital operations, are more complex to evaluate for quality, robustness and resilience, and it is therefore more difficult to assign a value with certainty.

When evaluating the idea of bringing two entities together, most organizations look at the talent base as a way to create new opportunities for the future. While it is very difficult to assess talent in general, in a normal setting, the virtual world has complicated matters. Management must seek and demand quality data on the target entity's people. Quality data ensures fact-based decision-making, which is more important than ever to determining a fair valuation and setting reasonable synergy expectations.

Based on your experience with past M&A deals, what has been the typical length of time needed by your enterprise to achieve at least 80% of your expected deal synergies?



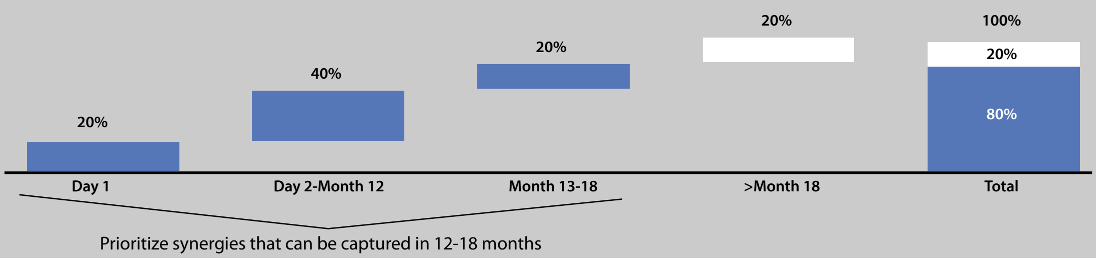
Yet, virtual due diligence can be and is being done—successfully. The lessons learned from the Covid environment must be carried forward to shorten the due diligence process in the future. On average, experts say deals that manage to achieve 80 percent of the intended synergies in less than 18 months are more likely to be successful.[2]

There is an important caveat to recognize, however: that timeline can vary based on the type of synergies sought and where the company is located. For instance, capturing non-IT (e.g., human capital) synergies in America is faster to realize because labor protection laws in the UK and Europe may slow the elimination of talent redundancies. IT synergies typically take longer regardless of location and often involve a lot of cost and capital investment to facilitate the integration. Quality of planning and decision-making, as well as executional precision, drive success in that regard.

Overall, 67 percent of companies participating in the study reported taking less than 18 months to achieve at least 80 percent of expected synergies. Those that exceed that timeline increase the risk of the deal falling short of its intended goal—particularly in today's fast-paced environment.

Companies that understand the speed at which consumer behavior is evolving and the number of disruptions that can bear significant impact on the value of a deal must ensure that the bulk of the synergies are realized as early on as possible.

Recommended Synergy Capture Timing



❶ The Day 1 target should be roughly 20% of aggregate run-rate synergies and will likely be driven primarily by headcount reduction and, to a far lesser extent, by technology infrastructure consolidation and/or transformation.

❷ During the next 12 months, the plan should target an additional 40% of total estimated run-rate synergies, which will likely be comprised by a mixture of people, technology infrastructure and contract-related cost reductions.

❸ During the months 13-18, the plan should target an additional 20% of total estimated run-rate synergies, which will be largely driven by technology application cost reductions.

❹ The magnitude of technology-related savings will be driven by the type of integration selected, with greater synergies often made possible by broad-based, select transformational approaches, such as moving to cloud-based business architectures.

❺ The CIO and team is essential for the outward demonstration of an integrated business, which can be achieved by way of such digital and organizational changes as a unified product catalog, optimized website presentation and harmonized ordering and customer services.

M&A DRIVERS

According to the research, the majority of companies planning a transaction over the coming months say they're either doing so to strengthen their competitive position within current markets (37 percent) or to capture new markets (35 percent).

If you are planning a merger, acquisition or divestiture over the next 6 to 12 months, which of these describe the primary driver?

STRENGTHEN COMPETITIVE POSITION WITHIN CURRENT MARKETS (e.g., expansion in existing sectors or markets))

$1B+	69%
<$1B	33%
Overall	37%

CAPTURE NEW MARKETS (e.g., vertical integration or expansion into new sectors or markets)

$1B+	23%
<$1B	36%
Overall	35%

IMPROVE MARGINS (e.g., lower costs through increased economies of scale)

$1B+	0%
<$1B	6%
Overall	6%

GENERATE CAPITAL (e.g., for other strategic investments)

$1B+	8%
<$1B	6%
Overall	6%

ACQUIRE INTELLECTUAL PROPERTY (e.g., R&D or other strategic assets)

$1B+	0%
<$1B	4%
Overall	3%

MARKET IS CHANGING—BETTER TO EXIT THAN TRY AND ADAPT

$1B+	0%
<$1B	3%
Overall	3%

INCREASE DIGITAL MATURITY (e.g., digital technologies, channels, solutions)

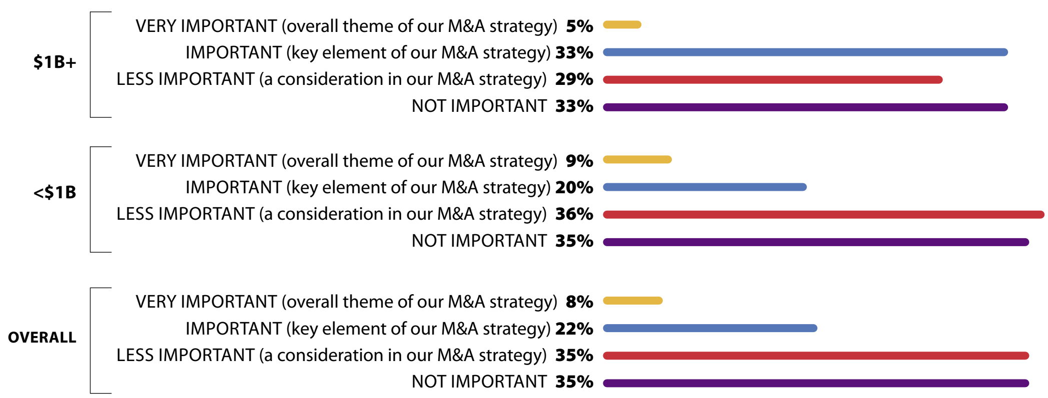
$1B+	0%
<$1B	2%
Overall	2%

OTHER

$1B+	0%
<$1B	9%
Overall	8%

Digital technology, which has been deemed the most critical element to growth in the near term, ranks last on the list of drivers of M&A, and only 30 percent of companies say their upcoming deal is important to the realization of their digital strategy. This finding is very telling of the environment we find ourselves in, where technology is no longer a purely isolated play but rather fully integrated into the strategy and operations. There are now very few deals that can provide that 'quantum leap' advantage or digital capability differentiation that an organization couldn't build, buy or license directly.

How critical is your M&A strategy to the realization of your digital strategy?

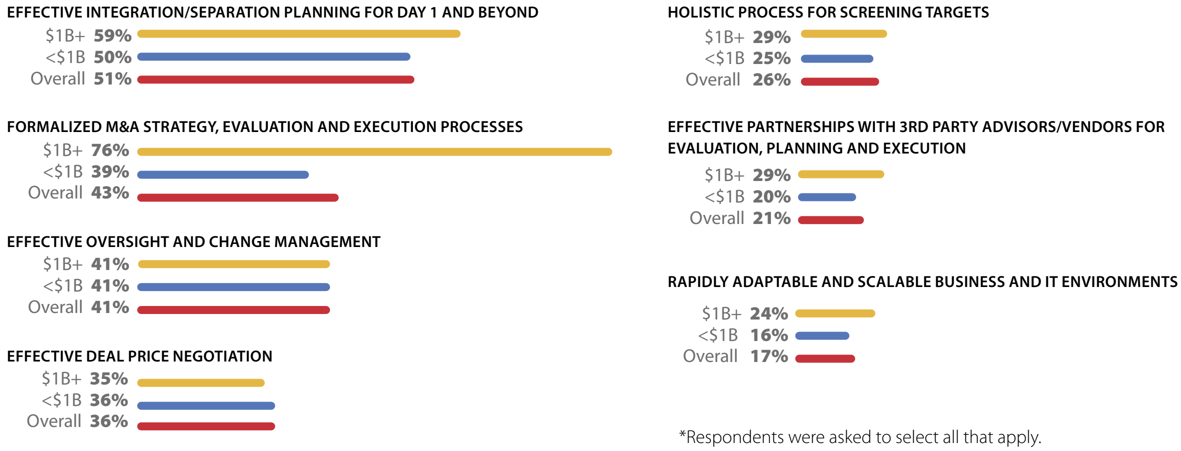


CONCLUSION

Today, nearly every sector is experiencing a surge in M&A activity, as organizations search for bargains to strengthen their market position and expand into new ones. As M&A demand increases, so does the deal price, making bargains harder to find and adding to the pressure to quickly capture the value once the deal is signed.

While good execution planning is imperative, speed and agility continue to be the key differentiators. Ultimately, it's about people. Organizations that are the most successful in navigating M&A's murky waters attribute a large part of their success to effective oversight and change management. Being able to adapt and, ultimately, be resilient in the face of adversity is what will differentiate companies that not only survived the Covid-19 global pandemic but also seized the opportunities it presented to thrive and boost prosperity well into the future.

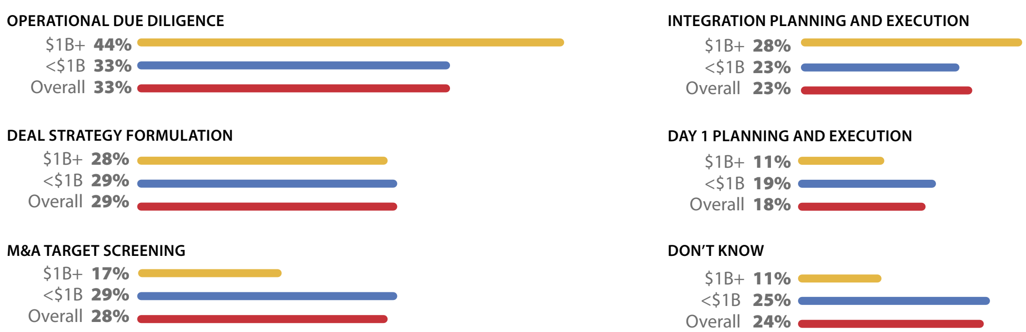
If you have been successful at completing similar deals in the past, to what do you attribute your success?



*Respondents were asked to select all that apply.

In the M&A space, regardless of the environment, strategy and planning are what will deliver the ROI: the strategy sets the goals and synergy expectations, and the planning delivers. Companies would be best served to ensure they first acquire a baseline of knowledge and experience, including benchmarks and repeatable, fact-based frameworks and processes, before taking the leap into deal-making in this new environment.

During which phase of the M&A lifecycle do you believe it is most useful for companies like yours to leverage an M&A consulting or systems integration partner?



*Respondents were asked to select all that apply.

Footnotes:

(1) https://www.fool.com/earnings/call-transcripts/2020/07/22/thermo-fisher-scientific-inc-tmo-q2-2020-earnings.aspx

(2) https://www.tcs.com/content/dam/tcs/pdf/Platform/new-strategies-tackle/cfo-tcs-white-paper-updated.pdf

DEMOGRAPHICS

TITLE/ROLE

CEO	49%
President	28%
Chair	7%
Owner	6%
Founder	5%
Managing Partner	1%

ANNUAL REVENUES

$1 Billion +	6%
$500 Million to $999.9 Million	3%
$250 Million to $499.9 Million	4%
$100 Million to $249.9 Million	14%
$50 Million to $99.9 Million	15%
$25 Million to $49.9 Million	10%
$10 Million to $24.9 Million	18%
$5 Million to $9.9 Million	13%
<$5 Million	17%

INDUSTRY

Manufacturing (Industrial Goods)	23%
Professional Services (Legal, Consulting, Accounting, Architecture)	11%
High Tech/Telecommunications/ Information Technology	10%
Other	9%
Financial Services (Banking, Insurance, Brokerage, Investments)	7%
Manufacturing (Consumer Goods)	6%
Wholesale/Distribution	6%
Construction/Engineering/Mining	6%
Health Care (Providers and Payers)	5%
Advertising/Marketing/PR/ Media/Entertainment	4%
Transportation (Airlines, Trucking, Rail, Shipping, Logistics)	3%
Government and Non-Profit	3%
Energy/Utility	2%
Retail Trade	2%
Pharmaceuticals & Medical Products	2%
Real Estate	1%
Travel and Leisure	1%

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