DFIN | Mergermarket
An Acuris company

WHITE PAPER | VENUE DEAL SOLUTIONS

Navigating the Modern Deal Process: Negotiating

DFINsolutions.com

METHODOLOGY

Mergermarket surveyed 50 senior global executives to learn about their strategy and views regarding sell-side M&A negotiation. Respondents were split geographically across North America (33%), EMEA (33 percent), and Asia-Pacific (33 percent), as well as divided among financial advisors (67 percent) and private equity executives (33 percent).

Introduction

Some 44 percent of respondents say that one of the top two difficulties in sell-side negotiation is structuring the deal legally and financially.

Negotiation is often referred to as an "art form." And indeed, there are elements of the process that are based on intuition, emotion and practice. However, there are also aspects of negotiation in sell-side M&A that could be considered scientific. If you study this process in the context of the current business environment and specific geographies and sectors, a wealth of useful insight can be gained.

Negotiation in China, for instance, is often a long-term endeavor in which a relationship is built gradually. This contrasts with the more common approach in the West, which is to negotiate a deal in a relatively short period of time. Or take a specific sector, such as industrials and chemicals. Environmental regulations are becoming an increasingly important consideration, and therefore have become a key part of negotiating the terms of an M&A deal.

Across geographies and business types, there are also issues relevant to nearly all M&A negotiations. Difficulties related to due diligence frequently occur in the process, especially when dealing with private equity (PE) buyers and founder-owned businesses. The timing of a sale can play a critical role in creating leverage for a seller — or, even more so, for a company going public.

In the second part of our three-part series, Navigating the Modern Deal Process, we interviewed global dealmakers to better understand the challenges sellers face when negotiating M&A deals. Our survey participants identified a number of issues both in broad categories of transactions and in their specific areas of practice and expertise.

KEY FINDINGS FROM THE SURVEY INCLUDE:

- **Deal structure is key.** Some 44 percent of respondents say that one of the top two difficulties in sell-side negotiation is structuring the deal legally and financially, underlining the delicate nature of these technical aspects of the process.
- **Geography is an important consideration for dealmakers.** Some 40 percent of survey participants say there are specific aspects of the country or region where they work that affect negotiation in sell-side M&A.
- **Technology is changing the negotiation process.** On average, respondents say 60 percent of M&A negotiation currently takes place in person while 40 percent is done electronically — a significant shift in the landscapein recent years.
- **Timing is crucial for investors.** In an IPO, 56 percent of respondents say that one of the top two difficulties in a roadshow is convincing investors that the timing is right for the offering.

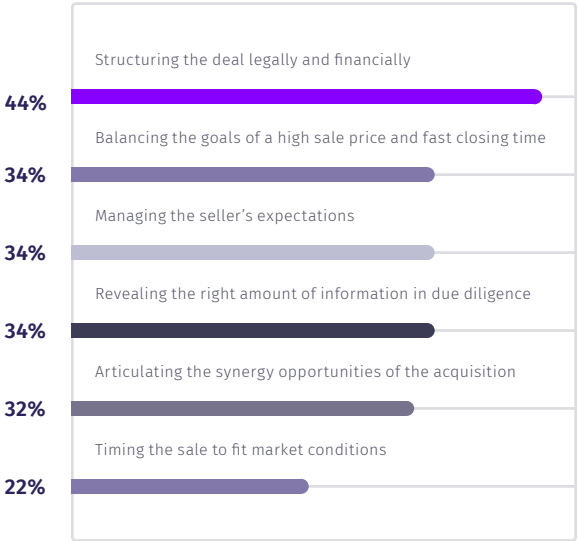
PART ONE:

Global strategy, local tactics

Challenges of sell-side negotiations

When it comes to identifying the biggest overall challenges of sell-side M&A negotiation, the largest proportion of respondents singled out one issue, in particular: structuring a deal legally and financially. Forty-four percent named this among the top two difficulties they face when selling a company. A roughly equal share of respondents (32-34%) named four other challenges as being significant, including managing the seller's expectations and revealing the right amount of information in due diligence. This indicates that these issues are all roughly equivalent in importance.

What are the biggest overall challenges of sell-side negotiation currently? (Select top two)



Negotiating the financial structure of a deal in today's market is littered with uncertainty. Changing market conditions, weak stock markets, and shareholder demands must all be navigated — and all in a timely fashion. Similarly, the legal considerations of a deal have become a minefield of their own, with ever-changing regulations and uncertainty in the US around proposed tax and healthcare reform.

"Business environments have become a lot more difficult to navigate, and for this reason it becomes very important to carefully develop the sell-side negotiation process and structure the deal legally and financially," says a managing director at an investment bank in Japan. "If this is not done right, it can put both the buyers and the sellers at risk from regulatory problems. Another part of the sell-side negotiation that has become a challenge is divulging the correct information in the right amounts to keep risks down for the different parties."

Indeed, respondents agree that while the due diligence process is an important one, the sharing of sensitive information can be problematic for sellers. "Managing these challenges and sharing the correct amount of information to keep buyers interested and still not jeopardize the deal is a delicate task for companies," explains one managing director at an investment bank in the UK. "The timing of a sale is an important aspect of the sell-side process as well, so that risks are minimized and the value gained from the sale is high."

While respondents have worked on deals in a range of sectors over the past three years, a majority have focused on technology, media and telecoms (TMT), and industrials and chemicals. In the technology industry, concerns specifically related to intellectual property (IP), cybersecurity and IT infrastructure often shape the nature of negotiations. In the industrials sector, however, difficulties are more likely to arise sell-side when negotiating accounting standards.

"Companies from the energy, mining and utilities and industrial and chemicals sectors are involved in a lot of M&A deals, and the biggest problem that we face in these sectors are inconsistent balance sheets and accounting problems. The regulations related to accounting are not always strict and this is a major challenge when trying to execute deals," says a managing director at a PE firm in Singapore.

In which sectors have you worked the most on the sell-side over the past three years? (Select top two)

54%	**Technology, media & telecoms**
44%	**Industrials & chemicals**
26%	**Financial services**
24%	**Consumer**
22%	**Energy, mining & utilities**
14%	**Pharma, medical & biotech**
8%	**Real estate**
2%	**Transport**

Sell-side negotiations are facing challenges as companies increasingly look to invest abroad. This presents hurdles in the form of regulatory differences, cultural and language barriers, and taxation considerations. Add to this list the ever-present threat of cyberattacks and the sell-side position in a deal has never been more difficult to navigate.

"IP is becoming a major issue in the sell-side process in TMT. Finding the right prices and managing data protection regulations in different markets, along with cybersecurity regulations, is also a crucial issue that affects the negotiation process and creates hurdles for both the teams," says a managing director at an investment bank in India. "Developing the right portfolio to bring about the price expected by sellers has become difficult because of differences in regulations and the minute complexities in IP, cybersecurity, and other market regulations that make business operations difficult. Tax differences also play an important part in dealmaking and the negotiation process."

Just under two-thirds of respondents (60 percent) say that sales to strategic competitors typically provide a better negotiating position than sales to private equity buyers. When selling to a strategic buyer, respondents explain that the company often has greater leeway when it comes to valuation, but that the involvement of shareholders can hold up the closing of a deal. In the case of PE firms, fierce competition for assets can drive up the sale price, but the bidders often demand more information in due diligence.

"From our experience, it is easier to sell to a strategic competitor in markets where growth exists," says a managing partner from a PE firm in UAE.

In the US, there was $1.7 trillion worth of M&A deals for corporate strategic buyers in 2016 — representing 80 percent of total M&A deal value. As corporate cash reserves reached a 10-year high and stock prices also soared, strategic buyers were winning more deals over their PE counterparts.

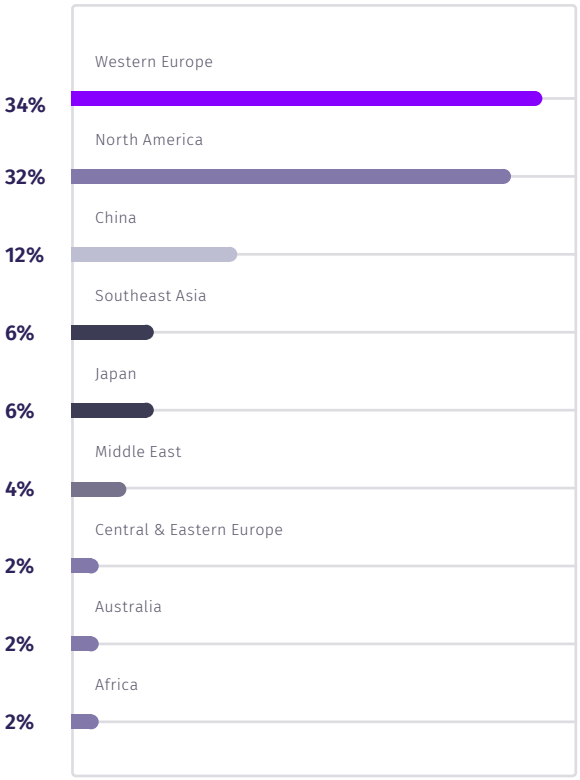
In your experience, in which types of sale processes do sellers typically have the better negotiating position?

40% **Sale to a private equity firm**

60% **Sale to a strategic competitor**

What are the biggest challenges when it comes to negotiating the sale of an asset to a private equity firm? (Select top two)

In which country or region have you worked the most on the sell-side over the past three years? (Select one)



A managing director at an investment bank in Canada explains the difficulties in doing business with PE buyers over their strategic counterparts: "Getting the team members of the PE firm and the seller to carry out discussions amiably is difficult. A difference in business approach and work ethic has affected deals in the past. Structuring deals legally is a very important aspect of the deal, which becomes difficult because of PE companies and their process, which can delay the completion of a sale."

Our respondents work across various regions on the sell-side, with a majority having spent the most time in Western Europe (34 percent) and North America (32 percent). Interestingly, just 40 percent say that specific aspects of the culture in the region or country where they work has an effect on negotiation. This may be a reflection of the increasingly globalized business environment, which has led to more standardized practices across borders.

However, a more globalized business environment doesn't necessarily mean it's an easier business environment. Companies in the Asia-Pacific region, in particular, often require a different approach than buyers in other regions, respondents noted. For example, one managing director of an investment bank in Hong Kong lends some insight: "Chinese businesses are very particular about their priorities. Also in China, even now, importance and recognition is given to face-to-face meetings and discussion on negotiations."

Are there specific aspects of the culture in that country or region that typically affect sell-side negotiating?

40% **Yes**

60% **No**

A managing director at an investment bank in Japan explains further: "Japanese executives are always focused on long-term business relationships with a stable and trustworthy outlook. Japanese companies are more interested in preserving group harmony and ensuring as broad a consensus as possible than trying to reach a deal quickly."

A little more than half of survey respondents (54 percent) indicated that selling to a domestic buyer provides a superior negotiating position when compared to selling to an international company. And indeed, this is due in part to the many challenges presented by cross-border M&A deals. Our respondents cite cultural and language differences (68 percent) and legal and regulatory issues (60 percent) as roadblocks to selling assets abroad.

In Q2 2017, cross-border M&A deals accounted for almost half (47 percent) of global deal value and more than a third (36 percent) of deal volume — signaling that this particular challenge is unlikely to disappear any
time soon.

"Selling to an international buyer increases the value the company can get from the deal," says a managing director at a PE firm in France. "The difference in currency rates also plays an important part in negotiating for a higher value."

A managing director at a US investment bank agrees: "The differences in cultures, working styles and language barriers is a major problem. If they are not managed properly, it can lead to miscommunication and affect the value of the deal or stall the cross-border sale. Differences in regulations can also severely increase prices and lead to complications in the deal process."

Technology is rapidly changing the modern deal process, including the negotiation phase, as our survey respondents noted. On average, they said that just 60 percent of negotiations still take place in person, while the remaining 40 percent of the talks are carried out electronically. The increasing sophistication of electronic communications is allowing dealmakers to cut back on face-to-face meetings in favor of digital exchanges.

Despite the majority of respondents agreeing that face-to-face negotiations are preferred, the use of technologies in negotiations is becoming the norm — making the process quicker and more efficient — particularly when it comes to larger-scale deals.

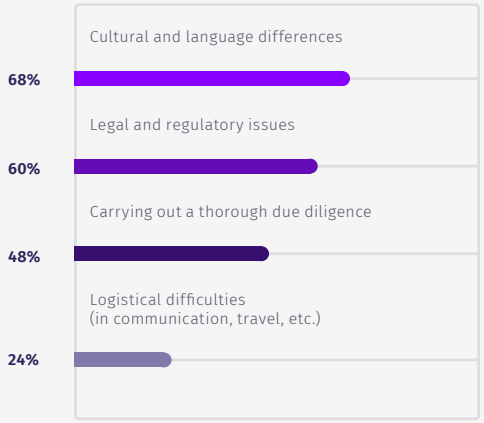
"We try our best to get parties to meet in person, but we are slowly beginning to carry out negotiations using technology," says a managing director at an investment bank in Germany. "Because of the scale and change in the nature of deals, it is very difficult getting teams to meet with each other during the negotiation process. It is costly managing transportation, and by using video conferences we can achieve the same results for a much lower cost."

In your experience, in which types of sale processes do sellers typically have the better negotiating position? (Select one in each category)

54% **Sale to a domestic buyer**

46% **Sale to an international buyer**

What are the biggest challenges in negotiating a cross-border sale? (Select top two)



Respondents also suggest that in cross-border deals in particular, there can be cultural reasons for pursuing more in-person negotiations than using technology. Many of the Asia-Pacific countries, for example, place more weight on in-person dealings. "Chinese businesses are very particular about their priorities. Also in China, even now, importance and recognition is given to face-to-face meetings and discussion on negotiations," explains a managing director of an investment bank in Hong Kong.

A founder-owned business has its own unique issues on the sell-side of deal negotiations, our respondents explain. The most-cited challenge was being able to provide bidders with enough business metrics to satisfy them during due diligence, which was noted by 48 percent of interviewees. Startups and other companies that are run by their founders have often not maintained strict books, which can present enormous challenges during a sell-side process. More broadly, a founder's overall lack of M&A experience is one of the biggest issues for 42 percentof our interviewed dealmakers.

"Founder-owned businesses do not calculate all aspects of the company, focusing instead on just a few metrics to gauge performance," says a managing director at an investment bank in Bahrain. "This becomes a problem when approaching a large-scale company, because they focus on a number of measures before considering an acquisition. The lack of metrics and necessary reports becomes an issue in the negotiation process. Establishing a rapport between the two teams is also a very complicated process because of a difference in cultures and opinions on how to run a company."

In the current digital era, how much of the deal negotiation process would you say is done in person vs. electronically? (Select percentages for each that add up to 100 percent)

60% **In person**

40% **Electronically**

What are the biggest challenges in negotiating a cross-border sale? (Select top two)

48% **Providing enough business metrics to satisfy buyers in due diligence**

42% **Coping with seller's lack of M&A experience**

40% **Negotiating the terms of an earn-out**

36% **Managing the seller's valuation expectations**

36% **Establishing a positive relationship between the seller and buyer**

Sell-side M&A stories from the trenches

Dealmakers share negotiation experiences

Deal negotiations can be rife with all manner of unexpected challenges. The respondents to our survey have named seller expectations, revealing the right amount of information in due diligence, and structuring a deal legally and financially as the greatest hurdles to overcome when executing deal negotiations. However, their extensive comments reveal that current market uncertainty and a changing regulatory environment are also creating challenges to negotiation efforts during the deal process.

Do your research

"It is all about the experience and knowledge you have about the market and how well you have done the due diligence. In one of our deals in a foreign market, because of our lack of knowledge and poor due diligence, we faced a tough time negotiating and eventually had to settle for an unexpected and unsatisfactory deal value."
— Managing director at a PE firm in China

Due diligence abroad

"Being based in different markets does not allow for a very smooth due diligence and the sharing of information becomes very difficult. Any miscommunication of information can cause problems for the teams and can lead to a fallout in the deal process."
— Managing partner at a PE firm in France

Beware the overshare

"Sharing information during due diligence is important, but the oversharing of information can lead to several problems. It can put the company at harm and affect the growth of the company in case the deal doesn't take place. Keeping information is also important to avoid a sabotage from a competitor."
— Managing director at a China-based PE firm

Mind the expectation gap

"A recent sell-side negotiation for a food delivery services firm was not an easy one. The buyer, a major Chinese food services company, wanted to acquire a controlling stake in our client's firm, and working out the terms and conditions was difficult because our client did not want to change their existing technological infrastructure. Our buyers were keen on making changes, however. There were also a few regulatory issues and synergistic problems that arose in the dealmaking process."
— Managing director of an investment bank in China

Dealing in times of recovery

"Because of the economic slowdown that took place two years ago, the market was growing at a very slow pace and this increased the challenges for companies trying to execute a deal, because targeting buyers was difficult. The seller wanted a certain price, but because of market conditions, it was problematic getting a buyer."
— Managing director of an investment bank in Canada

Battling against Brexit

"We represented the shareholders of a UK-based recruiting company in the sale of two of its subsidiaries to Ireland's largest recruitment agency, and this was a very difficult deal to undertake because of the uncertainty in the UK market. Getting our represented companies the prices they sought was the most difficult part because buyers took advantage of the problems in the market and tried to reduce the price of the deal significantly."
— Managing partner at an investment bank in New Zealand

Regulatory roadblocks

"Environmental regulations were a major challenge for us to deal with — making changes to our investment strategy to make sure we could reduce issues to help us get an edge in the negotiation process was a very difficult process. Risks related to new regulations, like the Solvency II regulations, also affected our sell-side negotiation process. They were used against us when we tried to carry out a sale and we had to reword our company's business operations to reduce their threat to our returns."
— Managing director at an investment bank in Australia

Learn to adapt

"We represented in a deal during which the sale of businesses faced problems because of regulatory challenges. The strategies we used were pulled up by regulatory bodies that felt we overpriced the company we were selling. Overcoming this was difficult because it halted the deal process and affected the value of our company."
— Managing director at an investment bank in the UK

IPO instability

"Advising a major Australian bank to demerge and merge with another company to help bring about growth during an IPO was an extremely difficult task. The changes in market conditions and internal problems, along with the fear of changes in regulations, made this a very difficult deal to carry out."
— Managing director of an investment bank in Australia

Changing rules in China

"We assisted a few companies in Mainland China in a few sell-side negotiations, and the process was difficult because of strict government rules and regulatory hassles. Getting access to the documents and information we needed was difficult and our customers were not very prepared to carry out a divestment, putting our company under pressure."
— Managing director of an investment bank in Australia

Ensure the price is right

"Convincing investors about the timing for an IPO is not easy, since providing data that support the premise as to when would be the right time to carry out an IPO is necessary. Another important aspect would be setting an initial share price, as a share price needs to be established to help bring about a successful IPO."
— Managing partner at an investment bank in New Zealand

Know your buyer

"We took our time in a deal two years back. It was difficult convincing buyers to acquire a target because we did not understand the reason for their purchase. We did not understand if they wanted to diversify or expand, and negotiating the deal process became difficult to manage because of this."
— Managing director at an investment bank in the US

> "Sharing information during due diligence is important, but the oversharing of information can lead to several problems."
>
> **MANAGING DIRECTOR, CHINA-BASED PE FIRM**

PART TWO:

Reading your buyer

Know what you're negotiating for

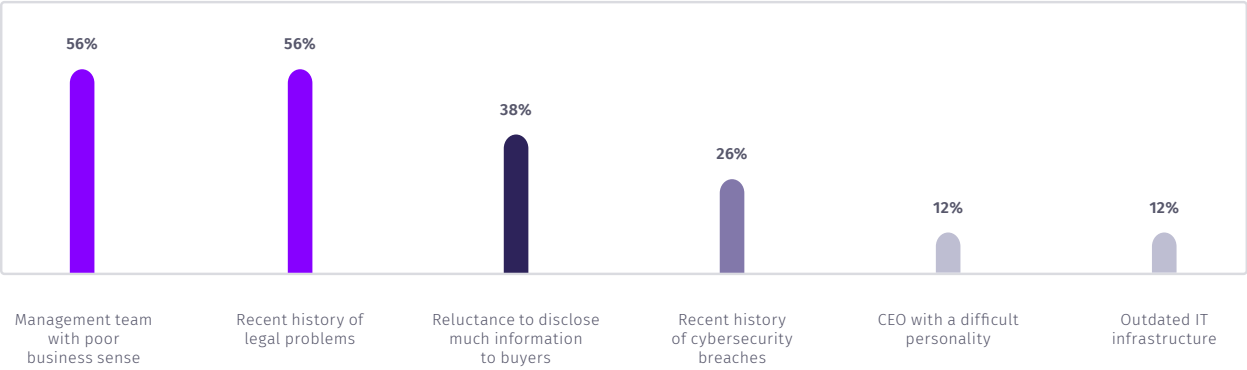
Two negative attributes of sellers stand out for our respondents as particular challenges to overcome: a management team with poor business sense (cited by 56 percent in our survey) and a recent history of legal problems (also cited by 56 percent of respondents). A poorly informed management team is often a red flag for potential bidders, indicating that the buyer would be unlikely to keep the team after the deal is done. It may also indicate that more systemic problems are present at the company. When it comes to legal issues, this kind of history can create liabilities that remain unknown until after a deal would close. The resulting risk is unacceptable for many buyers.

"It is very tough trying to negotiate a deal on behalf of a company that has a management team with poor business sense," says a managing director at an investment bank in the US. "Explaining past decisions and the strategies used by the company to attract buyers affects the value of the company, and problems arise when working with these teams. Their lack of understanding about how the market should work can delay the deal."

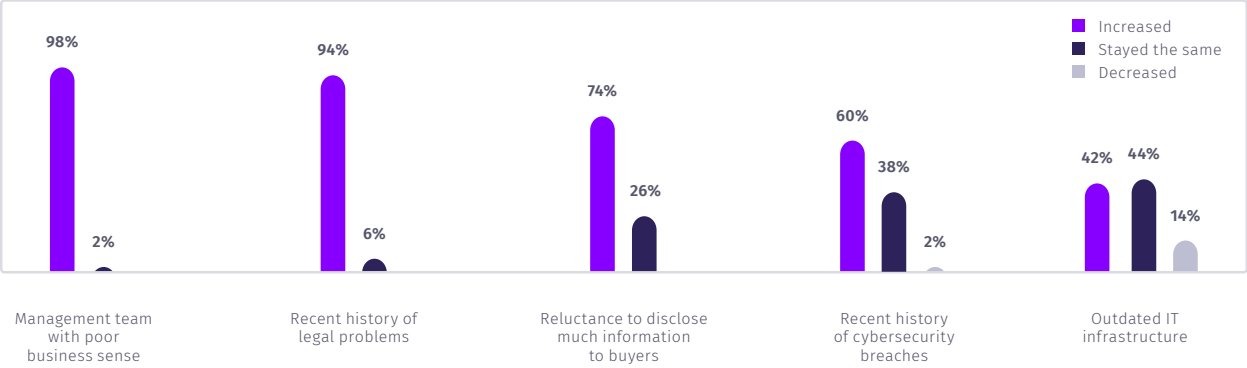
While buying a company with a history of legal problems can give the buyer an upper hand in terms of price negotiations, it will also make the deal riskier, potentially delaying completion or leading to a cancelled deal.

Buyers' motivations play a key role in how sellers position their companies in an M&A deal. A majority of our respondent pool says that three key motivators have increased in particular over the last three years: the drive to increase innovation (98 percent); opportunistic acquiring basedon market dynamics (94 percent); and pressure to putcash to use (74 percent). Respondents had diverse opinions regarding the effect of these changes on the sell-side process, however.

What are the biggest challenges in negotiating a cross-border sale? (Select top two)



Which of the following negative attributes of a seller are most difficult to manage when it comes to negotiating a deal? (Select top two)



Some say they have been able to adapt well to the new environment, while others argue that the changes have made the sell-side process much more difficult.

"We have access to a lot of information that allows us to assess the changes that drive companies, and because of this we were not negatively affected by any changes in buyers' motivations. In fact, we used the changes in motivations to make our negotiation stances better and develop a strong and effective manner of dealing with buyers," explains the managing director at an investment bank in the US.

Another US-based investment bank manager explains that in the case of their particular situation, changes to the sell-side environment have not been seen in a positive light. "They did affect us negatively because dealing with these changes is a very complicated process. Understanding the needs of buyers is

simple, but developing the right strategies to deal with them is not simple. The lack of effective plans can stall the negotiation process, and getting the amounts expected by sellers becomes difficult."

It is a classic sell-side M&A technique to play two rival bidders against each other in pursuit of a higher valuation or a faster close. Yet less than a third of our respondents (30 percent) say they have used the tactic in a negotiation. However, among the group that has used the technique, eight in 10 say it was effective — demonstrating, perhaps, that others in our respondent pool should consider adding it to their negotiation toolbox.

"We are extremely competitive, and in a few of our deals, we did play different bidders against one another to help us get a better price from the deal," explains a managing director of an investment bank in Australia. "It was required to allow us to increase the amounts from the deal and to help us achieve higher returns. We achieved what we set out to because the deal was a good one, and the market was very competitive, giving us an opportunity to carry out this strategy."

For those who did not employ this competitive technique, some cited ethical reasons for their hesitance, believing it was not a fair way to do business. One managing director at a PE firm in the US says: "We do not feel this is ethical and it goes against our company's principles. We use other strategies to help us in the sell-side negotiation but do not play two or more rivals because it is a very difficult strategy that can backfire if not handled carefully."

Others say they felt it required a certain amount of juggling and could result in losing both buyers if not managed carefully.

IPO roadshows present unique challenges to the bookrunner for a company seeking investment. The two issues cited by most survey participants are convincing investors that the timing is right for the public offering (56 percent) and settling on the right initial share price (54 percent).

"Taking a company to an IPO is a very risky process that can damage a company's value," says a managing director at an investment bank in China. "So, getting the right initial price for a deal is an important part of the IPO — it helps attract buyers and investors. Having enough information that will interest investors is also an important aspect of the dealmaking process, so that buyers will take interest in the IPO and will assure companies of the sums expected by them when carrying out an initial offering."

Have you ever played two or more rival bidders against each other in a sell-side negotiation?

70% **Yes**

30% **No**

If yes, would you say the strategy was effective?

80% **Yes**

20% **No**

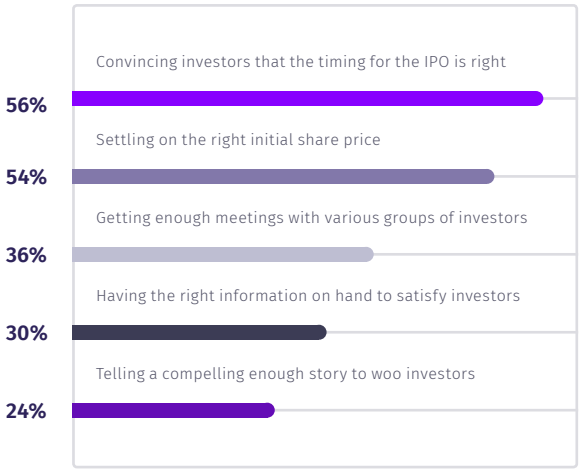
A managing partner at a PE firm in the US explains that the initial share price offer can make or break the deal: "If it is too high, companies will not raise the amounts required by them. We also need to make sure our IPO story is compelling enough to attract investors to put capital in the company, to successfully raise the amount required by the company."

The advantages of M&A over IPOs in the current market environment have been clearly illustrated by our respondents. Nearly eight in ten respondents (78 percent) say that conducting an IPO is more challenging at present than selling a company in an M&A deal, while 8 percent said it depends completely on the nature of the company being represented.

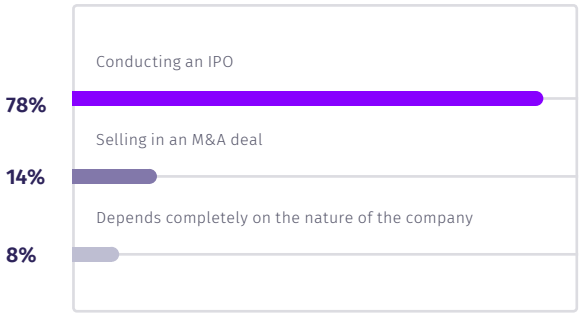
One such respondent, a managing director of an investment bank in Malaysia, says: "It depends entirely on the company and the market it is based in. Looking at the market conditions and the number of buyers as well as the risks involved, companies will have to make the call. In our view, buyers are negotiating hard and stock markets are underperforming at the moment. Formulating the right strategy is an important step for a company, but it is best left to the company to understand which strategy suits them best."

This comes during a year that was predicted to see a return to a high volume of IPO activity. However, the market has seen recent IPOs such as Snap and Blue Apron floundering after strong open trades. These examples will cause other companies considering an IPO in today's market to act with more caution, making our respondents' comments unsurprising.

When taking a company public, what are the most challenging aspects of marketing the company on an IPO roadshow? (Select top two)



Which would you say is more challenging in the current environment: conducting an IPO or selling a company in an M&A deal?



Conclusion

In this second part of our three-part series Navigating the Modern Deal Process, global dealmakers have indicated that they believe that we remain in a challenging market environment for doing deals. When trying to negotiate a deal in this climate, deal structure, price, seller expectations and information provided during the due diligence process are causing the most hurdles for dealmakers.

We can expect to see fewer cross-border deals, which are considered more difficult than domestic deals, particularly with the changing nature of laws and regulations in the current political climate. Respondents also agreed that selling to a domestic buyer provides a superior negotiating position when compared to selling to an international company.

The main motivations behind today's M&A drive are the desire to increase innovation and opportunism, depending on market dynamics. So, while market uncertainty and instability are causing increased challenges to some part of the negotiation process, in others it is attracting a new type of buyer.

Once the tasks of deciding to sell and finding a buyer have been achieved, the greatest challenge that our dealmakers face when approaching the negotiating table is how to best structure the deal legally and financially. And while in-person negotiations are preferred over electronic channels, the speed and efficiency of using digital channels is winning over respondents, with some 40 percent saying they have incorporated this medium into the negotiation process.

As was true for targeting, timing remains a challenging aspect of negotiating the terms for an IPO. In fact, respondents say getting the timing right is the most difficult part of preparing for — and convincing investors of — executing an IPO.

Today's geopolitical and regulatory climate is giving dealmakers more considerations than before when approaching the negotiating table. While the use of technology is helping to speed up the process for some, others are skeptical, deferring to face-to-face meetings. And with cross-border deals further complicating matters due to different cultural norms, negotiating the deal has truly become an art form, and a critical part of the modern deal process.

Mergermarket
An Acuris company

Mergermarket is an unparalleled, independent mergers and acquisitions (M&A) proprietary intelligence tool. Unlike any other service of its kind, Mergermarket provides a complete overview of the M&A market by offering both a forward looking intelligence database and a historical deals database, achieving real revenues for Mergermarket clients.

Acuris Studios

Acuris Studios, the events and publications arm of Acuris, offers a range of publishing, research and events services that enable clients to enhance their brand profile, and to develop new business opportunities with their target audience.

To find out more, please visit **www.acuris.com/publications**

About Donnelley Financial Solutions (DFIN)

DFIN is a leading global risk and compliance company.

We're here to help you make smarter decisions with insightful technology, industry expertise and data insights at every stage of your business and investment lifecycles.

As markets fluctuate, regulations evolve and technology advances, we're there. And through it all, we deliver confidence with the right solutions in moments that matter.

Learn about DFIN's end-to-end risk and compliance solutions.

Visit **DFIN**solutions.com | Call us **+1 800 823 5304**