

The 17th Annual Southeastern M&A/Private Equity Forum

Proceed with Caution: Due Diligence Considerations in the Current Environment

Moderator



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PRESENTATION AGENDA

- 1 Financial Diligence
- 2 Supply Chain Interruptions
- 3 Insurance/ RWI
- 4 Technology, Cyber & Data Privacy Concerns
- 5 Environmental, Social & Governance
- 6 Questions

FINANCIAL DILIGENCE

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- Same attention to financial diligence as a result of COVID-19, but certainly modifications and adaptations have occurred in the process
- As a result of the pandemic, an in-depth analysis is required to understand the direct impact on businesses and what line items should be normalized to make them comparable to historical periods and estimate projections



- COVID Adjustments
 - Businesses have tried to isolate the impacts of COVID-19
 - Are they recurring or non-recurring revenue and expenses?
 - Has the target company benefited from changes in its primary markets and customer behavior?
 - Is the increase in revenue a repeatable cash flow?
 - Are there any remaining PPP Loan or CARES Act considerations left on the books?

FINANCIAL DILIGENCE

- What can businesses do to protect themselves?
 - Dynamic financial scenarios
 - A range of 'what if' scenario capabilities using advanced inputs such as real-time market intelligence and transaction-level data, tailored to each aspect of the value chain

What if the target loses a key customer?

What if the cost of underlying commodities change?

Can the company boost share in a segment by re-allocating marketing spend? How much would be needed?

Which element of working capital is most flexible?

What does our cash flow forecast look like? What if the company changes channel or product mix?

What are the opportunities to grow revenue in a down market in this industry? What would enable that?

FINANCIAL DILIGENCE

- Shifts in Technology & Timelines
 - “In Person” versus “Remote” financial and business diligence
 - Management meetings
 - Employee evaluations
 - Facilities review
 - Third party advisors and vendors
 - Quality of Earnings
 - Legal
 - Insurance/ RWI
 - Regulatory processes
 - Hart-Scott-Rodino filing and review
 - CFIUS filings
 - Corporate filings

SUPPLY CHAIN INTERRUPTIONS

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- Material Adverse Effect, Force Majeure, Default Triggering Provisions
 - The pandemic has affected the ability of many contracting parties to perform their obligations. Diligence will need to identify where this has already triggered an event of default or where there are indications that a future breach is likely
 - Need to understand whether the target can invoke such provisions if it wished to and, on the flip side, the impact on the business if a counterparty was entitled to remedies for delays
- Looking Forward
 - When negotiating acquisition agreements, parties should consider specific carve-outs for COVID-19 and similar situations
 - Given the current supply chain challenges, it is expected that companies will retain higher inventory in the future to avoid stock outs as well as re-strategize to source or manufacture raw materials locally
 - However, increased production in certain areas of the supply chain may lead to supply chain issues in other areas

INSURANCE/ RWI

INSURANCE/ RWI

- Representations and warranties insurance has become an increasingly important aspect of M&A deals in recent years
 - Accelerates the deal
 - RWI takes a contentious piece between the buyer and seller and makes it a little smoother, the parties can focus on the deal side—the bigger points—and take this equally critical piece and let RWI companies moderate it
 - Higher costs
 - High M&A activity has affected the demand on insurance companies, making it a sellers' market for the providers of RWI products
 - More selective
 - RWI providers have the upper hand and are quicker to decline offering policies if the transaction does not meet their terms and standards

INSURANCE

- Underwriting Process and Timeline
 - Lead time for acquisition agreement review
 - “Back to the future” with respect to diligence memos?
- Current RWI Focus/ Exclusions
 - Issues with employee classification (exempt or non-exempt) and contractor classification (whether individuals are properly classified as employees or independent contractors)
 - Disputes or confusion about the ownership of intellectual property
 - Increasing focus on anti-corruption compliance
 - The use of offshore contractors, creating regulatory compliance problems
 - State and local tax compliance

TECHNOLOGY, CYBER & DATA PRIVACY CONCERNS

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- How has due diligence been impacted by the many companies that had to pivot from in-person to either a fully remote or a largely remote workforce?
 - Far more frequent use of IT, data security and cyber liability specialists, and a specialist firm or consultant in addition to the law firm's IT specialist team
 - For those businesses in retail or that touch customer or third-party data—greater need to review internal compliance policies, procedures, and standard operating procedures
- Rapid Digitalization
 - Stakeholders are adapting to virtual due diligence and deal-closing, forcing buyers and sellers to look at their digital channels and process efficiency
 - Such accelerated digitization indicates the need for a change in technology due diligence
- Technology Diligence
 - In the past, technology diligence was risk focused and looked at data centers, core application lists, and system architecture. Due diligence today must consider how well technology platforms and systems support the company's strategy and enable revenue
 - The back-office diagnosis will still be important, but sophisticated buyers will want to understand a business's broader digital strategy—seeing greater use of specialist firm or consultant in addition to the law firm's IT specialist team

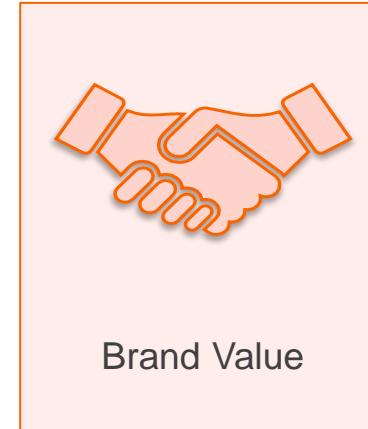
TECHNOLOGY, CYBER & DATA PRIVACY CONCERNS

- Cyber Concerns and Insurance
 - Many traditional RWI specifically exclude cyber security liability
 - Buyer's increased focus on cyber liability insurance—both in terms of reviewing adequacy of existing target company coverage and any history of claims or breaches
- Data Privacy Concerns
 - Virtual Data Room Market size to grow from USD 1.6 billion in 2021 to USD 3.2 billion by 2026
 - Secure virtual data rooms and document sharing technology is available and must be utilized by all parties during and after the M&A process, to keep important and sensitive information safe
- Increased use of background checks among key employees

ENVIRONMENTAL, SOCIAL & GOVERNANCE

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- Recent years have shown a commitment to integrating ESG information into a company's M&A target selection process
- Focusing on profits alone is no longer enough. All companies' KPIs should capture the value created for all stakeholders – including traditional measures like revenue and costs, but also brand value, diversity and inclusion, community impact, sustainability and other measures



QUESTIONS

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