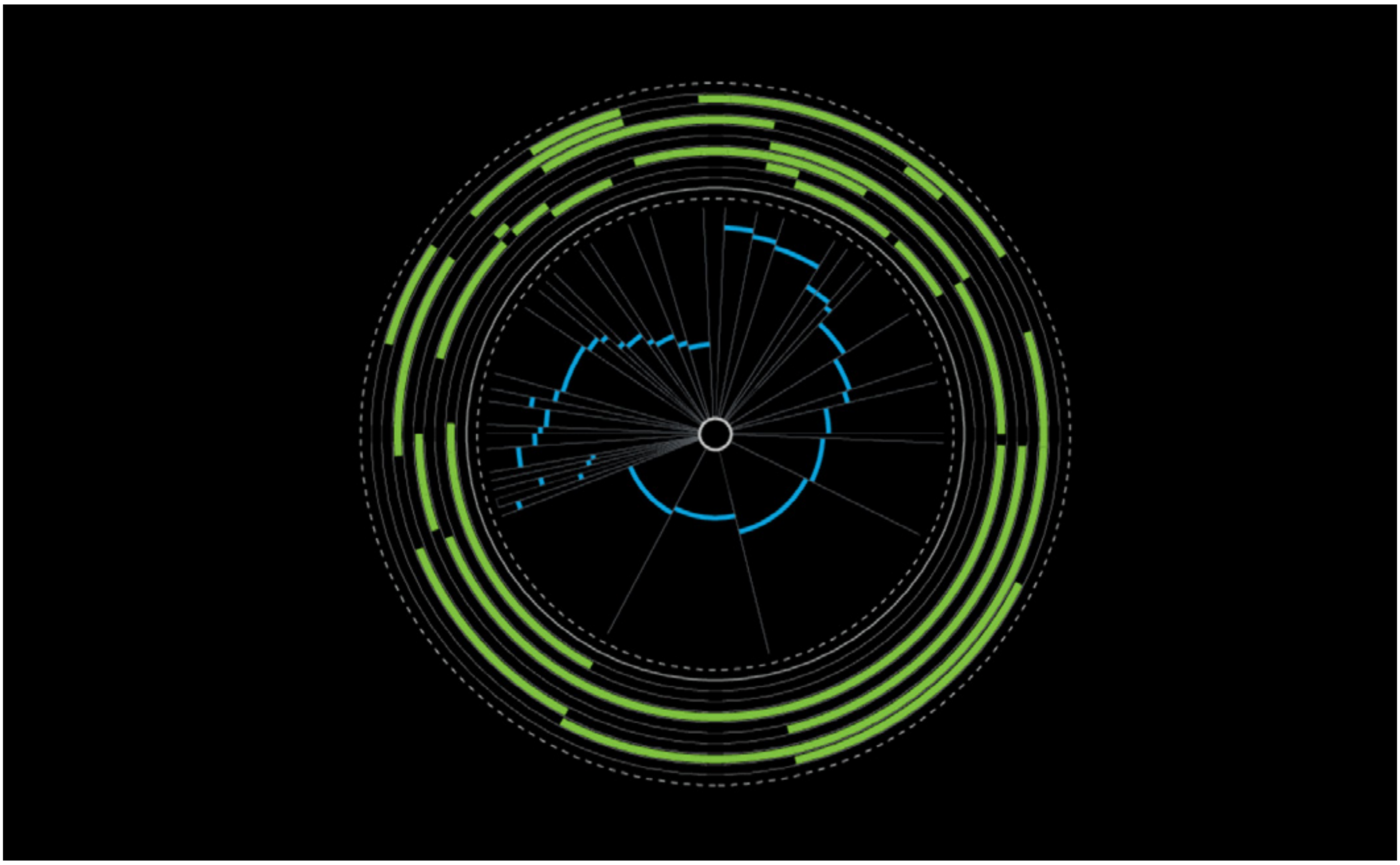


Is your IT M&A-ready?

Mergers and Acquisitions (M&A) are among the most disruptive events for companies and they are becoming increasingly complex in today's ever-changing business environment. For both acquisitions and divestments, IT has become a critical success factor and a bigger part of the operational and strategic importance of a company's value. At the same time, IT represents one of the biggest risks in an M&A deal. To ensure a successful transaction for both parties (buyer and seller), it is therefore advisable to give special attention to the objectives and activities associated with the integration or separation of IT systems, while ensuring a seamless continuity of business operations after closure of a deal (known as Day 1).

An M&A process usually involves a series of complex tasks for the IT department due to differences in IT systems and landscapes, the necessity for coordination with other workstreams and functions, and strong time pressure to avoid costly delays. Furthermore, to realize synergies from the deal, the need for new requirements or additional modifications to IT systems may arise at a relatively short notice. For this reason, IT has very often been a barrier to realizing the expected value to the buyer from the deal value (e.g. revenue growth, cost savings, higher operating margin, greater asset efficiency, or competitive strength).

Yet many CEOs and other board members are not aware of the complexity and challenges associated with IT in a transaction and only recognize them when it is already too late.

At Deloitte, we therefore believe that every transaction faces IT challenges that need to be addressed to protect the deal value and to avoid unexpected additional costs and delays during the execution of the deal, be it a deal with a specific deadline for completion, or an integration with synergy targets.

To execute or close a transaction successfully buyers and sellers need to overcome a number of IT-related challenges

Challenge #1: Demystifying IT

IT is often considered as a 'black box', with no understanding of what goes on inside it. However, all participants involved in an M&A transaction should clearly understand the scope of IT activities required to plan, execute and close the transaction. This will make it possible to identify unplanned expenditure and effort and to mitigate risks of negative impacts on the deal value.

The following questions could help highlight typical IT areas worth considering during a transaction:

On the **sell-side**

- Am I clear about the strategy for all shared IT systems and infrastructure while carving out the business for divestment?
- Can I identify clearly data relating to the divested business in all systems, including ERP and shared data repositories?
- Do I have sufficient IT resources available to extract and hand over to the buyer all IT assets included in the deal within the timeframe required by the deal documentation?
- Are my internal processes ready in case I need to provide IT transitional services for a certain period of time (e.g. acting as an IT service provider)?

On the **buy-side**

- What IT expertise do I need in order to take over the systems and data included within the perimeter of the deal?
- Can I effectively operate the systems and manage data that I am acquiring from the time the transaction closes on Day 1?

Many companies make incorrect assumptions about IT, leading to:

significant cost overruns resulting from delayed IT delivery or a necessity to close gaps in IT assets (e.g. in infrastructure hardware, software licences, network components, or user devices) that have not been included in the initial valuation of the transaction

a negative impact on the efficiency of the operating model after the transaction closes and on the ability to secure business continuity post-closing

a loss of unique IT knowledge and business critical IT talent

Challenge #2: Involve IT early enough in the transaction process

When it comes to preparing for a transaction, Finance and Legal, and often also Tax, are typically the teams that get involved early in the transaction process. M&A teams tend to invite Chief Information Officers (CIO) to join the transaction process and provide input only after the transaction perimeter and timeframes that have been agreed, and sometimes not until after the deal has been signed.

IT tends to be a topic that is addressed 'later' in the process with no involvement in strategic discussions, for example about how to achieve synergies or to identify potential risks and roadblocks to a successful deal. Instead, IT teams are often tasked with operational activities (e.g. setting up network connections) without an understanding of the rationale for the transaction.

Furthermore, the main IT challenges during an acquisition or divestment depend largely on the objective of the transaction and the post-closing integration strategy. For instance, for companies that take a co-existence approach to integration, the business processes and supporting IT systems remain largely unchanged; whereas for a 'best-of-breed' type integration, a closer assessment is appropriate to determine the strengths and weaknesses in the systems of both organisations and to decide which IT components to select from each.

By involving IT teams at an early stage of the transaction, on both sides of the deal, it should be possible to make more accurate estimates of separation costs, the time to complete the deal and synergy targets, and to arrange measures for their realization.

Considering aspects of IT early in the deal process also allows for a more robust validation of bid evaluations, transaction timeframes, and stranded costs at the retained business. Coordinating other functions such as finance, legal and HR with IT helps to resolve interdependency issues and facilitates decisions about the deal that affect multiple business functions and improves the understanding of the financial and operational consequences of the deal.

Challenge #3: IT preparation is vital for deal success

Divestments are typically complex undertakings. Separating systems (such as ERP) and data requires more time than divesting business processes, operations or contracts. Preparation for separation pays off with better input into the deal valuation, greater readiness for potential business disruption, and a more thorough understanding of timeframes and resource requirements. The complexity of a separation will be driven by the degree to which IT systems of the divested and the retained entities are dependent on each other (e.g. the level of entanglement), the number of applications involved, the technical environment, support arrangements in place, the volume of transactions, and required availability of processing (e.g. 24/7). For instance, if IT applications are closely integrated, are hosted on a common infrastructure or rely on a centralized IT service, IT separation effort required is significantly greater.

Similarly, in an acquisition a more in-depth assessment of the migration strategy can help to avoid unexpected costs once the deal is closed. In particular, legacy systems are one of the difficult aspects to manage. It is ultimately beneficial for the economics of a deal that an early decision should be made by IT leaders about when to leave legacy systems behind and which ones to migrate to the buyer's IT environment. It is vital to ensure that the right personnel with appropriate knowledge of the relevant legacy systems will be available post-deal, since replacing lost knowledge of these systems can be expensive or even impossible.

Selling or buying a business is such a critical transaction that it ought to take priority over any other new IT project or initiative, although not over the business-as-usual. Ensuring that business operations continue uninterrupted and that performance does not drop during an M&A transaction should be a top priority for the CEO and the M&A team, as well as the CIO. However, there will be a finite number of IT people with appropriate knowledge of the systems and infrastructure affected involved and impacted by the deal. It is essential to prioritise tasks and reallocate resources in line with the deal resource plan while maintaining appropriate support for the business operations. Creating a plan of IT tasks in each area of IT (applications, infrastructure, networks, data, etc.) helps with the resource planning and prioritisation.

Challenge #4: Unique skills in IT M&A

Overall, IT projects associated with an M&A deal are very different from classic IT projects in terms of speed and level of information available, and also in terms of interactions among the parties that are involved. It is important to understand the unique skills required for the job.

While corporate IT teams have functional and technical skill sets, they have less transaction experience and typically will not be able to allocate resources full time for due diligence and transition programmes (since they will also have to maintain day-to-day operations).

An augmentation of resources early in the process with IT M&A relevant experience, to provide assistance, guidance and leadership from pre- to post-deal, helps ensure appropriate support for the business and the transaction.

Third parties can help close gaps in internal IT team skill sets, including:

- An ability to engage with the seller and ask relevant IT M&A questions
- An ability to form an objective view of the target's IT infrastructure, often under tight time constraints and with limited information
- Knowledge of how IT due diligence feeds into valuation of the target
- Knowledge of the allocation of group IT costs could be used to estimate an EBITDA of a carve-out

IT ought to be addressed at all stages of the transaction

While it is important to consider the IT challenges #1- #4 at the very early stage of a proposed transaction, companies should also understand how IT is used to support the transaction at each step of the deal process.

The typical M&A lifecycle divides into three main phases:

(i) Pre-signing (ii) Deal execution and (iii) Post-closing.

1 Pre-signing

We help you to get ready for your Deal

- IT DD - Buyer and seller side
- Perimeter definition
- Financial carve-out of IT assets
- IT seller information document/ memorandum
- Virtual data room assistance
- Management presentation and buyer/seller Q&A support
- IT TSA preparation

2 Deal execution

We enable you readiness for the Deal Execution

- IT readiness planning
- IT blueprint execution
- IT TSA preparation
- Separation / Integration management office
- Applications, ERP, infrastructure, data, contracts, licences, operating model separation and integration (mainly logical)
- IT security and compliance
- IT TSA operationalisation
- Cut-over and testing management

3 Post-closing

We accelerate your IT landscape optimisation

- IT physical separation or integration
- IT landscape optimisation (application/infrastructure rationalisation, decommissioning, etc.)
- ERP Integration
- IT performance improvement
- IT cost reduction
- IT strategy, organisation, architecture review

It is important, and generally beneficial from the deal value perspective, that in each of the three phases, specialist IT teams are engaged to ensure that any issues or risks are addressed early in the deal lifecycle and dealt with appropriately.

In the pre-signing phase, an appropriate understanding of IT assets included within the perimeter of the transaction helps with the assessment of the deal value; the estimation of any separation, integration or stranded costs; definition of the scope and cost of any transitional arrangements; and the impact on the business in the post-closing phase. It also helps with understanding the likely lead times to close a deal and estimating the duration of subsequent post-closing phases.

Potential IT risks may be worth considering in the early stages of a transaction. These risks usually relate to cybersecurity threats or the protection of sensitive customer data. Often, the buyer's enterprise network is exposed to the threat of cyberattacks when integrating outdated and unpatched systems and IT assets of the target company.

Identifying cyber risks early in the M&A lifecycle can help both the buyer and seller to tackle these issues effectively and prevent a reduction in the overall deal value or damage to the company's reputation.

In the deal execution phase, where a deal typically emerges from beneath the cloak of confidentiality, it is essential to involve specialists from all areas of IT and security to ensure that the conditions for closing the deal can be met on time, including implementation of solutions required by law and regulations in all applicable jurisdictions. This often requires change in priorities. It may even be necessary to cancel or postpone certain non-M&A IT initiatives that would have competed for the same IT specialists.

In the case of cross-border deals for example, an additional layer of complexity may exist when deciding how to adapt to different regulatory standards for IT security. If the buyer's target company is located in a country with stricter data protection standards, it is crucial to evaluate which standards to apply across the board in the combined entity and for international clients. In order to have a suitable data management solution in place, an effective IT roadmap and work plan is key to ensuring a smooth Day 1 transition when the deal is closed.

In the post-closing phase, it is important that the work of IT specialists should not lose momentum, so that any outstanding activities are completed cost effectively and in line with the business strategy, either from the seller perspective for the retained business or from the buyer perspective to achieve desired strategic or integration objectives.

A common challenge faced by CIOs during the first 100 days of post-closing is to ensure a seamless employee on-boarding programme. In this post-closing phase, the consolidation of collaboration platforms such as Office 365, active directories and email is usually complex and time intensive, as it requires many manual processes to migrate the underlying accounts between two companies.

Companies are confronted with specific challenges during each phase of an M&A deal and require a tailored approach and guidance to deal with them. There are a number of steps that both the buyer and the seller can take to better understand their IT risks and how to look for opportunities to deploy IT to achieve a higher probability of deal success.

IT due diligence

Adding value through IT due diligence

An in-depth due diligence exercise on the seller's IT at an early stage in negotiations reduces uncertainty, improves transparency and helps to build trust between the parties.

On the **buy-side**

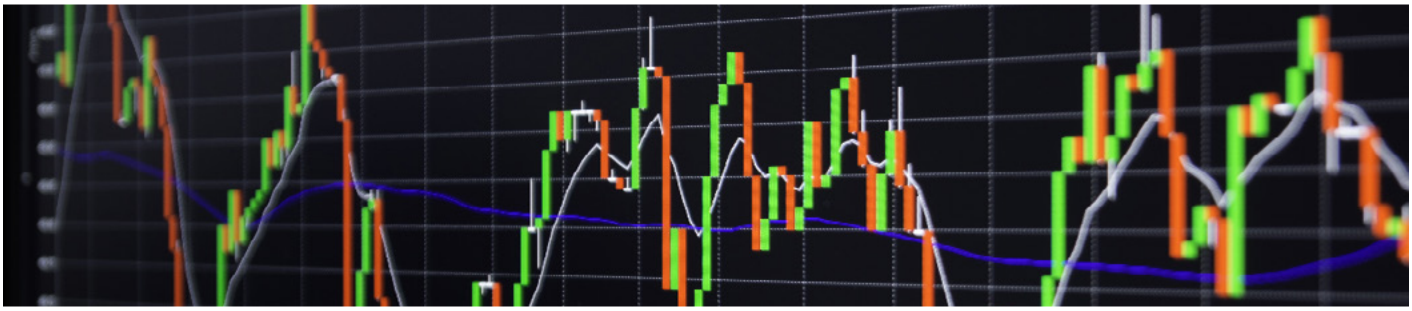
Focusing on IT due diligence allows the buyer to collect information on the value of the IT assets included in the deal, identify potential synergies and any security concerns; evaluate IT staff and structures; and decide what new investment in IT might be required.

	Key activities
Increase opportunities to deliver synergies	• Determine the extent to which IT can help improve the effectiveness of business operations
Identyfication of potential risks	• Identify sources of potential operational or financial risk related to the IT environment of the target company • Ensure data quality, integrity, security and compliance
Cost assesment	• Assess current IT operating costs and develop an estimate of the target state IT operating costs
People & process	• Provide the IT resources required for the transaction • Advise on IT governance during and after the transition

Buyers can assess IT-related costs only if they conduct thorough due diligence on a seller's IT environment and systems. In the absence of sufficient information, the buyer may make incorrect assumptions about IT costs, which could affect the purchase price.

On the **sell-side**

For sellers, it is essential to have up-to date information on all IT assets and costs affected by the transaction, and to be prepared when entering into negotiations during the pre-signing phase. In the case of a carve-out, an early view on the separation and stranded costs helps with the evaluation of bids from buyers. In addition, a clearly described IT perimeter in the seller documentation, be it the seller information document or vendor due diligence report, reduces the risk for the buyer, improving the chance of a higher valuation and bid.



In general, CIOs need to have good knowledge of the IT assets on both sides of the deal to determine how the two systems can best fit together, and where integration or separation risks could occur. This assessment usually requires a survey of the seller's IT landscape and arrangements for supporting resources and eliminating redundancies. Typical areas for examination include hardware, data centre, network and enterprise and functional application, as well as core systems (e.g. ERP and/or CRM systems) and corporate software programs for specific business lines, products, services and vendor platforms.

Therefore, an in-depth IT Due Diligence completed before starting the transition reduces uncertainty and improves transparency and builds trust for negotiations.

IT integration

IT is a key enabler for synergies

IT has become increasingly complex, underpinning all business functions and facilitating and supporting day-to-day operations. IT is therefore an important enabler of synergies, and often represents a large part of the total synergies obtainable by the buyer from the deal.

A well-defined roadmap that incorporates IT activities contributing to the realization of synergy objectives across the entire business also leads to successful IT integration.

	Key activities
IT governance and approach	• Develop a common integration framework that outlines the combined companies' IT policies and procedures
IT blueprint & operating model	• Identify the IT-related processes and initiatives (for example, ERP platform rationalization and data centre consolidation) required to achieve end-state plans • Align cost and revenue synergy plans with end-state business capabilities and need
IT integration planning	• Develop an integration roadmap and key milestones • Prepare detailed Day 1 execution plan • Develop synergy plans and one-time cost estimates
Day 1 / Post Day 1 execution	• Identify, track and monitor realization of cost synergies

Integration will likely require also new or additional security measures - and possibly also new compliance requirements for the buyer.

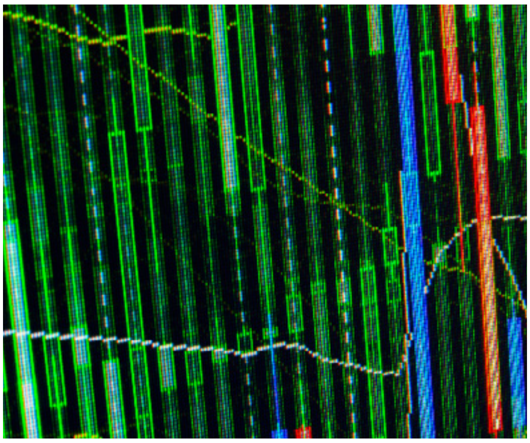
Close collaboration between the security, data privacy and legal teams helps to ensure that legal lines are not crossed inappropriately. For example, it is often prohibited by data regulators or anti-trust bodies to share sensitive data such as employee's details, customer lists or vendor contracts before the closing date.

To help enterprise integration teams minimize risk exposure, CIOs and security teams can establish early, clear and decisive guidance on maintaining data security and privacy controls and establish an integration governance body that reviews questionable scenarios throughout the deal execution process.

IT separation

Seamless business continuity after Day 1

Dividing shared assets as part of a carve-out transaction is often complex, time consuming and costly. It requires careful planning with various parts of the IT function working closely with other business functions. In such transactions, the assets being sold are operationally dependent on systems or processes it shares with other parts of the seller's business, such as manufacturing lines, ERP systems and IT security systems. In certain situations, the seller's retained business might also be reliant on systems that are being sold. To ensure business continuity for both the seller and the carve-out after Day 1, access to such functions needs to be maintained and deals can close only when the operational needs of both parties are met, either through a separation of systems or via transitional arrangements.



Otherwise, there may be an impact on the deal value, the mechanics of the deal closure or regulatory compliance, and changes to the original transaction documentation may be required.

	Key activities
Separation strategy	• Identify initial separation strategy, which sets the parameters for the separation activities
Preparation and data gathering	• Define the approach, including initial high level IT separation planning • Identify the functional dependency between entities (e.g. wsystems, processes)
Day 1 readiness	• Implement the IT separation initiatives required to enable stand-alone operation of the carved-out business unit(s) on Day 1
TSA exit plan	• Provide any services under the transitional service agreement (TSA) as well as transition activities required to hand over responsibility for all IT services to the buyer of the carved-out business unit(s)

To ensure that issues with shared assets do not cause a delay to the deal and to avoid stranded costs and unwanted assets on either side of the transaction, the CIOs and the deal teams may prepare detailed IT separation plans that can guide the deal teams' strategy for negotiating the division of shared assets, and the timelines by which any division will be completed.

Conclusion

The strategic rationale behind every deal is unique – but it is increasingly underpinned by IT. Resolving IT issues is a significant challenge to achieving transaction goals, new technology solutions have emerged to execute deals faster, more efficiently, or with a greater value to both the buyer and the seller. Yet, the importance of IT to delivering a successful deal is often discovered too late in the transaction process. At Deloitte, we have seen that transactions achieve greater value and are more successful when they address IT challenges throughout the transaction process, involving the IT function at an early stage.

If you would like to know in more detail how this approach could work as part of your M&A strategy, please reach out to us.

Krys Dudek
Director
+41 58 279 69 37
kmdudek@deloitte.ch

Panya Viraphan
Senior Manager
+41 58 279 97 21
pviraphan@deloitte.ch

Anand Lehmann
Senior Consultant
+41 79 548 83 48
aalehmann@deloitte.ch

Deloitte has dedicated technology, M&A and due diligence teams in a number of geographies with unrivaled experience in deal preparation and execution, as well as in IT assessments. Our M&A Technology practice is a worldwide leader and the largest in Switzerland.

Deloitte.

Designed by CoRe Creative Services. RITM0783536