Typical acquisition process

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KPMG.PL

Typical acquisition process

Acquisition process – key stages and schedule

Steps of the process

A corporate acquisition is a complex and time-consuming process. The essential steps in the process are:

01 Market analysis

02 Identification and pre-selection of potential acquisition targets

03 Examination of transaction interest

04 Due diligence, valuation and analysis of returns

05 Negotiations and transaction closing

06 Integration

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STEP 1
Market analysis

Market analysis (Poland and / or beyond)

- Defining the acquisition strategy, drawing up a plan and a timetable for the process
- Analysing market trends, threats and opportunities
- Determining financial and operational parameters of potential acquisition targets
- Preparing an overall profile of the potential acquisition target
- Prioritising tasks

Formulating an investment thesis

STEP 2
Long list of targets

Pre-selection of potential acquisition targets

- Contacting pre-selected potential acquisition targets
- Presenting the investor's competence, credibility and successes
- Obtaining additional relevant information on potential acquisition targets
- Initial valuation and financial analysis of potential acquisition targets
- Initial confirmation of the seller's transactional motivation

Identifying potential acquisition targets

STEP 3
Shortlist of targets

Examination of transaction interest

- Further financial and operational analysis of potential acquisition targets
- Selection and acceptance of a limited number of potential acquisition targets for further process
- Arranging meetings between the parties
- Concluding a non-disclosure agreement (NDA)
- Gathering non-public information on potential acquisition targets
- Final confirmation of the seller's transactional motivation
- Preparing a declaration of interest: letter of intent or preliminary bid

Selecting and contacting highest-potential acquisition targets

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STEP 4
Due diligence
Examination of acquisition target

- Financial, tax, legal, operational and other due diligence
- Meetings with management boards and business owners
- Analysing key risk areas and the impact of the due diligence findings on business valuation and transaction structure
- Preparing financial model/forecasts, valuation, and analysis of returns on investment and synergies
- Preparing a confirmatory bid

Confirmatory bid

STEP 5
Negotiations
Purchase

- Determining the negotiating strategy
- Negotiating terms of the transaction
- Finalising the sale and purchase agreement and fulfilling conditions precedent
- Acquisition financing

Negotiation and transaction closing

STEP 6
Integration
Synergies

- Implementing the developed business plan
- Integrating the acquisition target with the buyer in terms of operations, finance, accounting, IT, HR, etc.
- Assessing the resulting synergies

Evaluation of the acquisition

Duration

An M&A transaction usually takes less than a year to close. There is a distinct relationship between the investor type and the time it takes to sign a sale and purchase agreement (SPA) from the date of first contact. The average transaction time for strategic investors is longer than that declared by financial investors. The difference may be because industry investors have less experience with transactions and tend to carry out a more detailed market analysis and due diligence process in order to adapt the business model to the investor’s objectives.

It is difficult to determine the exact timeline of an M&A process because of the multiple factors that may affect the timing of specific steps. The main factors to be taken into account include:

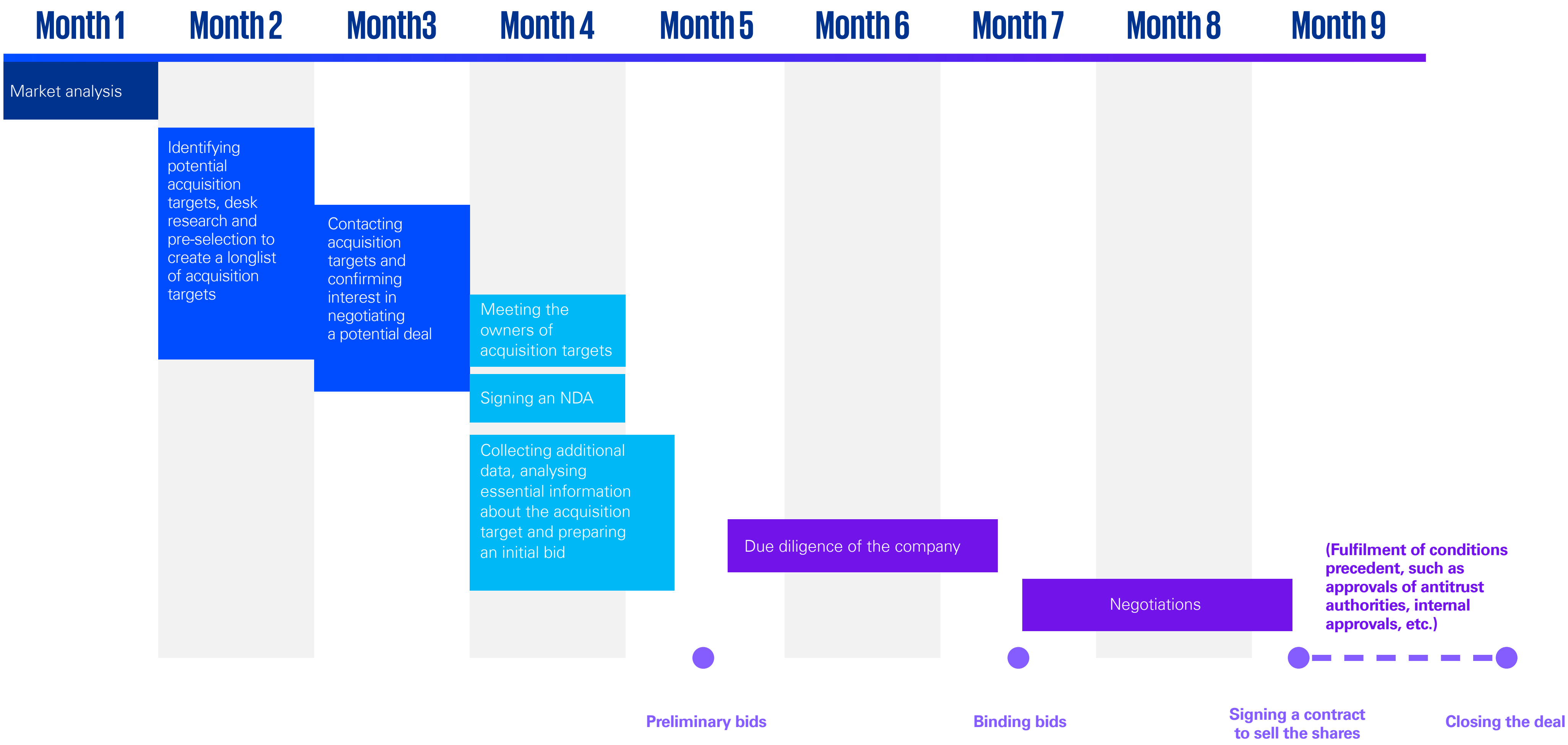
- Decision-making pace within the company
- Preparation and performance of due diligence
- Negotiations
- Compliance with conditions precedent depending on third parties (e.g. financing institutions or administrative bodies).

Average number of months needed to close a capital translation on the Polish market (from first contact to signing the SPA)

	Minimum	Average	Maximum
Strategic investors	5	9	14
Financial investors	3	7	11

Source: KPMG in Poland, “Transaction processes in Poland: Expectations versus reality”.

Sample flowchart of a business sale



Transaction motives and identification of acquisition targets

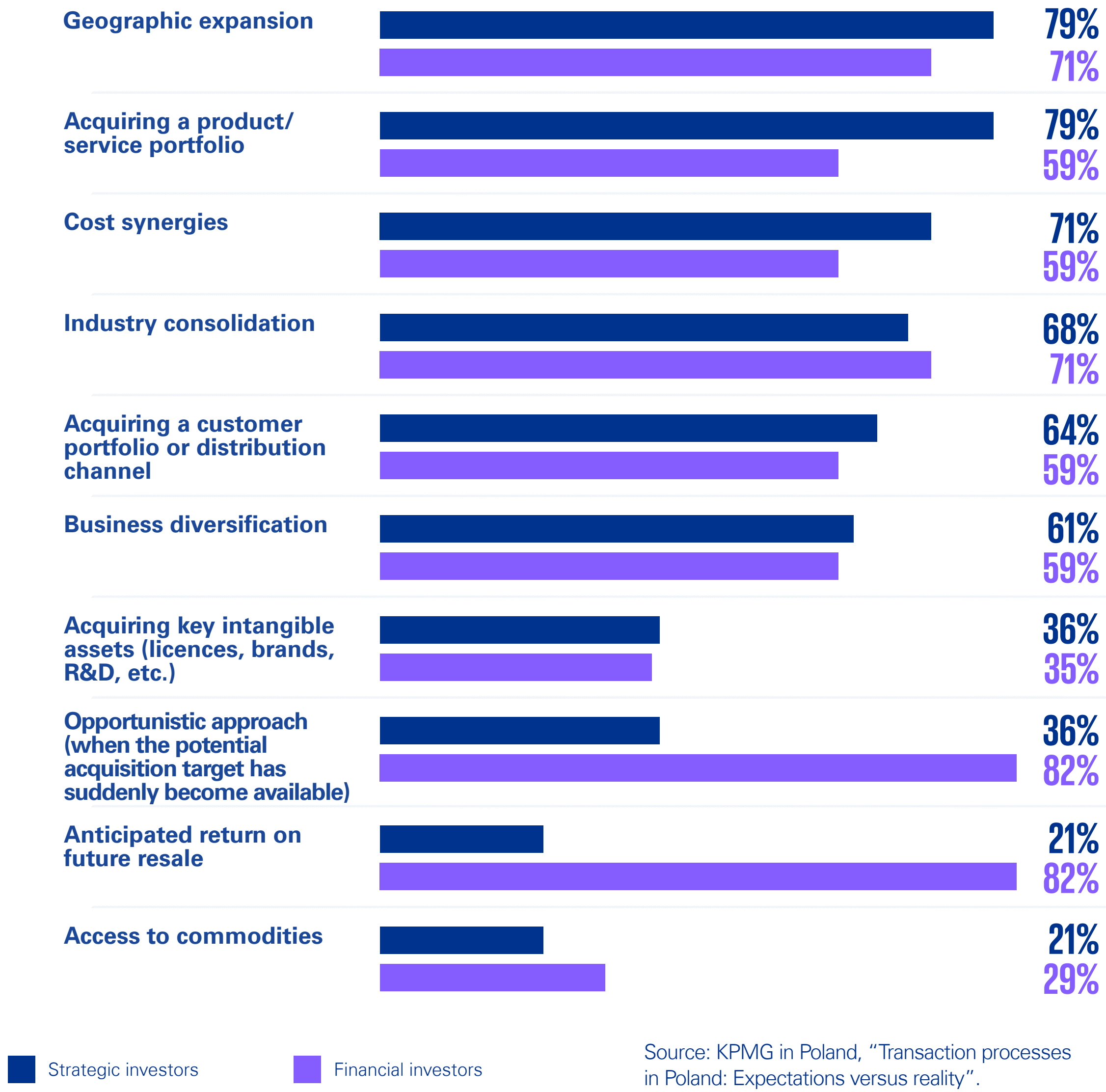
Transaction motives: strategic vs. financial investors

Investment motives vary depending on the type of entity carrying out the transaction. Strategic investors who acquire companies want to integrate the target into the rest of their organisation and have a real impact on its management. In contrast, financial investors engage their capital in the target company, counting primarily on profits from its future resale.

Understandably, the desire to make a profit on the future resale of the target company is the fundamental factor considered by financial investors when engaging in transactions. This objective is achieved by, among other things, increasing the operational efficiency of the target, geographical expansion, or achieving cost or revenue synergies through industry consolidation.

A more diverse approach to transaction processes is presented by strategic investors. In most cases, they mention geographic expansion as well as acquisition of a portfolio of products and services as their main or most often considered reason for investment. They also attach importance to cost synergies, industry consolidation, and acquisition of customers and distribution channels.

Main or usual investment motives



Source: KPMG in Poland, "Transaction processes in Poland: Expectations versus reality".

Identification and selection of acquisition targets

Market analysis, as well as identification and pre-selection of potential acquisition targets, is a step that prepares investors to engage in dialogue with sellers on a potential transaction. If conducted properly, this step ensures that investment guidelines are fine-tuned and the most appropriate entities are selected to match the buyer's specific investment criteria.

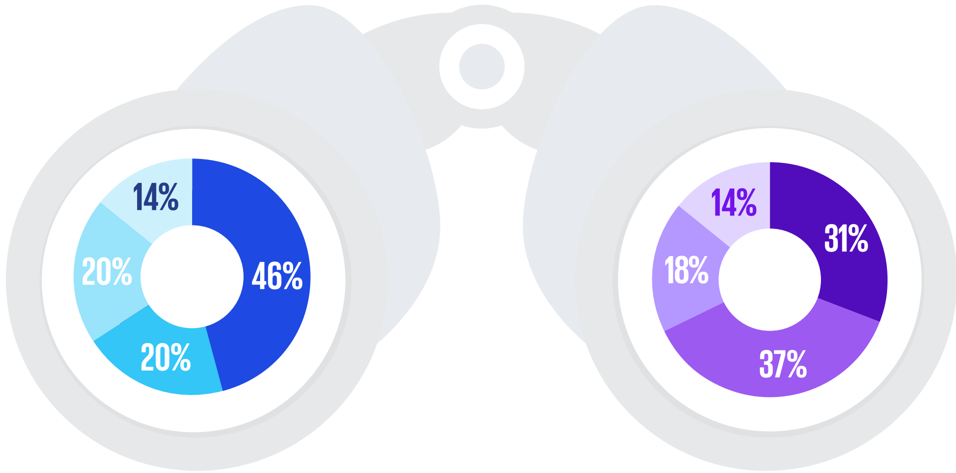
The key methods for identifying acquisition targets include:

- Identification and selection by the investor based on its internal resources—this path is more likely to be chosen by strategic rather than financial investors
- Support of an external transaction advisor acting for the buyer or leading the company sale process
- Direct contact between the parties, e.g. as a result of relations with the management of the seller

Overall, some 40% of acquisition targets are determined as a result of an internal identification and selection process. This path is more likely to be chosen by strategic investors (46%) than financial investors (31%). Acquisition targets are also chosen with the help of an external consultant, engaged by either the seller (26%) or the buyer (14%). Financial investors were much more likely (37% of mentions) than strategic investors (20% of mentions) to be contacted by a consultant engaged by the seller. One in five acquisition targets is identified through direct contact between the parties.

Once potential acquisition targets have been identified and a list has been drawn up, critical verification of the potential targets takes place, and a longlist of acquisition targets is created, based on the investor's criteria.

Most common methods applied by investors to search for acquisition targets



Strategic investors		Financial investors
●	As a result of an internal identification and selection process	●
●	Through an external consultant hired to identify potential targets	●
●	Through a contact from a consultant hired by the seller	●
●	Through direct contact from the seller	●

Source: KPMG in Poland, "Transaction processes in Poland: Expectations versus reality".

Examination of transaction interest

In the next step, the selected acquisition targets are contacted and the owner's interest in the potential transaction is confirmed. After confirming the seller's initial interest in the deal, information about the acquisition target is collected to enable the investor to present an initial bid or a letter of intent. At this step, sellers expect the investor to present its intentions and motivation to complete the transaction, as well as the buyer's competence and success in growing business through mergers and acquisitions.

Often, the exchange of information about the company and the investor's investment strategy takes place during a meeting of the parties, which enables the owners of the acquisition target to meet the potential buyer's team.

Once the information about the acquisition target has been gathered and preliminary analyses have been conducted, the investor presents an initial bid or letter of intent to the sellers. When the proposed conditions have been accepted by the owners, the investor is invited to carry out due diligence.

From the investor's perspective, it is vital at this stage to determine whether the talks with the acquisition target are being held on an exclusivity basis (this requires a specific agreement to be made between the seller and the buyer, e.g. in the form of a term sheet) or the investor is participating in an auction process.

While obtaining exclusivity is the preferred scenario for investors, owners in most organised sales processes are unwilling to hold one-on-one talks, or try to significantly reduce the duration of the exclusivity period.

Due dilligence

Due diligence is available to the buyer and the seller. Company owners have (or at least should have) complete information about the activities of the target company, while the investor only holds partial data, and only those that the sellers have agreed to disclose.

From the investors' perspective, maximum reduction of transactional risk is one of the key success factors in carrying out an acquisition. If properly conducted, the due diligence process helps to eliminate information asymmetries between the parties and to identify and assess potential risks, so the investor can start negotiating the transaction dossier with the necessary knowledge about the acquisition target.

The key objectives of due diligence are:

- Verification of previously received information about the target company
- Analysis of historical financial data and growth prospects of the acquisition target, in order to put a value on the company and confirm the pricing terms in the binding offer
- Identification of risk factors (market, financial, tax, legal, commercial, human capital and other risks)
- Analysis and estimation of synergies arising from the transaction

Due diligence is usually carried out in the following areas:

Financial. As a rule, investors pay most attention to the financial analysis of the target company in order to gain assurances about its financial standing and to confirm that the underlying data for the initial bid are correct.

Market. As part of due diligence, investors also focus on assessing market risks, including market structure, competition, entry barriers, and growth prospects for the industry.

HR. Investors pay increasing attention to human assets. HR due diligence provides insight into structure of employment, remuneration policies and costs, talent retention, performance of employees, organisational culture (business behaviours), as well as a look at HR processes.

Legal. Another important area is the analysis of legal risks and potential legal and financial consequences arising from specific ways of doing business. Legal due diligence includes an analysis of agreements with contractors, employee issues, regulatory aspects, corporate documentation, etc.

Identification of potential risks is directional and includes recommendations as to how to include them in the transaction documentation, e.g. a suggestion to obtain appropriate security, a price reduction or retention of part of the price.

Taxation. Tax due diligence aims at confirming compliance with tax requirements and identifying potential tax liabilities arising from irregularities.

Business. In this area, the investor analyses relations with suppliers and customers, financing institutions and employees. As a rule, this part of due diligence is carried out directly by the investor's team, but an external advisor may be involved in some cases.

In addition to the aforementioned elements, the due diligence process may include, for instance, environmental or intellectual property issues.

Challenges encountered in the course of due diligence often prolong the process, and the parties may even hold up talks and leave the negotiating table. The following main problems may be encountered:

No access to the data required by the investor. Restricted access to data may result from the reporting methods within the organisation or from the seller's decisions not to disclose full information which, in their view, is too sensitive to be disclosed to potential investors. This kind of situation leads to difficulties in estimating potential synergies and achieving sufficient comfort for the investor to make a confirmatory bid.

No preparation for due diligence. This element may occur on the part of either the seller or the investor. Missing elements in disclosed documentation, low quality of data, and slow response time are the most common shortcomings on the part of the seller. In turn, investors may incorrectly select their team members or the time to carry out the due diligence, which may cause delays or insufficiencies in analysis.

VDR vs. full access. In recent years, due diligence in the form of a virtual data room (VDR) has grown in popularity, replacing the process where documentation is made available at the company's headquarters or on electronic data media. A VDR ensures parallel access to data for the investor's team and their advisors who take part in the process. However, depending on the rules adopted by the seller for the due diligence, this tool may also have certain limitations, e.g. restricted access to files (no possibility to save or print documents) and constraints in sending questions through the platform.

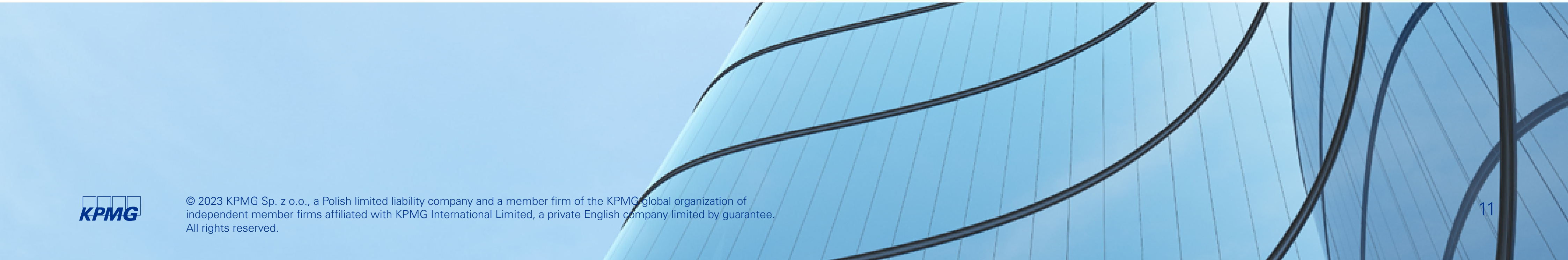
Typical challenges during the due diligence process in Polish companies include:

Common unawareness of due diligence procedures among sellers who do not use advisory services	No dedicated controlling team and/or accounting function performed by outsourced providers
No management reports or very limited informative value of the existing management accounting	No procedures in place to forecast and monitor performance.

Analysis of the acquisition target as part of due diligence provides input for a detailed model and financial forecasts. The financial model developed by the investor at this stage should be based on highly granular historical data, and take into account the future business growth prospects discussed directly with the management of the target company.

In the case of strategic or financial investors who plan an acquisition through a portfolio company, an analysis of potential synergies to be released after the contemplated transaction and effective integration is an indispensable element of financial forecasting. Likewise, it is important for financial investors to understand possible exit paths within the anticipated timeframe and potential returns on investment.

Additionally, it is important from the investors' perspective to design and analyse possible growth scenarios for the target company, taking into account key sensitivities and their impact on financial forecasts.



Negotiations and deal closing

Settlement methods for transactions

Analysis of the business value precedes the sales process in order to frame the negotiations. However, several mechanisms that are agreed before the transaction documentation is signed may lead to price adjustments after closing the deal.

The first mechanism is preparation of a closing report, where an initial sale price is determined and then adjusted for actual performance, as reflected in the company's balance sheet as at the date of the deal. The closing balance sheet is prepared about 8–12 weeks after the deal has closed. If the balance sheet shows a better net asset position than that assumed when calculating the initial selling price, the purchase price is adjusted upwards and the buyer pays an additional amount. If the net asset position is worse, the selling price is adjusted downwards and the difference must be returned by the seller.

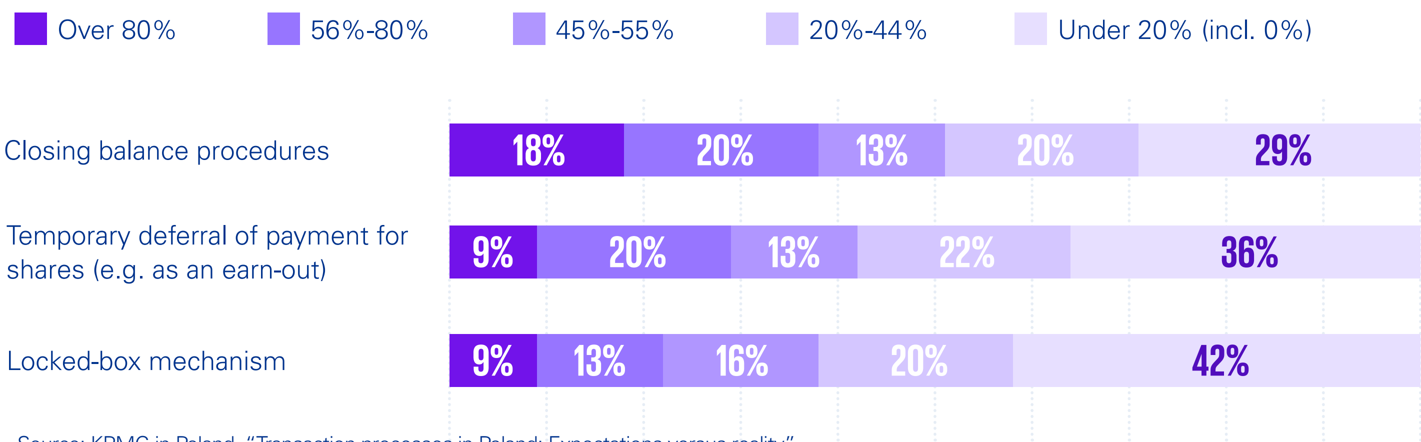
To reduce the time it takes to determine the selling price and avoid possible disputes over price adjustments after closing, the parties may use a locked-box formula, where the price is fixed in advance, as of a certain date, and is not subject to any adjustments after closing.

The essence of this solution is to limit cash outflows to the owners, i.e. to "lock" the company for the duration of the transaction and handle usual business flows only. Under the locked-box mechanism, the buyer assumes the risk that the target company's financial performance may change after closing.

The parties may also agree on an earn-out clause, i.e. that the price will be paid in parts. The earn-out mechanism is generally applied when the purchase price does not reflect the future business performance, in which case the parties agree on an initial purchase price payable at deal closing, and an additional payment to be made after a certain time has passed and the target company has achieved the intended performance levels.

The experience of nearly four in ten surveyed investors shows that closing balance verification was carried out in more than half of the transactions. Strategic investors were willing to use partial deferral of payment for shares when making transactions (more than one in three respondents used this option in over 55% of cases). On the other hand, financial investors often opted for the locked-box mechanism (more than one in three respondents used it in over 55% of cases).

Percentage of transactions involving the following settlement methods (based on investors' experience in the last 3 years)



Source: KPMG in Poland, "Transaction processes in Poland: Expectations versus reality"

Transaction documentation

Transaction documentation plays a key role for the acquisition process, as it sets out the legal conditions for conducting and closing the process as well as the conditions for execution of the sale. In particular, it determines the seller's liability for defects/claims related to the business being sold and the buyer's options to pursue claims related to such defects.

In the initial phase of the process, documents such as a letter of intent, memorandum of understanding, or term sheet are often used.

Such documents usually accompany the buyer's bid and are normally not legally binding. In most cases, such documents are intended to delineate and organise further steps in the process.

Therefore, they are not used in competitive procedures, where the process is determined by the seller (or its advisors) in the form of a process letter.

The main legal document that strictly determines all conditions for the purchase of shares or a business is a sale agreement, usually taking the form of an SPA (share purchase agreement or sale and purchase agreement). A sale agreement may be signed simultaneously when the entire transaction is closed, which entails payment of the price.
If the deal closing is subject to certain conditions (conditions precedent), the deal may be closed only after they have been effectively fulfilled or the buyer has waived the conditions, provided that waiver is legally permissible.

In transactions where the buyer does not become the sole owner of the shares of the acquired company, various types of agreements between the investor and the other shareholders are used in addition to the SPA (shareholders' agreement). Such agreements precisely define the cooperation of all shareholders with regard to business management, including corporate supervision, decision-making procedures of the company's governing bodies and, in many cases, other obligations of specific shareholders with regard to financing the company and its operations.

Other types of agreements are often negotiated and signed along with the SPA, and they become part of the overall transaction. For example, there may be managerial, financing or refinancing agreements, or agreements concerning various areas of operations in the target company.

Antitrust approval

The law contains regulations to counteract excessive business concentration in various market areas. Hence the need to analyse the impact of the transaction on the competition situation in specific areas where the transaction participants operate.

Depending on the circumstances, the competent antitrust authority may be the Office of Competition and Consumer Protection (UOKiK) in Poland or even the European Commission.

It is important to know in advance whether approval is required for the proposed transaction and which authority will be competent in the case. The procedure to be conducted by the antitrust authority may influence the timing of the transaction.

Benefits of the transaction: synergies, integration and evaluation of the acquisition

Many strategic investors fail to achieve the expected benefits from acquisitions due to the absence of an effective integration process. After closing the deal, the investor should immediately commence the integration process as planned for the first 100 days after the transaction. This process is prepared before the purchase and determines elements such as ways for the management to achieve the intended growth, cost synergies, as well as integration and enhancement of operational processes. The support of an advisor during the integration process may prevent disputes.

The integration process covers aspects such as IT infrastructure, operations, accounting, and organisational culture. The investor's support in creating an integration team before the deal closing, involving the company's existing employees and the investor's representatives, will partially alleviate the pressure on the sellers. During the transfer of the business, many situations may arise where the sellers will need to be involved, for instance:

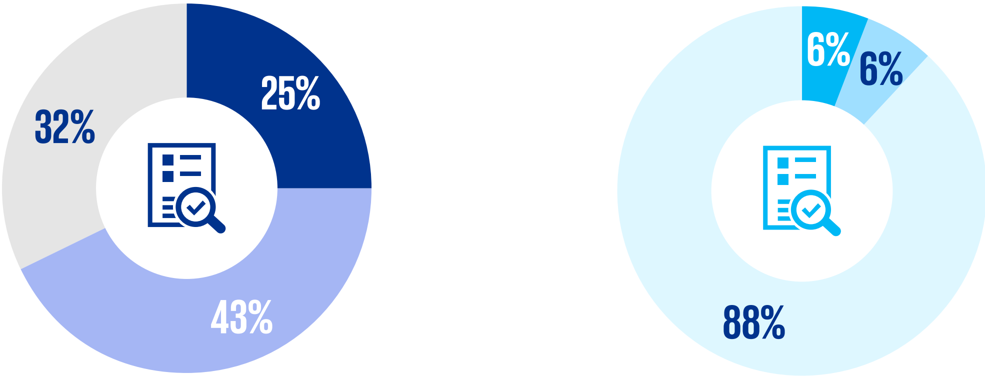
- Support in employee issues, the role of trade unions, integration of employees into the investor's organisational structure
- Participation in meetings of the investor's management board in order to support adaptation of the company's business strategy to the investor's strategy
- Support in establishing relationships with customers and suppliers
- Supporting the management board in decision-making for a limited period

Establishing and leading change management program can prevent loss of know-how held by employees and enable retention of key talent. Advisor can also support investor in assessing and appointing key management whose profiles provide best predictability of delivering on expected transaction objectives.

It is crucial for the seller to provide the investor with as much business information as possible, which is recommended even before the deal closing so that the information can be used during the integration process. The documented and verified processes and procedures in the company will be essential as a guide to running the business after the transaction.

Achieving the expected return on investment (ROI/IRR) is a key factor in assessing the outcomes of acquisitions for 88% of financial investors and 43% of strategic investors. This is hardly surprising, since the main purpose of acquisitions for financial investors is to resell the company at a profit. Strategic investors, in turn, aim to integrate the acquired target into their group, which means they also attach great importance to achievement of certain key performance indicators and the absence of problems other than those identified when analysing the standing of the target company.

Key factors considered when assessing transaction outcomes



Strategic investors | **Financial investors**

Strategic investors		Financial investors
●	No problems after transaction completion other than those identified during the due diligence process	●
	Satisfaction of the managerial staff and owners on the buyer's side	●
●	Was the intended ROI/IRR achieved?	●
●	Were the intended KPIs (or synergies) achieved?	

Source: KPMG in Poland, "Transaction processes in Poland: Expectations versus reality"

Based on their own experience with M&A transactions in Poland, the surveyed investors shared their comments on what they would like to improve during future transactions. Most of them mentioned better due diligence, more efficient transaction planning, and a thorough understanding of the specific characteristics of the target company. Due diligence, considered more important by the surveyed strategic investors when assessing potential investments, is the main area for improvement, mentioned by 40% of them. Additionally, 20% of strategic investors said they would like to ensure better transaction planning in the future, while 15% would like to perform a more detailed valuation of the target company. Financial investors, hoping for future profits from resale, want to negotiate more attractive purchase prices (27% of mentions). Moreover, 20% of the surveyed financial investors indicated they would like to ensure better transaction planning, and the same percentage would like to understand the nature of the target company better and implement organisational changes faster.

How can we help you?

KPMG supports clients in all aspects of a transactions process, both the buy-side (investors) and the sell-side (vendors).

- M&A advisory services for the acquisition or sale of businesses
- Valuations for the acquisition or sale of businesses
- Ownership changes: Comprehensive legal support
- Financing
- Financial and tax due diligence
- Commercial due diligence
- Operational due diligence
- HR Deal Advisory & Change Management
- Post-Merger Integration (PMI) Assistance
- Real estate M&A and valuation services
- Carve-out assistance

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The Deal Advisory Department in Poland employs professionals with significant experience in a wide range of M&A transaction services. We have an integrated approach: from the beginning of your search for a potential target or preliminary consideration of business disposal, to drafting of the final documents, signing of the sale and purchase agreement, and integration of acquired entities.

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