JANUARY 2023

CORPORATE DEVELOPMENT'S 2023 DEAL OUTLOOK

Contending with economic uncertainties and complex unfolding trends, corporate development professionals indicate a persistent—if pragmatic—optimism in their deal outlook for 2023

RIVERON

Despite economic uncertainty, optimism persists. As an outlook of what's to come in 2023, The Corporate Development Officer (CDO) Forum and Riveron partnered again to survey more than 250 CDOs across the country for their predictions of what trends will affect the deal market and what pain points they will continue to grapple with in 2023.

HIGHLIGHTS

- Deal appetite continues despite dynamic valuations and borrowing costs
- An increase in divestitures is on the horizon
- Protecting value by solving the culture-fit dilemma
- ESG is currently sidelined, but that trend will change
- At the core, it's about relationships

89%

PLAN TO DO THE SAME OR MORE DEALS IN 2023

53%

CDO RESPONDENTS LOOK TO DIVEST IN 2023

63%

SAY AGREEING ON VALUATION AND PRICE WILL BE THE MOST DIFFICULT PART OF THE M&A PROCESS, AN INCREASE OF 50% IN SENTIMENT YEAR-OVER-YEAR

64%

SEE THE POSSIBLE RECESSION AS AN OPPORTUNITY TO ACQUIRE STRATEGIC DISTRESSED ASSETS

60%

ARE WALKING AWAY FROM DEALS EARLIER IN THE PROCESS

56%

SAY CULTURE CLASH IS THE TOP REASON INTEGRATIONS FAIL

DEAL APPETITE CONTINUES DESPITE VALUATIONS AND BORROWING COSTS

"Focus on quality deals and stay disciplined on price."

CDO Forum survey respondent

89%

PLAN TO DO THE SAME OR MORE DEALS IN 2023

Despite ongoing market volatility, 89% of CDO respondents plan to do the same or more deals in 2023 as they did in 2022. To achieve this desirable pace, CDOs face a complex task: traversing the ever-changing economic conditions to ensure their businesses flourish into the future.

For deals to continue at a steady or increased pace, CDOs were asked what are the most important criteria in searching for the right deal. Responses varied widely with a top reason cited as choosing a product, service, or offering expansion.

Consistently, when asked what will drive their M&A activity in 2023, 95% of survey respondents stated their focus is on adding new capabilities, with a close second of 84% saying to increase market share. Other drivers identified were diversifying products, carving-out business units that do not align with corporate strategy, and digital transformation.

Top five drivers for M&A activity in 2023

95%	Add on new capabilities
84%	Increased market share
63%	Product diversification
58%	Divest in alignment with corporate strategy
53%	Digital transformation

CDOs can better position their businesses for strength amid uncertainty

In addressing economic uncertainty, corporate development leaders should implement best practices that help mitigate risk while keeping their organization's finances and future secure and stable. This could include diversifying product or geographic mix, maintaining liquidity levels above industry standards and expectations, monitoring currency exchange markets closely for potential opportunities or risks, and investing in financial technology solutions that can help automate processes.

CDOs must also be aware of other factors that may affect loan terms and other areas of borrowing costs in 2023. These include liquidity premiums, borrower credit ratings, and lender policies – all of which can impact how much money businesses are able to borrow at a given time. Understanding these elements is paramount for securing competitive loan agreements that can benefit an organization now and into the future.

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CONTENDING WITH DEAL DYNAMICS

"Don't chase valuations and maintain discipline when looking at assets. Stick to the core strategy and have a long-term mindset."

CDO Forum survey respondent

The terrain surrounding mergers and acquisitions (M&A) during 2022 presented many corporate development professionals with an unstable path toward value-creation. Challenges including inflation and other drivers of volatility—as well as often-mismatched expectations regarding valuations—have called for a deeper level of diligence and scenario planning.

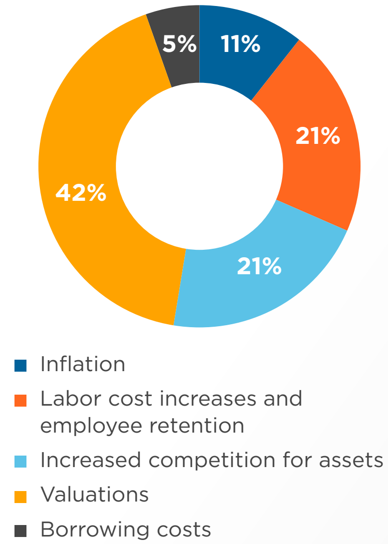
Valuations have remained a top concern for CDOs. As a look back to 2022, 42% of respondents stated valuations impacted or affected their transaction activity. Looking forward to 2023, concern has grown to 63% who say agreeing on price and valuation will be the most difficult part of the M&A process, an increase of 50%.

"Stick with the plan. Sometimes the best deals are the ones you don't do."

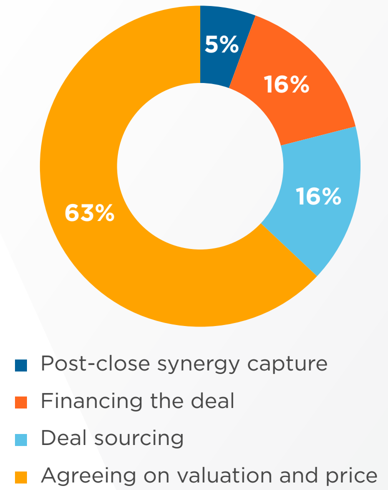
CDO Forum survey respondent

Leaders are also being more focused on their search timing and efforts, as 60% of CDOs said they are walking away from deals earlier in the process now and report the number one element that can interrupt, or stall transaction activity, is valuations. Sellers have not forgotten the recent high multiples that similar businesses received in recent years. The reality is that many of these deals will need to be valued lower in order for deals to get done. There are plenty of assets available.

Which of the following has most significantly impacted or affected your 2022 transaction activity?



Which part of the M&A process will be the most difficult in 2023?



60%

ARE WALKING AWAY FROM DEALS EARLIER IN THE PROCESS

UNTIL THE ECONOMY SETTLES, PROCEED WITH PRAGMATIC OPTIMISM

While being mindful of the deal landscape, inflation is the foremost concern noted by CDOs. A distinct pattern emerged when survey participants were asked what economic factors need to exist within the next six months for deals to proceed effectively. In sum, for CDOs to regain deal confidence, the economy needs to settle down. Specifically, inflation needs to come to a halt to help deal cycles become more predictable.

It is difficult for CDOs to navigate deal cycles with so much uncertainty, and if things start to normalize, it will be easier for business leaders to look at the elements of a deal that strategically make sense for the business.

37%

NOTE THAT FINDING THE RIGHT DEALS TO DO AND CAPITAL FINANCING CONSTRAINTS WILL BE THE BIGGEST BARRIERS TO DOING DEALS IN 2023

64%

SEE THE POSSIBLE RECESSION AS AN OPPORTUNITY TO ACQUIRE STRATEGIC DISTRESSED ASSETS

Respondent excerpts echoed concerns over inflation and stability:

stabilization of Fed rates
cost of debt
less market volatility
inflation tamed
the end of rate hikes
a belief that dramatic interest rate increases are ending
inflation back to less than 4%
clarity on inflation
confidence that rate increases will stop
lower inflation
a pause in Fed rate hiking
getting inflation under control
debt markets need to calm down
improvement in access to capital
consumer confidence must increase
inflation in check and stability in debt market
inflation needs to drop to below 4%
unemployment must remain below 6%
Controlled inflation
lower interest rates
stable market
interest rates can go up with a band but gyrations of the public market add uncertainty

DIVESTITURES ON THE HORIZON

A surprising 53% of survey respondents are planning to divest in 2023, citing assets that are not in the right alignment with company strategy as their main reason for divesting. Companies often pursue divestitures—or "carve-outs"—for a variety of reasons, such as shifting management's focus to core operations, raising capital, or improving overall financial performance. The current economic environment creates opportunities for management to examine their assets and operations in detail.

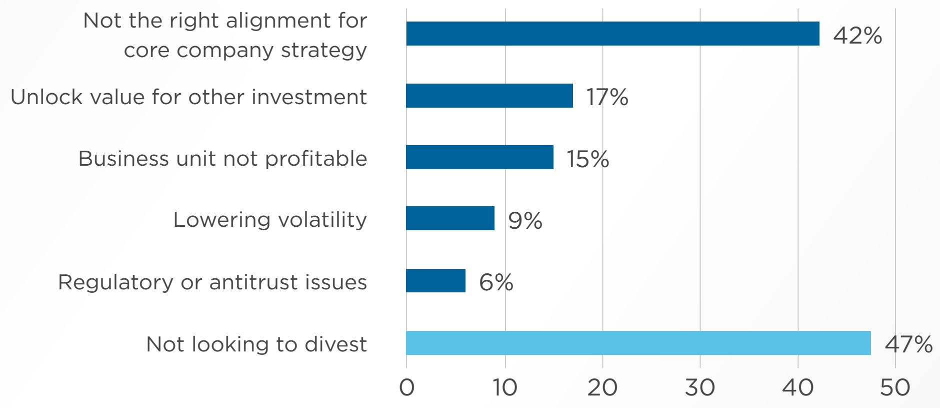
53%

CDO RESPONDENTS LOOK TO DIVEST IN 2023

"Focus on long-term goals versus short-term constraints."

CDO Forum survey respondent

Reasons for Divesting



Why divesting might be the right strategy for your company in the current economic environment:

1. **Back to fundamentals** – Times of volatility often underline the most critical portions of a company's mission and business. Shedding assets that don't adhere to what a company envisions as its future state can free up capital to invest in the core business, allowing for a stronger rebound.
2. **Exploring every option** – Today's economic climate may cause management to find they need to sell a division to keep the rest of the business afloat. This type of distressed sale is not preferred by management but is a useful option to deploy if necessary.
3. **Honest evaluation for future performance** – Finally, management may simply determine that the sum of the parts of their business is greater than staying together. Continuous assessment of your portfolio from an outsider's perspective will potentially yield more favorable performance over time. In the case of public companies, this may lead to shareholder activism driving strategic initiatives.

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Key considerations when planning for a divestiture

Planning and executing a divestiture is often far more challenging than expected. It is important for companies considering divestitures to carefully plan and execute the process to maximize value and minimize disruption, making every effort to emphasize communications with employees, customers and other stakeholders to ensure a smooth transition. Below are a few key considerations to make a divestiture as successful as possible:

Framework for the Deal

- Define the transaction perimeter to understand the potential scope of the population
- Identify value drivers and potential deal issues in advance of going to market, to allow time to highlight or mitigate them as necessary

Exploring every option

- Proactively think through audit needs and other regulatory requirements
- Plan to have a data room ready to house significant contracts, descriptions of IT workflows, key employee information, and other operating workflows and metrics
- Consider any necessary transition service agreements and purchase price mechanisms for the potential transaction
- Establish proper benchmarks and mechanics for working capital purchase price mechanisms, as well as purchase agreement reps and warranties

Honest evaluation for future performance

- Analyze the cost structure with a lens toward operating without the asset or to-be-divested business
- Identify ways to mitigate value loss from a tax perspective
- Determine who will stay with the organization versus who will be going with the new transaction

PROTECTING VALUE BY SOLVING THE CULTURE-FIT DILEMMA

Culture is the top concern when it comes to the success of a deal and subsequent integration. 53% of survey respondents validated what every CDO knows. Yet it is often overlooked as a critical success element to the overall merger integration—perhaps because factors that comprise company culture are often intangible such as occasional perks, leaders' personalities, or the collectively perceived mood of meetings. At the same time, paying attention to the overall health and impact of transition plays an undeniably integral role in whether or not organizations will reap the full value of the merger.

"Integration of processes, culture, and values is key to making deals successful. People are going to make the difference between a successful acquisition and one that fails. Surface-level integration won't fool buyers in this market."

CDO Forum survey respondent

Top five reasons for unsuccessful integrations

- **56%** Culture clashes
- **47%** Lack of employee buy-in or employee turnover
- **16%** Unachievable metrics
- **16%** Misalignment of IT systems
- **14%** Cost overruns

Guiding a successful merger when cultural differences exist

If corporate development leaders decide to proceed with a deal where the buyer and target have identified cultural differences, the messaging and mentality should not be, "Our (buyer) culture is best and will prevail." Rather, move forward with, "We will work together to determine who we want to be as a combined entity based on our combined vision, values, and strategies." The success of the deal depends on the ability to define a new and unified culture.

Culture is ingrained in the top-down messaging from leadership, emphasizing why the deal is important to the growth of the organization. When teams can understand and identify the differences between the cultures of the organizations in the deal, leadership can better define and address the future-state culture in the same way they are defining the future-state operations, processes, and technology infrastructure.

Culture should be treated the same as a company's finances when it comes to the deal thesis. CDOs should ensure that cultural evaluation of the target is as much a part of due diligence as financial and legal diligence. All analyses should continue throughout the pre-and post-close process, the 100-day plan, and well past year one of the integration.

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Key considerations when conducting cultural diligence

The framework and approach to cultural diligence is similar to considerations for HR, IT, finance, and operations. When conducting cultural assessment interviews, seek to understand:

- Communication style
- Management and leadership style
- Level of autonomy throughout the organization
- Decision-making processes

If the deal includes global or regional differences, include considerations for geographic differences that are often accompanied by cultural differences. The tricky part of cultural diligence is that the teams involved are dependent upon the subjective recall of a somewhat narrow demographic:

- Those in the know of the deal
- Those high enough up in the organization who can speak to the overall strategy of the company
- Those willing to provide candid answers to your questions with the collaborative goal in mind
- Those able to share findings from past employee engagement surveys for a more in-depth look into employee sentiment

Companies should collect enough information to understand the key differences between the buyer's and target's cultures in order to determine if a post-deal close plan might address the differences or if the cultural misalignment may perhaps be insurmountable.

SIDELINED FOR NOW, ESG WILL ONLY GROW IN IMPORTANCE

As both public and private companies develop their own environmental, social, and governance (ESG) programs over the coming years, we anticipate that ESG factors and their relevance will naturally increase. As a reference, three years ago, when the first CDO Forum study was published, ESG was not even a question. Now 37% of respondents identified that ESG factors are weighed more in the due diligence process. In the next two years, we anticipate mature ESG programs will likely help shape the due diligence process and priorities along with regulatory changes, shifts in investor priorities, possibly valuations, and approaching supply chain drivers.

37%

IDENTIFIED THAT ESG FACTORS ARE WEIGHED MORE IN THE DUE DILIGENCE PROCESS NOW THAN IN PRIOR YEARS

"Increased regulatory reporting requirements on ESG are coming, but demand for sustainability information right now is growing from a variety of stakeholders, including investors."

CDO Forum survey respondent

Key considerations to help corporate development teams prepare for the growing ESG trend

Research priority metrics relevant to the industry – ESG reporting frameworks and trends from an industry sector's perspective may inform each company of priority metrics relative to its peers. This insight could offer key ESG factors to be included in the due diligence process.

Prepare for enhanced audits – For public company CDOs, the proposed SEC climate disclosure rule would require climate disclosures in the 10-K. This would introduce the need for data collection and reporting processes robust enough to withstand external auditors and enhanced scrutiny from institutional investors and other stakeholders. As a result, climate risk management practices and greenhouse gas emissions may become worthwhile factors to consider in the due diligence process.

Investing in future gain – For private company CDOs, strategic acquisitions should consider ESG factors with sustainable practices that manage resources effectively and drive profitability.

Considering the ripple effects – For private company CDOs, leadership should prepare for climate reporting requirements to be pushed into the supply chain by public companies. This factor might impact private companies' strategy and due diligence priorities.

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AT THE CORE, IT'S ABOUT RELATIONSHIPS

"Cash preservation and relationship management are equally essential."

CDO Forum survey respondent

In 2020 CDO Forum study, CDOs attributed 38% of their acquisitions to the competitive process and 62% to relationship-cultivated, as compared to 51% and 49%, respectively, in the 2023 survey. This declining trend in relationship-cultivated acquisitions may be attributable to the pandemic but is concerning. To stay viable and win deals, CDOs must reinvigorate and refocus efforts on cultivating relationships with targets and the entire deal ecosystem.

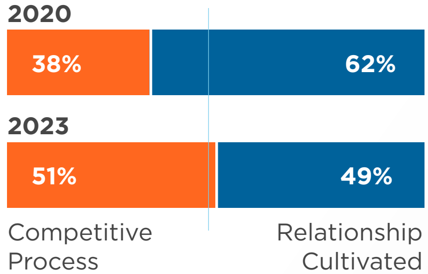
Equally important is for CDOs to continue nurturing internal relationships with executive management, business unit leaders, and the board of directors to stay in step with the future performance, strategy, accountability, and vision of the company.

CDOs vs. Private Equity

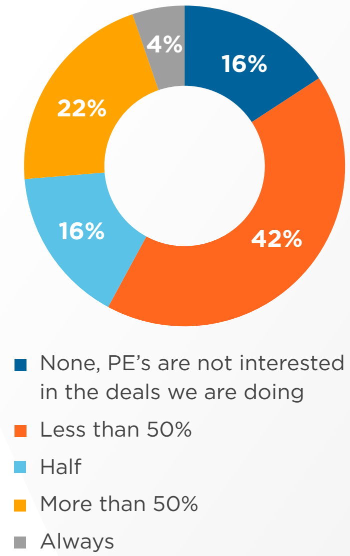
Despite the private equity frenzy of 2021, 58% of our CDO respondents encountered PE firms in less than 50% of their acquisitions, with 16% stating that PEs weren't interested in the deals they were doing. The difference may be due to many PE firms having a buy-to-eventually-resell approach versus that of corporate leaders, where the deal strategies often lean toward a longer-term business combination.

Even so, some target companies are likely to be highly sought-after, in which case CDOs won't always be able to avoid going head-to-head with PE firms.

What percentage of your acquisitions are competitive process vs. relationship cultivated?



When you are bidding in an auction process, how often do you compete with PEs for deals?



> *"It is a long-term game; think strategically beyond the close, and make sure a realistic long-term monetization plan is possible."*
>
> CDO Forum survey respondent

The coming year will bring with it unprecedented economic conditions – ones that may be unknown or hard to predict. That's why it's essential for corporate development officers to stay aware of market conditions and potential opportunities as they prepare their organizations' strategies for the year ahead. By understanding interest rates, inflation expectations, and other variables affecting borrowing costs, these professionals can ensure their organization remains agile despite ongoing uncertainty.

ABOUT THE 2023 CDO DEAL OUTLOOK STUDY

250+

Nationally diverse corporate development executives or those responsible for the CDO function were surveyed; 48% representing companies greater than one billion in annual revenue, with 32% being Fortune 500 companies; 52% are middle-market companies ranging from fifty million to one billion in annual revenue

The study is based on a survey administered in Q4 2022 to CDOs across the country. Questions for the survey were created by CDO Forum members – by CDOs for CDOs. Riveron, in partnership with the CDO forum, was responsible for survey administration and reporting. All responses are anonymous, have been held in the strictest confidence, and are generally reported within this survey.

We thank all the CDOs who volunteered to share their time and perspective.

Industries Represented

- **33%** Manufacturing, automotive, and industrials
- **21%** Healthcare
- **16%** Technology, media, and entertainment
- **11%** Retail and consumer products
- **19%** Other industries including aerospace and defense, energy, financial services, business services

FOR MORE INFORMATION

The Corporate Development Officer Forum, founded in Minneapolis in 2019, is an informal peer-to-peer network for corporate development executives to discuss best practices and hot topics. Now boasting over three hundred members nationally, the Forum features a series of peer-driven events focused on current trends and networking.

The CDO Forum is strictly for corporate development executives and for those individuals who perform the corporate development function for their company. To become a member of the Forum or to learn more about the 2023 CDO Deal Outlook Study, please contact Josh Bier, Managing Director, Riveron.

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Riveron is a business advisory firm specializing in accounting, finance, operations, and technology. We partner with the Office of the CDO and other corporate leaders to implement tailored solutions across the transaction and business lifecycle. Whether the company is experiencing high growth, distress, transition, integration, or separation, we deliver meaningful results to drive the business forward.

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