How Cybersecurity Can Drive Value in M&A: Improving Processes and Outcomes

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About Us: Today's Presenters

Richard Phillips, Senior Partner at Crossroad Capital
Richard is the Founder and Senior Partner of Crossroads Capital, LLC. He leads a team of experienced financial analysts, research assistants, and directors bringing the organization's tailored solutions to middle-market companies throughout the US and around the world. He is a seasoned dealmaker and accomplished financial analyst with more than 20 years of corporate finance, consulting, and investment banking experience. During his career, he has completed more than 29 M&A and other strategic transactions valued at more than $6.4 billion, across several industry sectors and geographic regions.

Bill Palifka, VP of Business Development at EmberSec
Bill Palifka is the VP of Business Development. Bill leads a team of experienced security experts that draw on knowledge of the cyber risk landscape, experience in auditing and assessing cyber capabilities and underlying technologies, and extensive expertise evaluating security programs. As a seasoned technology executive with over fifteen years of experience, Bill has led large-scale technology projects for healthcare systems, manufacturing, educational institutions and Fortune-100 companies.

Today's Host

Tom Craig, Managing Partner at FH+H
Tom leads FH+H's Corporate + Business Transactions team, which is a recognized leader in negotiated business transactions, particularly merger and acquisition deal-making. His clients have included domestic, foreign, public, and private companies of all sizes — from family-owned businesses to mid-size government contracting firms — at all stages in the business growth cycle. Tom also advises on breach of contract claims, violations of non-competition agreements, alleged trade violations, and more. He specializes in high-profile and high-risk matters that require comprehensive coordination of legal, media, political, and consulting efforts.

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Agenda of Today's Presentation

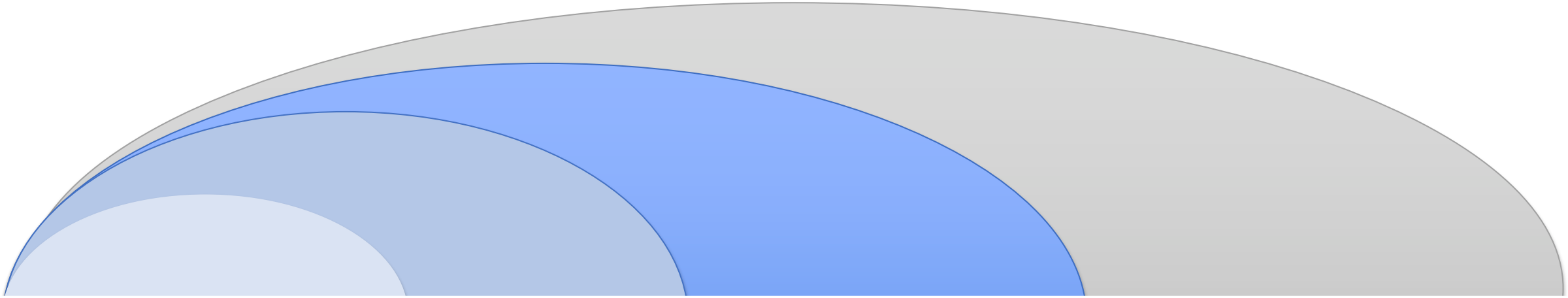
- Lifestyle versus "corporate minded" organizations how cybersecurity can be a key differentiator
- Typical due diligence processes and approaches in M&A
- Sources of information asymmetry and Cybersecurity deal risk
- How proper cybersecurity diligence can help solve information asymmetry and quantify risks, and limit exposure
- How implementing cybersecurity best practices can enhance value, streamline integration and improve deal outcomes

Life-Style & Corporate-Minded Organization Comparisons

Attribute	Lifestyle Company	Corporate-Minded
Purpose	Generate short-term cash flow for their owners, with limited appetite to make investments in long-term growth	Maximize shareholder value over the medium / long-term and is willing to make the corresponding investments.
Corporate Infrastructure	Limited	Strongly institutionalized
Leadership Team	Owner-centric and focused	Professionally managed; division of labor of management by function
Deal Sophistication	Limited – likely first and last deal, with limited outside help	Deal experience + ability to hire strong advisory team
Diligence Lift	Heavy and difficult, be prepared for hand-holding and helping the target compile	In place and better organized; still don't expect everything ready "as is" off the shelf necessarily
Valuation Expectations	High – Often because they don't know any better, or are unaware of market conditions	High – Because they are more market savvy, know their value and can articulate it to buyers
Demographic	Small companies, less than $10 million in revenue	$15+ million in revenue have reached "escape velocity" with growth momentum

Lifestyle companies do not often appear as attractive to sellers. Organizations that demonstrate attributes of a "corporate-minded" organization will garner greater interest and yield higher valuations.

Buyer Pool Dynamics: Lifestyle versus Corporate



Value of Existing Contracts/Ops

Perpetuity of Status Quo

Value to a Small Strategic

Value to a Large Strategic

Shutdown & Liquidate

Value to Different Buyers Based on Seller's Size

Ind. Sponsor

ESOP

Mgmt. Buyout

Private Equity

Values market access, past performance, capabilities, etc.

Values market access, past performance, capabilities and as buyers *can do more with them*

Lifestyle Businesses

Corporate Minded

Objectives of Due Diligence

Prevent Surprises – The most basic goal of due diligence is to prevent surprises both throughout the deal process as well as long after deal close. In other words, the purpose of due diligence is to rapidly identify and quantify risks, and resolve any issues of concern to the extent possible.

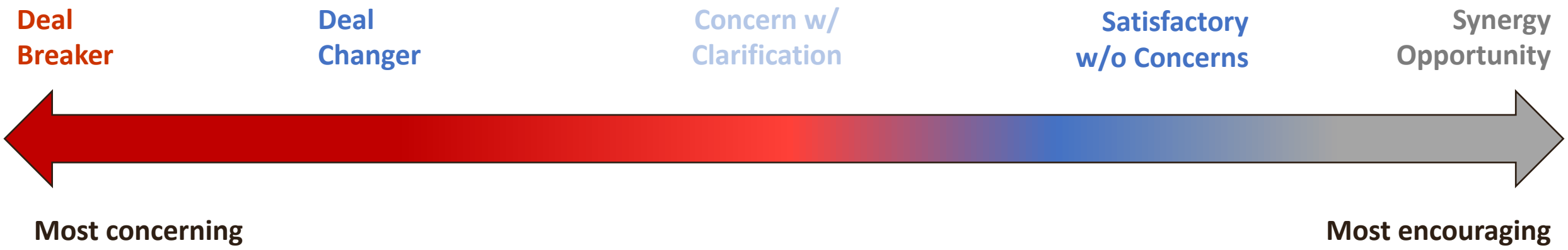
Identify Opportunities – The due diligence process is one of the few occasions in the lifecycle of a company where incoming management gets to do a focused deep-dive on all aspects of the organization from a fresh perspective. Using this time only to look for problems is short-sighted. Instead, the due diligence team should look for opportunities that can be implemented after the deal closes as the combined entity emerges.

Inform Legal Documents – When done properly, due diligence should inform and streamline the legal process and "papering" of the deal's definitive agreements such as stock purchase agreements The due diligence process should also help inform the negotiations over reps and warranties to allow the legal documents to mitigate key relevant risks and punt on hypotheticals when necessary.

Build Goodwill – The due diligence process allows the buyer and seller to work closely together, helping them build a stronger relationship fostering goodwill. This goodwill is a valuable asset during the tense and sensitive negotiations required to close and integrate a deal properly. When done properly due diligence need not be contentious.

Confirm Strategic Fit – The reason for consummating any acquisition is to achieve specific strategic objectives. The diligence process needs to confirm that the proposed transaction gives the buyer a measured probability of confidence of meeting these strategic objectives after deal closing.

Data Point Evaluation: The Spectrum of Diligence Concerns



Information from the target can be evaluated on a spectrum like the one above to guide discussions and triage concerns to better focus diligence efforts on key items.

Due Diligence Setup: Tasks & Logistics

1 Functional Modules & Team Roles → To facilitate the process, the buyer should segment due diligence topics into functional modules, corresponding to everyone's expertise.

2 Data Request & Map Diligence Tasks → Buyers need to create one central repository of all diligence matters to be investigated. Crossroads will turn this into the data request for the Target.

3 Manage Incoming Target Data → Email is a terrible way to manage or keep track of large volumes of data. Instead, all parties need to agree on the tools to be used for file sharing.

4 Clarify Process for Talking to Target → Communications with the Target must be well structured to avoid miscommunications and wasting time with needless back and forth.

Curating a Checklist of Questions and Data For All Parties

- Legal Counsel →
- CPA/Accounting →
- M&A Advisor →
- Other Advisors →
- Buyer Internal →
- External Research →
- *Add Cyber IT Auditor* →

Curated Master Diligence List

Content:

- Reconciles the questions & checklists received from all sources
- Eliminates duplicative questions
- Eliminates irrelevant data points
- Properly assigns each question into the right functional categories

Uses:

- Bird's eye view of diligence
- Ensure that no items are missed
- Create one single and organized diligence request to sellers

→ **Advisor to create first draft**

↓

Advisors Give Feedback to Diligence List Draft

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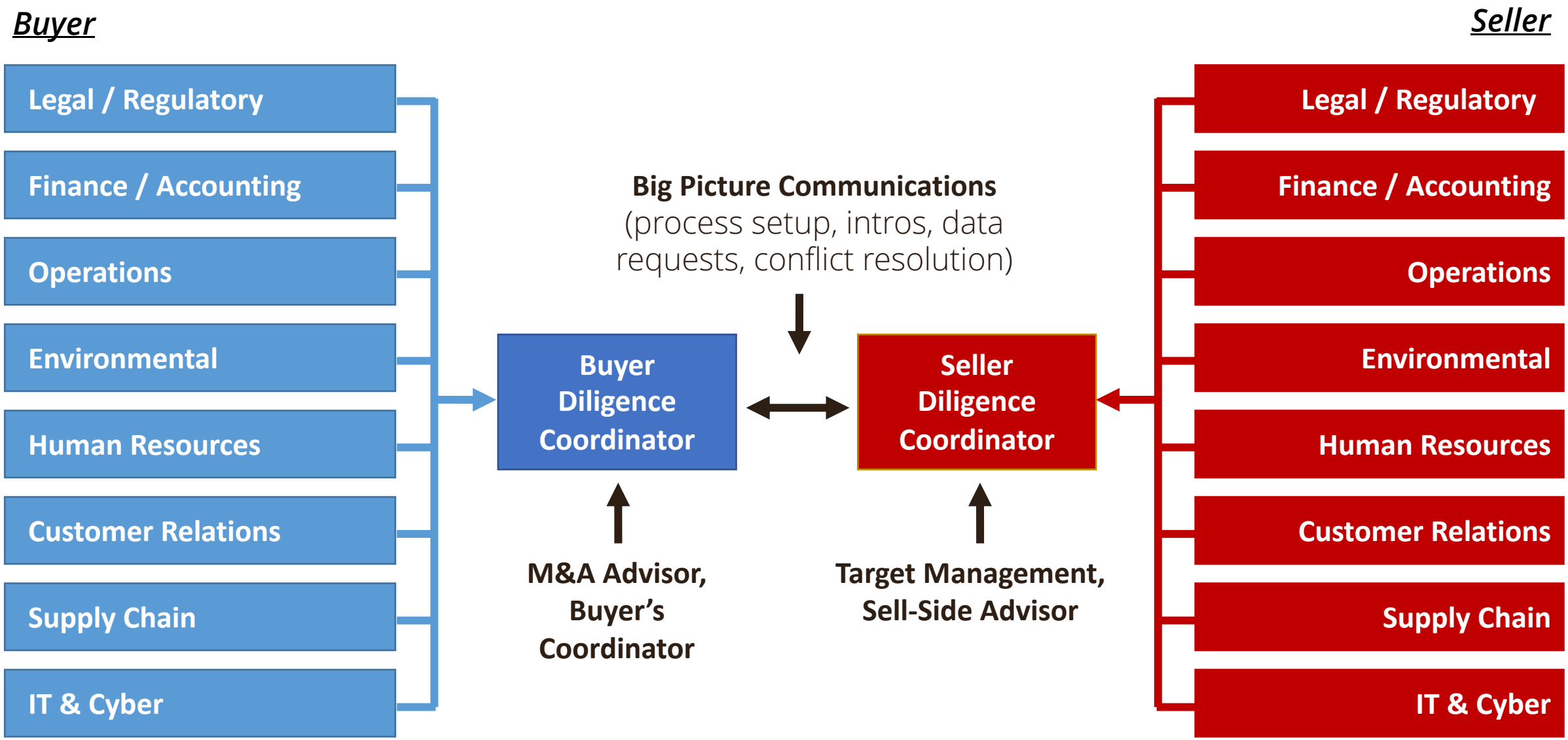
M&A Advisor to Send to Target as One Package

Target Communications: Big Picture Coupled with Functional Insights



Review Process: Standardized and Repeatable Process for Efficiency

1 Collect *All* Information → Buyers should only begin evaluating target data only once *relevant* information has been received from the Target.

2 Evaluate Data Received → Data should be evaluated thoroughly but expeditiously by classifying it on a spectrum ranging from "deal breakers" to "new opportunities".

3 Follow-Up Data & Questions to Target → If the data is unclear or if the findings beget context or an explanation, compile questions for the DD coordinator to send Target as needed.

4 Final Evaluation → Once all information is in, and the Target has had an opportunity to clarify or explain any items, conduct a final evaluation of the matter at hand.

5 Select Issue Resolution → Based on the final evaluation, if needed, seek internal consensus to appropriately resolve the issue identified..

Information Asymmetry in IT – Gaps in Knowledge

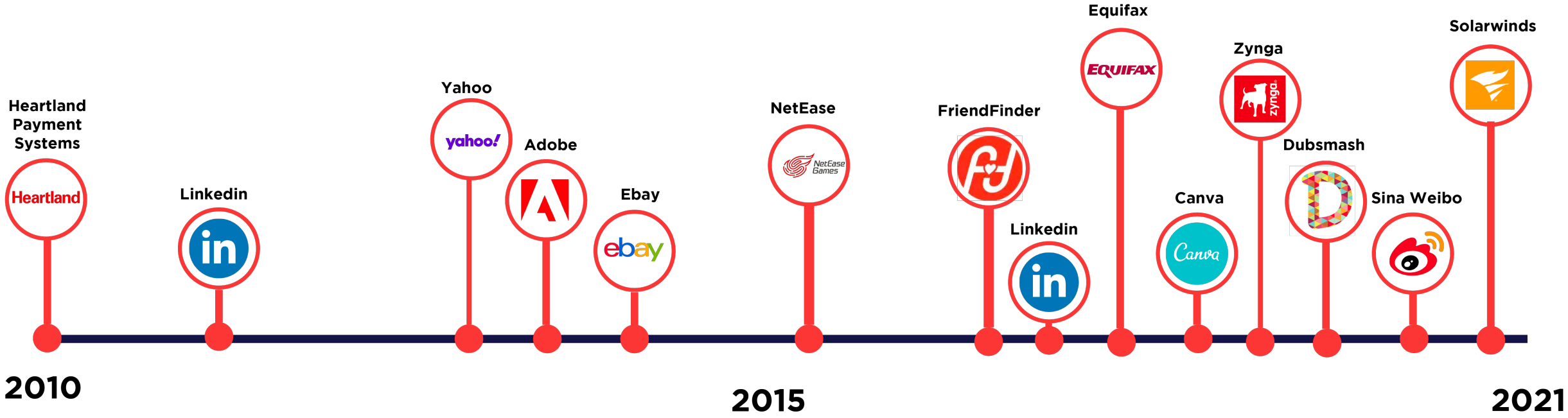
You really don't know anything about the M&A candidate beyond:

- What they are willing to share about the assets
- What assets they are aware of at a single point in time
- Many companies don't have a grip on what they have, where they have it, and it what operational condition it is in currently

What they share is not

CURRENT
ACCURATE
COMPLETE

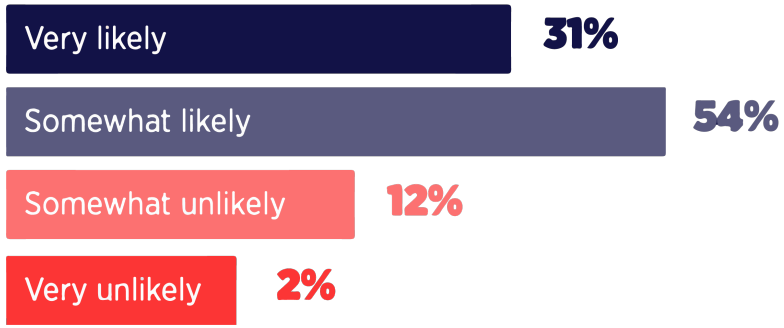
Biggest Breaches – 2010+



Survey of Buyers & Their Thoughts

Would You Consider Aquiring A Company That Has Recently Suffered From a High-Profile Data Breach

The Likelihood of Major Security Vulnerabilities Affecting A Merger or Acquisition



Impact of Buying a Breach

33%+
experienced data breaches attributed to M&A activity during integration

-5-30%
Decrease in valuation of potential acquisition targets that experienced breaches.

$5 Trillion
of predicted global cost of data breaches by 2024

2,244 A Day
average # ofcyber attacks registered by organizations

$123 Billion
Spent on cybersecurity in 2020

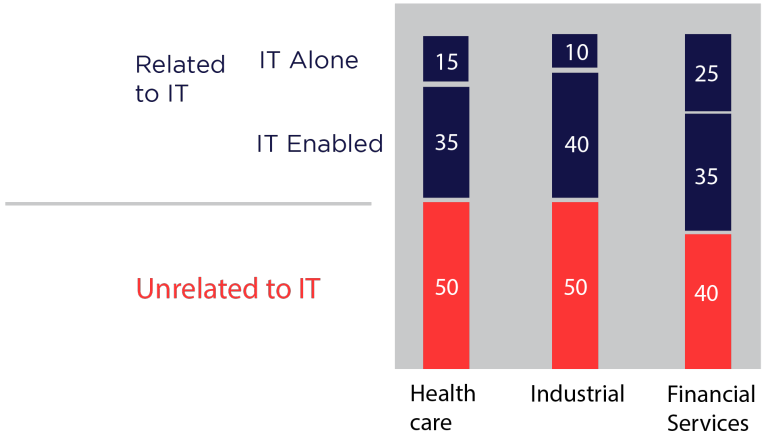
73% Undisclosed
Discovered previously undisclosed security breaches through cyber due diligence assessments

Role of IT in Creating M&A Synergies

Up to 40% of cost synergies are enabled by IT. Up to 25% are wholly within IT.

Often, more than half the synergies vailable in a merger are strongly related to IT.

Synergy distribution by industry%



Example of synergies

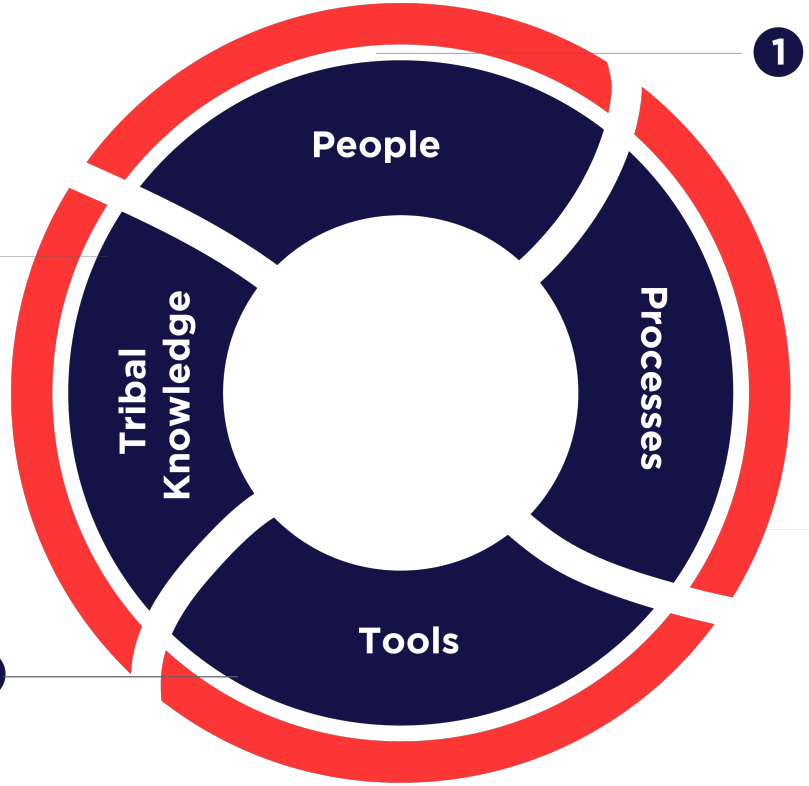
- Lower IT infrastructure costs
- Reduced IT head count
- Increased volume discounts for IT procurement
- Integrating functional systems reduces finance and HR costs
- Route optimization lowers logistics costs
- Integrating customer data offers better cross-selling revenue
- Fewer plants, distribution centers, and headquarters reduce facility costs
- Lower financial costs
- Vendor consolidation lowers procurement costs

Buy Vs. Sell Side M&A Considerations

Buy	Value Creation and Transformation		Sell
Tech Due Diligence (DD)	Risk Analysis	Data Safeguards	Vendor Due Diligence
		Threat Detection	
		Infrastructure Security	
	Deal Valuation	Transparency	
		Strategy Management	Sell Prep
Tech DD Reduced Scope		Cost Reduction	
	Technical Debt	Access Controls	
Outside-In		Remediation Cost	
Tech DD+		Integration	

Blind Diligence

Discovering the failures of a M&A candidate before execution of contract should be mandatory



1. The IT teams members on both sides are concerned with job stability
2. No processes on either side is designed to account for the complexity of modern IT systems for an M&A
3. No processes exists to discover / validate unknown assets (neither trust nor verification)
4. Both sides lack the tools needed for discovery / attribution / validation beyond what they think they own
5. M&A is a one-time event for most acquiree IT teams – they lack the knowledge needed to execute a successful event

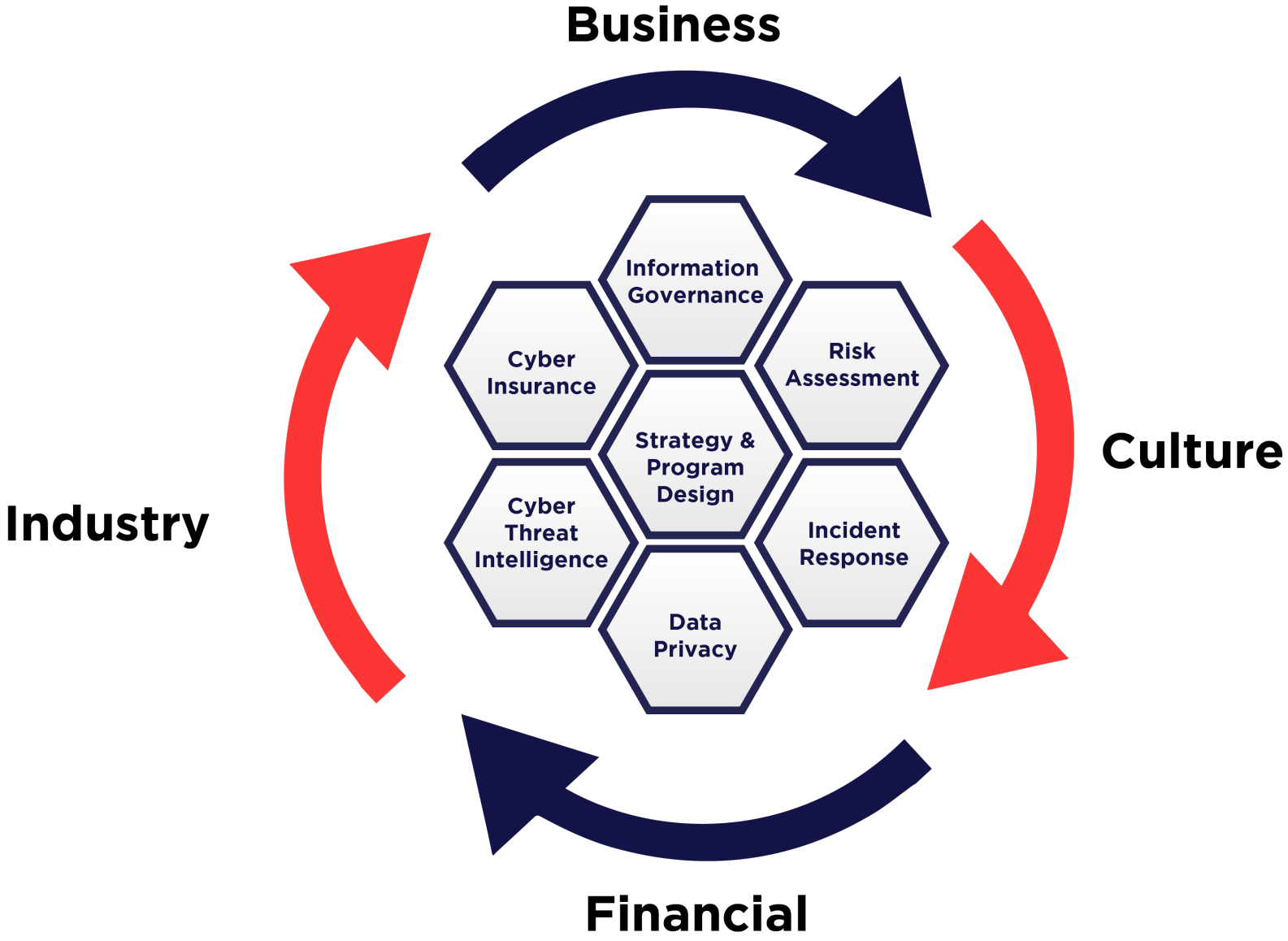
Common Mistakes

- Inadequate security and controls
- Unplanned software and license costs
- Old, unsupported legacy systems still needed
- Late identification of assets / Hidden or buried costs
- IT brought to the table too late
- IT Maturity Gap

Our Approach Answers the Following:

- Does a company adhere to IT and Cybersecurity best practices to reduce impact to business continuity?
- Can an organization protect themselves against a determined threat actor?
- Can a company detect a breach?
- Could they recover from the breach?
- Is there already potential adversary activity?
- Is their technical debt that can result in driving down costs?

Holistic Approach to Cyber Risk



Considerations

10 actions that can begin a complete and thorough M&A lifecycle

- ✓ Identify the IP Range associated with your M&A target
- ✓ Review active services on your target's IP perimeter
- ✓ Review target perimeter cryptographic health
- ✓ Note end-of-life software
- ✓ Pay attention to target perimeter "heterogeneity"
- ✓ Make a list of your target's business history
- ✓ Make a list of your target's vendor relationship
- ✓ Map your target's network by business impact
- ✓ Estimate integration costs as early as possible in the diligence process
- ✓ Remember that your target's security team are your potential future partners

Conclusions – Cybersecurity Considerations in M&A

- ✓ Cyber threats are increasing in complexity and frequency meaning the chances of buying a breach is greater than ever.
- ✓ With today's ever-evolving threat landscape, cyber risk has become a key matter of corporate governance.
- ✓ Cyber risks are not just technology problems. They have legal, financial, operational, and board governance implications.
- ✓ Businesses undergoing M&A must complete rigorous due diligence to uncover and remediate concerns about the security posture of their targets.
- ✓ Cyber due diligence should focus on revealing deal-breakers – or more likely, deal-changers that may require "re-trading."
- ✓ To ensure that you are not buying a breach it is critical to established relationships with cybersecurity stakeholders within a company and have a flexible cyber deals playbook to assist with cyber at each deal stage, cyber risk level and deal type.
- ✓ When levered properly, cybersecurity diligence can enhance deal value, de-risk a transaction, and improve integration efforts.

Thank You!

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