Insights

Impact of AI in the M & A Sector: Key Advantages, Challenges, and Considerations

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Artificial Intelligence (AI) continues to grow apace despite deal activity dropping overall in 2023 in response to economic and market instability brought on by a combination of high interest rates, inflation volatility, and geopolitical tension. AI can provide innovative improvements to the M&A sector that may help increase deal activity for 2024 and the years to come.

Advantages of using AI in an M&A transaction include the following:

1. **Due Diligence and Data Analysis:** AI can automate and expedite the due diligence process by quickly analyzing large volumes of data provided by one transaction party to the other. Typical diligence document review includes financial records, legal documents, contract portfolios and other relevant information, helping both buyers and sellers make more informed decisions about the deal. Frequently, buyers and sellers use a virtual data room (VDR) to exchange information. AI will facilitate the analysis of documentation uploaded in a VDR by quickly analyzing contracts and gleaning important information, such as change-in-control or anti-assignment language and other key contractual concepts. Additionally, diligence teams will be able to use AI to ask questions about documents in the VDR, allowing a reviewing party to learn more about key datapoints within the target company's existing documentation.

2. **Deal Sourcing and Target Identification:** Algorithms used in AI programs can assist buyers, sellers, brokers, investment bankers and other transaction parties and advisors identify potential targets by analyzing market trends, financial data, and other relevant parameters. M&A professionals on both sides of a deal will be better able to align opportunities with their respective strategic objectives.

3. **Predictive Analytics for Valuation:** By utilizing predictive analytics, AI can improve the valuation process. Machine learning models can analyze historical data, market trends, and other variables to provide more accurate predictions of a target company's future performance, influencing valuation decisions.

4. **Risk Assessment:** AI tools can also gauge and thereby help mitigate risks associated with M&A

transactions. Buyers can use AI to identify potential legal and compliance issues and predict how external factors, such as market trends and shifts in pricing models, might impact the success of a target entity post-closing.

5. **Streamlining Deal Flow:** AI has the power to produce and update transaction checklists, improving efficiency by allowing parties to stay on task and lowering the overall cost of a transaction.

6. **Post-Transaction Integration:** The tools of AI can play a role in post-transaction integration by assisting in combining systems, processes, and teams more seamlessly. This can improve the chances of realizing synergies and achieving the strategic goals of the deal.

AI also provides similar benefits to businesses from a day-to-day operational perspective. Companies can use AI to automate routine and repetitive tasks, such as data entry and customer support services. Businesses can also use AI to help analyze large sets of data to identify and predict trends, make informed decisions, and develop effective strategies to stay ahead of the competition. They benefit by reducing costs, allocating their resources more effectively, and achieving more rapid growth. These benefits help businesses gain an advantage in the market space and can lead to increased EBITDA, making that business a more attractive target candidate. On the flip side, businesses that do not use AI may still nonetheless be an attractive target entity. A private equity buyer or other sophisticated buyer could identify missed opportunities and conclude that the buyer will find room to increase profits by implementing and integrating AI into the operations of the business.

Deal activity should increase in sectors that properly utilize AI. The following positive results seem likely:

1. **Increased EBITDA:** By using AI to lower costs and allocate resources more efficiently, businesses can potentially increase their EBITDA and become a more attractive target entity for potential buyers. These businesses should experience increased deal flow arising from the opportunity to grow and benefit from the advantages of using AI, particularly businesses that have not yet started implementing AI in their business operations.

2. **Improved Valuations:** Buyers will know what they are getting. Through better data insights and predictive analytics, small businesses can better manage their working capital and predict cash flow needs. This will improve deal flow as buyers, using AI predictive analytics, can improve the quality of the target entity valuation and define with more certainty an appropriate purchase price.

3. **Faster M&A process:** As the adage goes, *times kills all deals*. By using AI in the M&A sector, especially AI's ability to analyze large volumes of data (such as financial statements) and to exchange and evaluate documentation through VDRs, buyers and sellers can better identify issues and negotiate deals faster.

4. **Better Insight:** Risk and uncertainty pose barriers to any deal. Through better data analysis and AI improvements to the due diligence process, buyers will have greater insight into the operational and business practices of a target entity and will more easily identify and predict business opportunities of a target entity. Consequently, AI allows buyers to better manage their risk in acquiring a target.

5. **Smoother Transitions:** The power of AI will allow for a smoother post-closing transition. Buyers and sellers can harness the information processed as part of due diligence to identify and implement effective strategies for the target company moving forward.

While offering various advantages, AI also gives rise to several challenges, such as regulatory scrutiny, ethical considerations, and cybersecurity issues. President Biden, on October 30, 2023, issued his **Executive Order on the Safe, Secure, and Trustworthy Development and Use of Artificial Intelligence** ("Executive Order"), which emphasizes America's pace in AI innovation and competition. The Executive Order also stressed the importance of ensuring small businesses have access to AI and can compete in a fair, open, and competitive AI market. In addition, the Executive Order noted that strong cybersecurity regulations can help consumers feel safe about spending money in today's virtual economy and will incentivize more businesses to engage in more e-commerce and digital methods of purchasing goods and services. An increase in consumer spending online because of stronger cybersecurity regulations can potentially increase deal flow going forward, particularly those businesses that rely on e-commerce to sustain and grow their businesses.

If you have any questions regarding AI, M&A transactions, or this Alert, please contact **Travis D. Lovett** or **Charles O. Richert** or any member of our **Business, Acquisitions and Securities Practice** or our **AI Task Force**.

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