



# COVID-19 and the possible impact on M&A

## Issues to consider in the short term

The rapidly evolving COVID-19 situation means that we cannot look too far ahead to predict what will happen next, and many of us will be dealing with much more immediate and important personal and business issues than M&A. However, for those already involved in an M&A process or about to embark on one, there are some immediate issues for buyers and sellers to consider, and we have set these out below. We look at (a) deals that are between signing and closing; (b) deals that are in the course of negotiation; and (c) deal processes that are about to launch. We also make some general observations that apply to all M&A transactions.

For further information on COVID-19, please see our hub on [Navigating the COVID-19 outbreak](#).

## Deals that are between signing and closing

### Impact on the target business

- **Changes in the target business** – It will be important for the parties, to the extent possible, to identify actual and anticipated changes in the target business. Issues to consider include contractual counterparty risk, supplier disruption, customer slowdown, employee issues, quality of earnings analysis and the ability of the target to invoke any force majeure/termination rights (or, conversely, its vulnerability to a contractual counterparty invoking such rights).
- **Insurance** – What relevant insurance does the target have that could be responsive to the situation? The buyer may want to be involved in discussions with the insurer.
- **Notifications** – The target should be considering whether it needs to make any notifications under commercial contracts about its ability to fulfil its obligations or to invoke force majeure/termination clauses. Again, the buyer may want to be involved in discussions about these issues.

### The documentation

- **Conduct of business and other pre-closing covenants** – Are there relevant pre-closing covenants where the buyer has consultation or approval rights? In particular consider any obligation on the seller to "carry on business in the ordinary course" – the seller may need to consider these when implementing COVID-19 measures. The buyer may want to have input, in particular into any employee well-being measures and/or communications.
- **Warranties and disclosure** – If there is a bring-down warranty regime at closing, what additional disclosures are permitted and what disclosures might a seller need to make?
- **Price** – Consider if there is any impact on the deal pricing that has been agreed, and if the pricing dynamic has changed (particularly if there is a locked-box mechanism, earn out or other deferred

contingent). If there is a re-pricing discussion, introducing contingent or deferred consideration may be a useful tool.

- **Termination rights** – What material adverse change (MAC) or other termination rights can a now reluctant buyer seek to invoke, either to terminate the transaction or in an attempt to renegotiate price?

## Financing arrangements

On leveraged deals, it will be important to identify if the lending banks to a buyer have any ability to pull the financing, and parties may need to find other solutions where there are new financing gaps. For example, we have seen sellers offering vendor financing to buyers, to get their deal closed.

## Closing the deal

Buyers and sellers who want to close are seeking ways of accelerating deal closing. However, where there is some discussion between parties about proceeding to closing, be careful when interacting with a counterparty, particularly one that is in financial difficulty or otherwise less keen to progress the deal. Each party should make sure it does not promise anything that could later be argued to be a waiver of rights under the deal documents.

Other key issues are:

- **Conditions precedent** – Identify any other obstacles in discharging CPs, and agree waivers where appropriate.
- **The practicalities of closing** – It will be important to address early on how the completion meeting will work where there are travel bans and restrictions on physical gatherings, and/or where critical signatories are or may be in quarantine.
- **Problematic jurisdictions** – Consider whether it is possible to de-link from the rest of the deal assets that are in jurisdictions experiencing a greater degree of temporary difficulty. For example, we have one transaction where the main deal proceeded to closing, with the assets in one particular jurisdiction being omitted from the deal for the time being.

Where deals, or part of them, are delayed or renegotiated, the parties will have to identify what new documentation is needed for those arrangements, whether any third party approvals will need to be refreshed and whether further consultation/employee communication is required (in particular where subject to TUPE or other consultation requirements).

## Additional considerations for listed companies

- **Inside information** – Companies will have to monitor whether any developments in relation to the deal (for example, price renegotiation or delay in the transaction) constitute inside or price sensitive information which has to be announced to the market.
- **Deals requiring shareholder approval** – If the deal is still subject to shareholder approval, is there any change in the directors' recommendation or in shareholder support (and do any irrevocable undertakings to vote in favour give any scope for the relevant shareholder(s) to withdraw their support)? The company will have the additional challenge of physically convening any shareholder meeting. Also, be aware that, even where shareholder approval has been obtained, further approval may be required if there is a material change in circumstances after the shareholder vote.
- **Shares to be issued as consideration** – Where the buyer is issuing shares as consideration, consider the impact on the deal, particularly where there is a significant deterioration in the buyer's share price. If the buyer has issued a prospectus, it will need to consider whether it should be issuing a supplementary prospectus.

## Deals that are in the course of negotiation

### Auction sales

Some auction processes are still continuing for the moment, although even those likely to involve delay.

The approach taken may in particular be affected by whether the assets are (a) attractive on a short/medium term basis (such as healthcare, home delivery and technology services), or (b) in potentially stressed or distressed sectors (such as travel, hospitality and retail). Asset valuations, and availability of finance for assets in the second category, may be key.

Vendor due diligence reports may need to be updated to take account of new circumstances or developments. Parties may want to establish whether W&I insurance is still available, and the terms, pricing and timelines for it.

Sellers will also be looking to de-risk transactions as much as possible. This is likely to mean that:

- cash buyers will be favoured over buyers who require deal financing;
- bidders who don't require merger control approvals are likely to be favoured over those bidders who do; and
- sellers will be more cautious about strategic bidders who require shareholder approval.

As we look ahead, buyers in jurisdictions that emerge out of the situation more quickly may be better placed to acquire assets.

## Bilateral processes

These are likely to be moving forward on a slower timetable, not least because parties may wish to avoid the distraction of an M&A process while working to maintain business as usual. The process may also be impacted by a change in either party's appetite to do the deal, in particular a need for cash conservation by buyers or the availability of debt. If a buyer is showing no real appetite to progress negotiations, the seller may wish to consider alternative options, and if so whether it can terminate any exclusivity period early.

If parties agree to continue on a slower timetable, they should consider extending the exclusivity period.

## New deals

The situation may impact the appetite for bold/transformational deals but is presenting new opportunities in stressed and distressed M&A. Sellers may also seek to accelerate anticipated disposals of non-core or underperforming businesses to raise cash. The issue then is which potential buyers have the appetite and funding ability at this stage, notwithstanding valuation and wider uncertainties. We may also see some opportunistic takeover bids, although market volatility may mean that bidders are more reluctant to bid, target boards may be more reluctant to recommend a deal and shareholders may be more reluctant to decide whether to support a deal.

Any anticipated government financing and/or intervention in certain sectors and businesses may make a deal more attractive but may also mean that there is greater unwillingness to risk a transaction where the situation is so fluid.

New deals will face the same challenges to valuation and availability of financing as deals in progress. Additional issues to consider include:

- What COVID-19 due diligence questions/warranties should the buy-side be requesting (including around employee health measures, the ability and adequacy of systems for business to be conducted remotely, insurance, supply chain risk, contractual termination rights and counterparty risk)?
- What new MAC/termination rights should the buy-side be requesting?
- What new pre-closing covenants (including around employee well-being steps and business continuity measures) should the buy-side be requesting?

ESG was already a key trend in M&A in 2020, and the political and social scrutiny of buyers and sellers, as well as investor pressure, to be responsible owners of assets (as regards employees, customers, suppliers and the wider community) is only likely to increase.

## Impact on the M&A process generally

There a number of factors that may impact the M&A process generally which should be borne in mind:

- **Anti-trust clearance** – Remember that the market positions of buyer and target are likely to change in markets where there are significant business failures (e.g. travel). The competition authorities will take the latest market share position into account, even as it changes in the course of the process. For transactions that have not yet been notified, consider whether the thresholds for notification continue to be met. Some jurisdictions may have special regimes for acquisitions of failing companies, but the threshold that has to be met to fall into that regime may be very high.
- **Dealing with regulators** – Where deals are still subject to outstanding merger control/regulatory approvals, obtaining those approvals may involve additional challenges, particularly where there is a rapid deterioration in the underlying business of the target, buyer or seller or other urgency to close. Already lengthy approval processes may take even longer because of disruption/bandwidth issues at those merger control/regulatory authorities or the courts (in the case of a scheme of arrangement). For example, in the UK the Takeover Panel has confirmed its remote working arrangements, and UK Companies House registry has confirmed the closure of its London office. We may also see governments introduce tighter restrictions on acquisitions by overseas buyers in the coming weeks and months, with Spain being an example of a jurisdiction which has already taken this step.
- **Data rooms** – Sellers may have difficulty accessing information and populating data rooms while in disrupted operational mode, for example if target employees are not able physically to access documents from their offices.
- **Transaction teams** – The teams, and so their ability to progress a transaction, may be impacted by any significant degree of quarantine/illness in senior/key deal team membership (including investment committees, board members and other key decision-makers).
- **Face to face meetings** – Many M&A processes typically rely on in-person meetings of senior individuals on the buy- and sell-side from time to time (e.g. CEO to CEO). They also typically involve a phase of in person lawyer/client team negotiations. In order to keep moving the deal forward, parties may now have to rely on calls, given the restrictions on gatherings and travel bans.
- **Long stop dates** – Parties should check, and if necessary extend, any long stop date.
- **Conditions on UK public M&A transactions** – Note that the UK Takeover Panel imposes an extremely high threshold for invoking MAC conditions on an offer (the circumstances must be “of very considerable significance striking at the heart of the purpose of the transaction”).
- **Activists** – As the world adjusts to this situation, it will be interesting to see what role activist shareholders play in potentially very disrupted markets.
- **Post-merger integration** – Buyers will need to consider how longer term restrictions on travel will impact on effective post-merger integration, particularly in cross-border deals?

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If you have any questions or would like to discuss this further, our teams are happy to assist – please contact any of the people below or your usual Herbert Smith Freehills contact.



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