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# Mergers and Acquisitions

## Uncertainty and Caution

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These are extremely uncertain and turbulent times—Coronavirus, supply chain disruption, share market panic, and an oil market war.

What does this mean to the M&A world? There will be uncertainty, tighter credit, opportunities, greater risk assessment and management, and defaults.

In this article we take a look at issues for current deals, those that have been negotiated and documented, those which have become unconditional, and those which are in the course of negotiation and due diligence.

### The market change

If a Buyer agreed to buy shares or buy a business a month ago, it is unlikely that same Buyer would offer the same price and terms today.

Conversely, a Seller is likely to be delighted to contract on the same or similar terms today, particularly if the purchase price is to be satisfied in cash, and is not subject to earnout criteria. But more likely, a Seller would accept a lower price and less favourable terms and conditions.

### Consider the scenarios

#### Agreements signed

Buyers under signed sale and purchase agreements will want to test whether they can cancel or abandon the agreement.

It may be that the Buyer considers the price is now too high, the terms no longer manage the Buyer's risk adequately or the line of credit the Buyer wanted to use is no longer available. It could be that the covenants imposed by the banker have made the deal unattractive or no longer bankable. The question will be, 'Is there scope to abandon or renegotiate under the existing terms?'.

Sellers will want to review agreements to see if there are opportunities for the Buyer to cancel or vary the agreement. Sellers must now also think about the downside scenarios if a Buyer fails to complete the agreement. For example, what knock on consequences will there be for the Seller if the Seller continues to own the business or company, particularly if the Seller has committed to buy another business or company in reliance of an unconditional sale or if changes have been made to the structure of the business or company in the expectation of the sale occurring?

If the agreement has conditions and some or all of those conditions remain unsatisfied, both Buyer and Seller must check to confirm in whose favour those conditions are and whether those conditions are sufficiently broad to allow the Buyer to cancel or renegotiate the agreement if those conditions are not satisfied. A Seller will want to enforce the agreement terms in a manner which provides assurance that the agreement will be completed.

Even if the conditions in the agreement have been satisfied, it may be that there is a provision in the agreement which enable the Buyer to cancel for reasons of convenience (most unlikely), or change of circumstance—possibly between the date the

agreement becomes or became unconditional and the completion date—or breach of warranty (given that most warranties in an agreement for sale and purchase are, or will be, repeated post signing). These clauses are often the subject of dispute and the wording of the relevant clauses will be determinative.

### Agreements under negotiation

If a sale process is underway, the decision for Seller and Buyer will be, do we continue?

From a Seller's perspective, questions include, do we need to proceed? Is it best to wait until this stormy period has passed? Or can I afford to wait in terms of money or circumstances?

From a Buyer's perspective, questions will include, is the timing for this purchase right for my business? Is it too risky? Can I afford it in terms of cash required or credit required from a bank? What will be my payback period and does it fit the strategy?

If the decision is made to continue with the M&A process, what will that mean for Buyers and Sellers?

- Buyers and Sellers will bring more intensity to their due diligence and agreement negotiation processes, particularly with respect to price, cancellation rights, warranties and price confirmation mechanisms. Sustainable earnings will drive investment decisions;
- The price is likely to be at lower (i.e. lower multiples will be applied to historic earnings with a greater focus on sustainability of earnings in the new business environment where forecasts made in the last few months will be vulnerable);
- There is a greater likelihood of payment by instalments referenced against sustained earnings;
- Sellers are more likely to require security for instalments of the purchase price to be paid post completion;
- Buyers will be seeking greater levels of indemnity and other comforts (such as guarantees or bonds) from Sellers;
- Sellers may seek a greater level of transparency with respect to a Buyer's funders to ensure completion funds are available;

- Exchange risk may become more of a focus for Buyers and Sellers, particularly with respect to overseas Buyers, deferred payment of components of the purchase price and/or where parts of the business are undertaken overseas, or where there are overseas components to its supply chain;
- Buyer conditions will be wider and more discretionary;
- Material adverse change or MAC conditions which allow cancellation of the agreement for COVID-19 or similar pandemics, and market downturns arising from such pandemics are likely to become more common from the Buyer's side.
- Sellers are more likely to require non-refundable deposits and deal cost payments from Buyers, which are non-refundable if the deal is cancelled due to COVID-19 or similar pandemics, and market downturns arising from such pandemics, or if the proposed purchaser abandons after signing NDA and undertaking DD; and
- The governing law for agreements is more likely to be New Zealand.

### Summary

These are turbulent times. Our advice is understand and manage your risk.

If you are a party, whether as a Buyer or a Seller, to a sale and purchase agreement ensure you understand your position under the contract and endeavour to manage your risk.

Likewise, if you are in the course of negotiating to buy a business or shares, be careful with your analysis of the business and negotiate on the basis that you protect your position, irrespective of whether you are the Buyer or the Seller. Always consider the 'let's not proceed' option.

If you would like our help in understanding the options and in managing your risk, with either a negotiated M&A deal or one still to be negotiated, please get in touch with one of our experts, or your usual Dentons Kensington Swan relationship partner.

**Please feel free to get in touch with any member of our wider team:**

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