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Corporate and Commercial Lawyers

MERGERS AND ACQUISITIONS

AFTER COVID 19 PASSES

ZOOM SEMINAR
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Q: WHAT HAPPENS WHEN PEOPLE GET OUT OF GAOL?

A: THEY DO STUPID STUFF

(An observation based on the author's binge watching of Netflix during Covid-19)

POINTS WE WILL COVER



- a) Deal Activity Post COVID-19.
- b) New Deals/Shelved Deals/Postponed Deals
- c) Conditions Precedent.
- d) Financing Support.
- e) Due Diligence.
- f) Valuations.
- g) Pricing.

“GOOD DEALS WILL BE AVAILABLE”

Everyone says there will be “Good Deals” available.

POINTS TO REMEMBER

- a) A “Willing Buyer” AND a “Willing Seller” is required for every transaction
- b) If the asset is cheap then there is usually a good reason for this

“Cheap Shoes v Expensive Shoes” (google Allan Jeans and 1989 AFL Grand Final half time address)
- c) Good dealmakers still adhere to fundamental processes
- d) If it is “Quick and Dirty” it is usually dirty on the way in AND on the way out.

REAL DEALS V TYREKICKERS

- a) NDA and Information Memorandum with strict time limits.
- b) Consider Break Fee or Deposit at early stage.

DEALS SHELVED OR POSTPONED

- a) Conditions Precedent...have they now been met?
- b) Is there a material change to the business from that when deal contemplated?
- c) Are Third Party / Regulatory Approvals (e.g. Finance, FIRB, ACCC) still current?
- d) Valuation/Pricing adjustment required?
- e) May be just stop?

NEW DEALS

- a) Seller may want to recapture equity lost.
- b) Buyers may want greater certainty on valuations
- c) Valuation issues (See later slides).
- d) Smaller pool of buyers.

DEAL ACTIVITY POST COVID-19

ROLE OF

- a) Corporate Advisor.
- b) Lawyers.
- c) Accountants.
- d) Others (eg Health Professionals).
- e) “Cheerleaders”.

ASSET SALES

- a) Likely to be favoured approach even after factoring in transfer duty.
- b) “Force Majeure” clauses likely to be inserted to cover against “Second Wave” of COVID-19.
- c) “Material Adverse Conditions” may specifically refer to COVID-19 recurrence. Note: Seller may seek to carveout MAC such that COVID-19 recurrence only applies to the business and not the economy generally.
- d) Third Party Consents and release of securities likely to take longer as businesses return to full capacity.
- e) Board Approval likely to be a condition precedent stipulated by the Buyers board i.e. preserving right to exit until last minute.
- f) Key Employees may have to be assessed as to health risk if critical to the business.
- g) Security of tenure of the premises may have been altered by waiver/deferral of rent and extra due diligence on leases required (or perhaps new lease entirely).

CONDITIONS PRECEDENT (cont)

SHARE PURCHASE

- a) Difficulty with Key Ratios e.g.
 - (i) working capital;
 - (ii) debtors;
 - (iii) sales;
 - (iv) nett assets.

Seller will seek to exclude the COVID period as abnormal and “can be ignored”.

Buyer will seek to factor in unusual trading results in this COVID period.

Historical steady financial results will be sought and considered a “premium”.

- b) Continuing Finance Facilities should not be assumed.
- c) Operational/Key Indicator Reviews will need to take into account COVID period.

NOTE: Different Due Diligence considerations and careful exclusion of abnormals required at the beginning (adds to timing to completion).

FINANCING SUPPORT (Tied to Valuation Assumptions)



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- a) Escrow (slow release).
- b) Holdback/Retention.
- c) Seller or Buyer Guarantees.
- d) Director Guarantees.
- e) Warranty and Indemnity Insurance likely to have COVID carveout.
- f) Warranty and Indemnity insurance likely to have carveout for valuation methodology applied by the Buyer.

Note: Buyers will push for lesser payment up front.

Sellers who can show consistent Future Maintainable Earnings (FME) should not be intimidated and ask for certainty and payment either in full or with small retention payable in relatively short period.

SOME DIFFERENT CONSIDERATIONS

- a) Unusual levels of inventory: what does this mean? A COVID one off?
- b) Unusual levels of receivables or accounts payable: what does this mean? A COVID one off?
- c) Recoverability of receivables may be an issue if customers are struggling or have not returned to normal activity.
- d) Convert financial statements to exclude abnormals.
- e) Identify the real FME.
- f) Consider what trading conditions during the COVID period should be excluded e.g. Compare the experience of a supermarket v a food court. Both in retail. The Supermarket probably had increased revenue. The Food Court may have had nil or minor revenue.
- g) Tax warranties likely to include correct reporting for any government benefits received during COVID period.
- h) Key employees that are a health risk may need to have a medical or similar to determine risks if a “Second Wave”.



DUE DILIGENCE (cont)



- i) Home office security will be reviewed to make sure the data and other important information and IP remains secure eg CRM databases.
- j) Supply chains: can they still deliver product/services or are travel restrictions interstate or overseas likely to impact ?
- k) Distribution networks: can they still deliver in a timely manner considering travel restrictions in other regions?
- l) What is the “ordinary course of business”? Important to establish as the Buyer will require the Seller to continue to operate in the “ordinary course of business” until completion.
- m) FIRB Approvals; currently a \$0 threshold so more FIRB approvals in the system and will take longer (if not altered by the Government).
- n) Financing approvals likely to take longer: Establish early on what a financier is seeking.
- o) Are the insurance policies still valid?

VALUATION CONSIDERATIONS

- a) “Locked Box” Valuations rely on historical steady trading. May not be the applicable valuation method in the short term post COVID-19.
- b) Valuation formulas based on Enterprise or Business value often seek a deferral of some of the price. Buyer may seek greater amount than usual to defer.
- c) Assumptions to exclude abnormals will be the subject of debate. (adding to time and cost).
- d) Significant “one off” costs may be required by a Buyer to rebalance the business.
- e) Buyer may need to factor in cost of new health protocols.
- f) EBITDAC? (Earnings Before Interest Tax Depreciation Amortisation and Coronavirus)



DIFFERENT POINTS OF VIEW

Buyers

- a) Will seek deferral or “earn out” payments to reduce risk.
- b) Will seek to weight the main payment towards earnout/deferral.

Sellers

- a) Will continue to seek certainty in the price and in some sectors this can be easily defended if the sector was not affected (either positively or negatively) during COVID period.
- b) Any earnout period imposed on a Seller should be carefully reviewed to ensure the Seller has full control of the business (if possible) during the earnout period.



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THANK YOU

