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**IMPACT OF COVID-19 ON MERGERS AND
ACQUISITIONS**

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Abstract:

The COVID-19 pandemic has disrupted business activities all over the world. The Mergers and Acquisitions sector has also been affected by this pandemic. It was expected that M&A business activity will ascend in 2020 but since the outbreak of the COVID-19 things have changed dramatically, thus impacting the deal environment significantly. It is believed that this pandemic will lead to several changes in the normal process of the M&A deal and there would also be fundamental shifts in the M&A domain. From the process of due diligence to the clauses in the contract, everything is being affected. This pandemic will crop up various challenges like delay in M&A deals, valuation, documentation, etc. perhaps, it will have an intense short term effect on M&A market but M&A will re-emerge as an important unit of operational and strategic growth. The M&A market can work smoothly only after the cooperation from all the participants of the deal and it is hoped that the M&A market will soon come back to a normal state. This paper goes in-depth to analyze the challenges faced by the M&A market in this crisis and assess the corresponding response by the stakeholders. The focus of this paper is to highlight the key impact of COVID-19 on M&A.

KEY WORDS : COVID19, Mergers and acquisitions, Strategic growth, Market crisis

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INTRODUCTION

The novel coronavirus is undoubtedly having and will continue to have a material global impact on mergers and acquisitions. At the start of the year, it was predicted by the M&A experts that 2020 will transcend 2019 in terms of deal activity. But since the outbreak of the COVID-19 things have changed dramatically, thus impacting the deal environment significantly. All the parties engaged or thinking of entering into the mergers and acquisitions (M&A) transactions will face the hurdles never seen before. Coronavirus has led the companies to change their corporate strategy. M&A deal activities will no longer be their priority for some time and the same would be slowing down or will fall apart.

However, M&A activity has not come to a complete standstill. Cash-rich buyers are well-positioned to take advantage of lower value targets, and activity in certain sectors remains strong under the nature of the crisis, For example; technology, online retail, healthcare, life science industries.³ The past economic downfalls i.e dot-com bubble in 2000-2002 and the Great Recession of 2007-2009 evidently tells us that the M&A world has endured and safely recovered from the crisis. It can be expected that as the impact of pandemic gets faded with time, companies will gradually get back on the track and will recover from the impediments that they are facing. M&A will re-emerge as an important unit of operational and strategic growth.

DUE DILIGENCE

There is a major shift in the due diligence process due to the work from home ecosystem created by the corporates amidst pandemic's norms. This has hampered the previously established practices in due diligence of physical meetings and site visits. The focus in the pandemic should be that the due diligence process is achieved remotely.

The prime focus of due diligence's team of buyer's side would be on operational and related issues that are imperative owing to the uncertainty of the COVID-19 situation. On the other hand, all the required information must be put forward correctly and there should be cooperation among the parties. Amidst COVID-19 the following points should be taken in the consideration:

- review terms under the material contracts entered into by target company to perform the obligations under the contract in the current environment
- review the contract whether if it include force majeure, warranties and indemnities

³Philip Watkins and Tom Braiden, The impact of COVID-19 on domestic and cross-border M&A (June 3, 2020, 10:05 AM) <https://www.financierworldwide.com/the-impact-of-covid-19-on-domestic-and-cross-border-ma#.XvSLypMzZQL>

- review of potential changes that come in law due to the pandemic or reviewing guidelines coming from the government such as instructions for employees to work from home, and whether this will have an impact on the operations of the target.
- review of how and to what extent COVID-19 will have an impact on the financial projections of the business.
- review of liabilities towards the health and medical care of employees (including the availability of insurance).
- review that there is compliance with data protection laws as any information collected by companies regarding the medical condition of their employees would be ‘Sensitive Personal Data’.⁴

The due diligence process should be carried with few recommendations like extensive use of virtual data rooms and video conferencing, Significant senior level time from diligence team, Management interviews to assess business continuity robustness and challenges encountered and surmounted during the crisis period.⁵

MATERIAL ADVERSE CHANGE / FORCE MAJEURE

The global outbreak of the COVID-19 has made the parties to consider their ability to perform their contracts. Where the performance of obligations under a contract is impossible, parties may need to look at the clauses in signed M&A contracts to avoid liability. The clauses in the contract are Material Adverse Change and Force Majeure. Under Material Adverse Change clause, the buyer has the opportunity to walk away from the transaction between signing and closing if events arise which are materially detrimental to the target which means they have a right to terminate the contract if the target business is materially and adversely affected by certain events defined in the contract between a specified period usually post-signing of the M&A documentation and closing date.

⁴Ramgovind Kuruppath, Archit Bhatnagar & Surabhi Saboo, MERGERS & ACQUISITIONS, COVID-19 and M&A in India: Navigating Risks and Understanding Opportunities (June 3, 2020, 1 : 20 PM) <https://corporate.cyrilamarchandblogs.com/2020/04/covid-19-and-ma-in-india-navigating-risks-and-understanding-opportunities/>

⁵Samir Sheth, Rajesh Thakkar , Lata More, Navigating merger & acquisition activity during Covid-19 (June 6, 2020, 4 : 25 PM)<https://www.consultancy.in/news/2940/navigating-merger-acquisition-activity-during-covid-19>

There is need of agreement upon the materiality of an event by both parties of a contract— buyers are likely to insist on enlisting events such as pandemics, lockdowns, closure of international and domestic boundaries as MAE events and would prefer to keep it open and as broad as may be possible so that it is easier for them to walk out of the transaction, whereas the seller will push for a narrower MAE.⁶ Force Majeure, on the other hand, is only applicable where the event in question has been defined as a force majeure event in the transaction agreement and its governing law. Force majeure means event or effect that can be neither anticipated nor controlled and it is outside the reasonable control of the parties to a contract, and this event disrupts the performance of that contract. If established, force majeure will usually relieve a party from its contractual duties when its performance has been prevented by a force beyond its control.⁷

However, the question arises Is COVID-19 a force majeure event?. In India, an office memorandum was issued by the Ministry of Finance on February 19, 2020, declaring that COVID-19 can be treated as a natural calamity and hence a force majeure.

VALUATION

The COVID-19 crisis is unprecedented and we have never in the course of our lives witnessed instances of the government of each significant economy barring businesses, foregoing exports and FDI and viably shutting down the economy so rapidly and abruptly to keep up the strength of the nation. The implications and challenges to valuations of M&A are also unique. The companies engaged in M&A struggle to maintain stability and the transactions must overcome the increased risk and uncertainties. The parties of those deals that marked pre-COVID-19 are re-evaluating their transaction terms and that after the preposterous symptoms subside. We may see a flood of deal renegotiations or terminations, while some deals will continue as arranged or on a postponed premise. A few purchasers who have entered into M&A transactions at pre-COVID-19 valuations may wish to terminate transactions or renegotiate the purchase price before shutting and will be searching for approaches to do as such without incurring liability Sellers, on the other hand, may wish to proceed to shut and look for ways to force purchasers to close.⁸ To bridge valuation differences among purchasers and sellers, negotiation may turn to a number of choices. Expecting the seller will remain

⁶ Rajesh Sivaswamy, COVID-19: A pandemic, a force majeure and a material adverse change(June 8, 2020, 11 : 32 AM), <https://ksandk.com/corporate-commercial/7078/>

⁷ Judith A. Archer Lisa Schapira Hannah Koseki Jacob Laksin, COVID-19: Force majeure, material adverse change clauses and related common law contract defenses under New York law(June 9, 2020, 1 : 40 PM), <https://www.nortonrosefulbright.com/en/knowledge/publications/c15c2f10/covid-19-force-majeure-material-adverse-change-clauses-and-related-common-law-contract-defenses>

⁸ Mara H. Rogers, Amelia Xu, and Geetika Jerath, Norton Rose Fulbright US LLP,COVID-19 Impact: Potential Risks and Problems in Signed M&A Deals, (june 11, 2020, 2:15 PM), <https://corpgov.law.harvard.edu/2020/04/20/covid-19-impact-potential-risks-and-problems-in-signed-ma-deals/>

engaged with the business post shutting, perhaps a purchaser is prepared to agree to a more extended term earn-out to give a seller or its principals the opportunity to participate in the future growth of the business as it recuperates post-pandemic. A purchaser might be set up to offer a type of equity participation rights to the seller as a method for allowing the seller to gain some further upside.

M&A DEAL ACTIVITY

Global mergers and acquisitions have already plummeted as the outcome of the coronavirus crisis, and by the end of March 2020 had come to a near standstill. M&A levels in the United States fell by more than half in the first quarter to \$253 billion differentiated to 2019, but the majority of those transactions were entered into or closed earlier in the quarter before the crisis spread worldwide. Among other things, officials of organizations that would commonly have been strategic purchasers have been compelled to divert the focus and energy of their teams toward the immediate health of their own organizations and away from longer term objectives that include pursuing growth through acquisition strategies. Similarly, private equity sponsors have invested an increasing amount of time on efforts to strengthen or save their existing portfolio companies, at the expense of new deal activity. Parties to pending M&A transactions are also abandoning significant deals that were pending, such as Xerox recently dropping its \$34 billion proposals for HP, after having delayed meetings with HP investors to focus on coping with the coronavirus pandemic. SoftBank has terminated its \$3 billion tender offer for WeWork shares, quoting the coronavirus impact together with the failure of several closing conditions. Bed Bath Beyond has started litigation in Delaware with respect to delays in the pending sale of one of its divisions to 1-800-Flowers for \$250 million. Boeing suppliers Hexcel and Woodward have called off their pending \$6.4 billion mergers of equivalent transactions noting the unprecedented challenges caused by the pandemic.⁹

IN PROCESS:

While parties ordinarily concur on the length of an M&A transaction, the pandemic may have a remarkable impact on this. Parties should expect delays in the fulfillment of certain closing conditions such as getting regulatory approvals and third-party consents. The limitation to physical meetings in place could also hinder down the negotiation process thus slowing down the transaction. Parties should, therefore, anticipate a delayed schedule and should consider an extension of the completion date and concurring on a suitable longstop date for the relevant conditions to be satisfied.

⁹Richard Harroch, The Impact Of The Coronavirus Crisis On Mergers And Acquisitions, (June 12, 2020, 12:05 PM), <https://www-forbes-com.cdn.ampproject.org/c/s/www.forbes.com/sites/allbusiness/2020/04/17/impact-of-coronavirus-crisis-on-mergers-and-acquisitions/amp/>

CLOSED:

For transactions that were shut in earlier years or more recently, the COVID-19 outbreak is having an unforeseen impact. Transactions that included contingent consideration based on financial performance are beginning to see unfavorable consequences. With respect to earnout provisions, sellers that consented to unforeseen consideration based on financial performance, whether tied to revenue or profitability (or both) or client retention and that had an earnout period that expanded to February or March of the current year have likely observed a significant decrease in financial performance or client retention and its subsequent effect on the seller's achievement of earnout targets. The inability to accomplish anticipated targets and to receive anticipated earnout consideration is an issue currently being tended by various buyers and sellers. Discussions around changes to earnout provisions are in progress to ensure continued performance alignment among buyers and sellers. These discussions will happen over the upcoming months and may lead to various transactional modifications and the potential for litigation in the context of the frustration of purpose. In addition, transactions funded with excessive debt are facing possible covenant defaults. The underlying operating companies are now forced to focus on preserving capital and maintaining liquidity to fund operations. The focus needs to shift from growth to maintenance of customer relationships, supply chain continuity, rationalization of products or services, and employee retention. Balance sheet management has become paramount as senior lenders try to understand the long-term impact of a borrower & cash flows and their ability to service the debt. Moreover, exchanges financed with exorbitant obligation are confronting conceivable pledge defaults. The fundamental working organizations are currently compelled to concentrate on safeguarding capital and keeping up liquidity to subsidize tasks. Concentrate needs to move from development to upkeep of client connections, gracefully chain congruity, the legitimization of items or administrations, and worker maintenance. Asset report the executives have gotten foremost as a senior loan specialists attempt to comprehend the drawn out effect of a borrower & incomes and their capacity to support the obligation.

FUTURE:

Mergers & acquisitions are undergoing a period of immense change. It seems inevitable that COVID-19 will weaken the financial status of most companies particularly small to medium size ones which only account for 13.5% of the value of the physical security business but 90% by number. M&A offers a life-line and theoretically a better future for these companies. Many small to medium companies could seek out opportunities to merge or be acquired. The major western companies in the business have not in the last two years used M&A as part of their business strategy. The analysts suggest that maybe COVID-19 will cause them to review it again and seek out opportunities causing a new cycle of investment.

TIMING AND DELAY IN M&A DEAL ACTIVITY:

For both existing M&A deals that survive the pandemic and new deals entered into during the pandemic, it is normal that deal timelines will be significantly broadened. Each phase of a normal transaction, including primer discussions between the parties, the negotiation of a letter of intent or term sheet, the negotiation of a conclusive the acquisition agreement, and the pre-closing period, will probably take more time to accomplish. These delays will result from a number of pandemic-related factors, including the following:

1. Negotiations will take longer: the abused adage of & getting everybody in the room to get a deal agreed is not currently possible.
2. Due diligence will take longer, and new M&A due diligence issues should be tended to. Third-party consents (such as from landlords, clients and intellectual property licensors) will take a longer time to acquire.
3. There will be delays in acquiring any important antitrust or other regulatory approvals. The Department of Justice has asked firms engaged with mergers and acquisitions to add 30 days to their deal timing agreements, and European competition regulators have suspended investigations of various proposed deals.
4. Purchasers and their boards of directors will be considerably much more cautious, and internal justifications for deal making in this condition will need to be more convincing.
5. M&A agreement terms will take more time to negotiate as purchasers will want to shift more closing risk and (where relevant) indemnity risk to sellers and sellers will seek comfort that the industriousness of the pandemic will not permit purchasers to leave from deals based on remorse.
6. Purchasers will have concerns about their capacity to appropriately value a seller in this condition. Valuations from comparable transactions, even those entered into very recently, will probably be no longer applicable.
7. Purchasers requiring financing will experience delays resulting from the disrupted state of debt markets and available liquidity, and M&A lenders may look for closing conditions that are significantly more severe than those sought by purchasers, expanding closing risk for both purchasers and sellers.

IMPACT ON LETTER OF INTENT

Letters of intent, term sheets, memoranda of understanding, and so forth are common features of the M&A landscape. Before investing heavily in due diligence and negotiating detailed transaction documents, purchasers and sellers ordinarily employ these preliminary, mostly non-binding documents to memorialize their mutual understanding of all or portion of the material deal terms. Further, since an award of exclusivity by the seller (which most of the time accompanies the execution of a letter of intent or completion of a term

sheet) shifts negotiating leverage considerably in favor of the purchaser, the seller will aspire to nail down as many major deal terms as possible at this phase of the M&A process. Obviously, it also is not abnormal for a negotiated letter of intent or term sheet to address the purchase price and little else. Highlighting the coronavirus pandemic, we expect to see purchasers and sellers alike refraining from engaging into a conventional letter of intent until the purchaser initially has performed incremental due diligence on how much COVID-19 has adversely affected the seller business, the outcome of operations, financial condition, customers, suppliers, workforce, and business possibilities.¹⁰ The length of this term of incremental due diligence will rely upon the seller conditions and the party's relative bargaining power. A purchaser can anticipate the seller to push hard for a short period while resisting concurrent exclusivity. Once the letter of intent negotiation starts, the purchaser should expect sellers to attempt to include in the letter of intent provisions correlating to closing conditions, pre-closing contract and drop dead dates. For most letters of intent, these are uncommon provisions. But during the pandemic, attentive sellers will want to take advantage of any bargaining leverage they need to address closing risk and closing certainty. In M&A, the LOI acts as a significant step in closing the deal. It defines the terms and the timing, and the seller agrees to stop talking to other potential buyers, and assuming the company passes the inspection and expecting buyer has the dough, the deal closes.

REPRESENTATIONS AND WARRANTIES

Representations and warranties are given by both the parties in the contract as to disclose material information in an M&A transaction. They are one of the primary risk allocation mechanisms in an M&A transaction. This clause has the purpose to protect for losses that can arise due to the seller's breach of representations made in the agreement. In representation and warranty, insurance parties must expect the insurer to seek exclusions for losses related to the COVID-19 pandemic and should seek to define these exclusions as narrowly as possible. Moreover, several policies don't cover breaches that first arise and become known between signing and closing. The risk created by this coverage gap may be aggravated by the uncertainty of the current business environment, particularly for transactions where a longer period between signing and closing is expected. A more traditional escrow and indemnity arrangement must be preferred by

¹⁰Richard Harroch, The Impact Of The Coronavirus Crisis On Mergers And Acquisitions, (June 14, 2020, 11:35 AM), <https://www-forbes-com.cdn.ampproject.org/c/s/www.forbes.com/sites/allbusiness/2020/04/17/impact-of-coronavirus-crisis-on-mergers-and-acquisitions/amp/>

the buyer that allows them to allocate known risks through negotiation rather than committing to using insurance at the outset of the deal.¹¹

CONCLUSION

While the short-term effect of the Covid-19 emergency on the M&A scene will be intense, it is expected that this emergency would also encourage a change in the viewpoint of consumers. A few measures are being embraced by the government as a reaction to the Covid-19 emergency and some strategic steps are being undertaken by the companies to tackle the pandemic. The COVID-19 pandemic is a humanitarian one but will have a remarkable impact on M&A in the foreseeable future. The M&A unit will recover from the crisis soon and one can hope that with innovation in medicine, the vaccine for the deadly virus will soon be created so that everything can return back to normal.

¹¹Joseph B. Conahan, Hal J. Leibowitz, Andrew Bonnes, Eric P., COVID-19: M&A Considerations During the COVID-19 Pandemic (June 22, 2020, 5 : 52 PM),<https://www.wilmerhale.com/en/insights/client-alerts/20200422-merger-and-acquisition-considerations-during-the-covid19-pandemic>