



Covid-19 M&A Update – June 2020

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High Level Observations

- A lot of scrutiny of –
 - Industry impact of Covid-19
 - Near-term cash flow impact
 - Nature and structure of the transaction
- Strategic deals in-process are likely to proceed
- Financial deals highly tested for cash flow impact
- Credit markets have tightened significantly, though there is some loosening compared to April
- Valuation impact is deal specific

Valuation

- It depends
- Very specific to industry and company near-term performance
- Deals are being “structured” to hedge uncertainty and preserve valuation
- Some discounting

Outlook

		Start of 2020		Current (Covid-19)		Future (Post-Covid-19)
Seller Sentiment	++	Strong seller sentiment; M&A backlog and overall sell-side market at / near record levels	--	Most sellers choosing to wait out crisis instead of selling at a discount vs previous valuation expectations	?	Sellers likely to return to market once financial visibility returns and a level of valuation discovery has occurred
Financial Sponsors	+/-	Sponsors generally aggressive, supported by strong financing markets; increasing scrutiny around econ cycle	+/-	Sponsors focused (i) existing portfolio management & (ii) opportunistic / structured deals	+	Sponsors have a tremendous amount of capital to deploy; return of debt markets will enable activity
Strategic Buyers	++	M&A often top agenda item for corporate boards; active strategic M&A market	-	Most strategics focused on managing their own operations and liquidity	+/-	Strategics return to M&A will depend on overall business recovery and confidence
Financing Environment	+	Financing market generally constructive; however sensitive to recession resilient assets vs cyclicals	--	Very high scrutiny on new deals; working with existing borrowers	?	Highly dependent on overall economic recovery and visibility
Valuation Environment	++	Valuations at / near all-time highs	-	Industry specific; challenging given uncertainty of forecasting	?	M&A market valuations lag public valuations for bigger deals

Source: BAIRD Global M&A Report May 2020

Q&A

M&A in the Time of COVID



Deal Timing

- Depending on industry, M&A deals are starting to come back
- Key variables – COVID impact on industry; Bank financing requirements (cash flow visibility lower)
- Even with renewed activity, many are pushing out closing
- Key variables – PPP loan forgiveness; Cash flow (un)certainly due to COVID impacts on business

Deal Structure - Legal

- Just starting to see PPP loans and COVID-19 addressed in Purchase Agreements.
- Buyers want longer closing time frames; purchase agreements addressing PPP loan (i.e., certifications, forgiveness, etc.) and COVID-19 issues (i.e., compliance with orders, no employee liability, etc.)
- One emerging structuring issue. Sellers who structure their deals as asset purchases (vs stock purchases) of their companies, are more likely to circumvent some issues by retaining the exposure to PPP loans and COVID-19 claims. However, under PPP loan documents, typically need bank approval for change of control and asset transfers.
- With stock deals, Buyers are more likely to defer closings until PPP loans are forgiven and visibility on COVID issues since they take all these liabilities (subject to Seller indemnity). However, Buyers and Sellers are becoming creative if necessary, in order to push to an earlier closing if desired.

Representations and Warranties

- What are Buyers starting to require?
- PPP Loan Reps
 - Seller's loan certifications were accurate and complete
 - Provided all loan documentation to Buyer for review
 - Confirmation that loan forgiven by closing or Seller somehow responsible or negotiated workarounds with Buyer
- COVID-19 Reps
 - Seller has complied with all laws, policies and guidelines related to COVID-19 issued by governmental entities
 - Key Variables:
 - Non-mandatory recommendations and guidelines
 - Organizations without direct regulatory authority (States vs WHO)

Representations and Warranties (cont'd)

- Compliance with Laws
 - A customary and broad representation that will “backdoor” COVID-19 requirements
 - Be sure to review carefully
- Customer Contracts
 - Seller has the ability to perform under its customer contracts (i.e, generate revenue), even with limited hours of operation or employees working from home

Representations and Warranties (cont'd)

- Infrastructure

- Seller has sufficient computers, equipment and software to continue current levels of productivity and network access for employees to operate from home
- Also sufficient security software, network security and protocols in place

- Company Relationships

- Sellers have not received notice that any of its customers, partners, subcontractors, vendors or suppliers will materially reduce operations in connection with COVID-19, or be unable to perform agreements

Conditions to Closing

- Material Adverse Event (MAE) clauses
- Typically a condition to closing is that no MAE has occurred
- COVID in general implicates these provisions, because it has impacted Seller business and cash flows in an adverse way
- Buyers want to back out of deals where the business has materially changed (i.e., gone down).
- There are currently several lawsuits in Delaware where Sellers are trying to force closing and Buyers are using MAE clauses to try to get out of closing transactions. Many were deals signed pre-COVID.
- MAE clause negotiations are therefore critical and the parties need to address how COVID effects these clauses upfront

Indemnification

- PPP Loan
 - Buyers seeking full indemnity on PPP loans and representations related to them. No basket, no cap, no time limits
 - Both accuracy of certifications and that all indebtedness forgiven
 - Concept – Just as indebtedness normally paid off at closing in full, Buyers will take no risk on PPP loans.

Indemnification (cont'd)

- COVID-19
 - Buyers seeking full indemnity related to COVID-19 exposure
 - Similar to PPP loan
 - Sellers are pushing back a little more on this
 - Narrow representations and warranties
 - Convince buyers that they are buying general COVID-related risk in the business
 - Materiality qualifiers

Questions?

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