H1 2020

# M&A in the face of historic uncertainty

## The Covid-19 pandemic has had a sharp and sudden impact on the global economy – and with it, on M&A activity.

**The Covid-19 pandemic has thrown the world into unprecedented crisis, and social distancing measures enacted to slow the spread of the disease have pushed the global economy into recession**

The IMF predicts that global real GDP will contract by 3% in 2020, while advanced economies will see a sharper drop of 6.1%.

M&A cycles tend to follow economic ones, and with many industries, such as travel, hospitality, retail and oil and gas, seeing their revenues disappear, M&A across the globe in the first quarter of 2020 fell 39% in terms of value, according to Mergermarket data. Meanwhile, deal volume decreased by 25% – and Q2 will, without a doubt, see even heavier declines in deal activity.

Much of what will happen next is still up in the air and will be determined by many factors beyond the scope of M&A – government decisions on lockdown measures, development of treatments and a potential vaccine, etc. While M&A activity can be expected to remain subdued as long as uncertainty remains and trading conditions for businesses remain difficult, "that doesn't mean that the M&A community is not busy," says Henry Wells, Head of UK M&A Advisory at Duff & Phelps. "I think the community is currently very busy in terms of assessing future opportunities, the needs of clients and the needs of portfolio companies," he adds.

To find out more about what the coming months might have in store, we brought together six experts from the fields of law, corporate advisory, academia, and technology to share their insights into the opportunities and challenges for dealmaking in the Covid-19 era.

# The state of play in M&A

## Expert speakers

**Gary McKeown**
CEO, Imprima

**Liz Claydon**
Head of Deal Advisory, KPMG UK

**Nicole Englisch**
Partner, Clifford Chance

**Timothy Galpin**
Lecturer, Saïd Business School, Oxford University

**Henry Wells**
Head of UK M&A Advisory, Duff & Phelps

**Roger Barron**
Partner, Paul Hastings

**Unlike the Great Financial Crisis a decade ago, this crisis did not originate in the financial markets – this means that the financial sector is better positioned, and can continue to provide financing and support to businesses.**

**Looking at headline figures, it is clear that M&A has fallen greatly, but that does not paint the full picture. Although many deals are being put on hold or cancelled altogether, some M&A processes which were already well underway have managed to proceed, albeit some have gone through re-negotiations on price and terms.**

**Mergermarket: How has the M&A market responded to the Covid-19 crisis so far?**

**Gary McKeown, Imprima:** We are well-placed as a virtual data room provider to see the actual impact on deals, including the impact on new deals coming to market, and on deals that are currently in play. There is no sugar-coating it – activity is significantly down. Although deals in later stages are generally being completed, there has been a significant decline in new M&A activity and many transactions that were in mid-stage have been put on ice, albeit not necessarily cancelled.

For our clients who are finding themselves in that situation, we have provided solutions – rather than close the data room, we've offered something called dormant hosting, which lets you leave everything in situ and in the security of the data room for a minimal price. And then when that deal starts again, you're ready to go.

**Timothy Galpin, Saïd Business School:** Some deals are being called off. There are some examples in the news of buyers trying to walk away or back out of commitments that they made because valuations have fallen dramatically compared to what they were a few months ago. Will these buyers be allowed to walk away? This will likely be adjudicated through litigation.

**Sellers understand that the price they could have achieved two or three months ago might not be the right value for today.**

**Roger Barron,** Paul Hastings

Another impact could be that companies and private equity (PE) firms which have access to cash will be looking at bargains. There is a lot of data showing that, on average, return on investment for deals done in weak economies outperform deals done during strong economies. Those that still have good credit ratings will have access to very cheap debt which can be used for M&A. Debt has been extremely cheap over the last ten years, but it's gotten even cheaper.

Lastly, protectionist rhetoric has become a lot more common. The European Commission, for example, has issued guidelines to bolster foreign investment screening in critical assets during the pandemic.

**Mergermarket: How does this crisis differ from previous crises? Are there any similarities?**

**Henry Wells, Duff & Phelps:** Similarities to the Great Financial Crisis include complete uncertainty around future valuation. M&A valuations are usually based on historic cash flow or a forecast of future earnings. With significant uncertainty surrounding future cash flow, buyers are nervous about what risks they are taking. One difference with this crisis is that it happened so suddenly. Entire sectors have seen their revenues drop to zero. It's unprecedented, as reluctant as I am to use that word.

**Roger Barron, Paul Hastings:** This time around, we have seen a bit more by way of re-negotiation on price and other deal terms. Sellers understand that the price they could have achieved two or three months ago might not be the right value for today. That's markedly different from immediately after the financial credit crunch in 2007-2008 – at the time, there was quite a long period where there was a real mismatch in expectations of valuation. Right now, there's a bit more commonality and acceptance of what's happened globally, and this in turn could help deals move forward.

**Liz Claydon, KPMG:** In 2009, the crisis was due to the supply of credit being constrained, i.e. banks just stopped lending. This time, really, we have an artificial constraint on demand – the restrictions that were put in place in response to the pandemic have unfortunately, for many businesses, significantly impacted trading. Given that – this is where I try and be optimistic – once restrictions are lifted, demand should come back at not dissimilar levels than before, particularly in more resilient sectors. My view is that it could be a savage downturn, but a relatively quick recovery, although some businesses may be lost during that period.

**Mergermarket: How is the financing environment at the moment for M&A?**

**Liz Claydon, KPMG:** That is something we are all pondering on. At the moment, the banks are focused on effectively sorting out the government schemes and supporting businesses who need effective access to capital to ensure that their businesses remain trading and their employees are paid during this period of time.

So, I think the issue at the moment is more about the use of resources within the banks, rather than last time where there was a huge financial crisis. The banks are working on enabling businesses to continue trading. I would also say that we're seeing, particularly in PE-backed businesses, that a lot of businesses are drawing down on their revolving credit facilities just to make sure they keep as much liquidity in their businesses as possible.

**Nicole Englisch, Clifford Chance:** There is money available in the market – and there is even more money available due to government programs which are currently being set up all over Europe and in the US. This is different from the financial crisis in 2008/2009, when you really wouldn't get any financing. This time around, it is still possible to get financing – although you still need to acknowledge that most banks are currently busy doing restructuring work. Most recently, however, we note that financing new deals is starting to get more difficult and financing banks are getting increasingly reluctant to finance new deals.

# Resilient areas

**While the current crisis is placing enormous strain and uncertainty on all sectors of the economy, some sectors are in better positions than others. Moreover, as an asset class, private equity has access to large reserves of dry powder and cheap financing. These can contribute to some degree of continued dealmaking, even as most M&A processes lie dormant.**

**Mergermarket: What are some sectors that could remain resilient for M&A? On the flip side, what sectors do you expect will see distressed M&A?**

**Liz Claydon, KPMG:** We are seeing sectors such as healthcare, telecoms, and any cloud-based businesses being resilient. Microsoft and Zoom are great examples of companies supporting home working and trading strongly as a result. The public sector and infrastructure, as well, remain resilient.

And those, obviously, that are struggling tend to be the ones that rely on consumer spending – hospitality, travel, food, casual dining, automotive, aviation, etc.

**Gary McKeown, Imprima:** Many technology companies, be it Zoom or Netflix or social media, are doing quite well. The healthcare and pharmaceutical sector will continue to do well because of the focus on healthcare at the moment.

There are certain sectors worse affected by Covid-19, such as travel and hospitality. We have already seen that in the airline sector, for example, quite a few companies only have a number of months in cash reserves. I think there will be consolidation, but it's probably too early for that as there is not enough visibility at the moment on which companies will survive and which might receive government bailouts.

**Roger Barron, Paul Hastings:** There are some businesses that you might expect to be trading brilliantly in the current environment – pharma is a great example. Some might think that because a business is doing well operationally then that could lead to increased M&A in its sector. Actually, probably not. A business could be thriving, but there's not necessarily an appetite for M&A.

In contrast, one sector which is operationally doing well and where there might be increased M&A is tech, although frankly this isn't new. There has been a focus on tech M&A for a number of years, driven by advances in technology on the one hand and convergence on the other. The use of technology around the world has clearly increased as a result of this crisis and you may well see an uptick in bolt-on deals, though not necessarily any megadeals. This is exactly where M&A can create genuine growth opportunities – buyers acquiring a target for the technology it has developed and helping it scale up in a way that it would not have been able to do on its own.

**Mergermarket: What about the difference between corporates and PE buyers? Do you expect PE firms to be more active?**

**Nicole Englisch, Clifford Chance:** The activity of PE firms at the moment probably depends on the segment they are in. Pricing is currently difficult and that's true for both private equity and corporates. Corporates may be a bit more critical with regards to pricing going forward. Corporates generally tend to act more conservatively than PE firms. I don't think this is going to change. PE buyers who are open to distressed situations will become more active going forward.

**Timothy Galpin, Saïd Business School:** It depends on the firm. Some PE firms are going to focus in the near term on their portfolio companies. If they've spent a lot of the fund, and they have a lot invested already in the portfolio companies, that will be their main focus.

PEs with funds that haven't been deployed yet are going to be searching for bargains. There are quite a few private equities that have built up big war chests over the last several years and they will be looking for ways to deploy that cash.

That being said, the fundamental leverage model that PE uses will be a bit harder potentially to implement, because the funding bodies – the banks and debt funds they typically use – are going to be more cautious about lending. So, the leverage ratio may go down a bit. PEs typically use quite a high leverage ratio, which will likely have to be reduced as they may have to fund buyouts with more of their own capital, at least in the short term.

**Henry Wells, Duff & Phelps:** I think we are going to see the growing trend of strategic bolt-ons for trade platforms, both within corporates and PE portfolio companies. Once PEs and strategics have a better idea of how their businesses will operate post-Covid-19, they'll look at how to deploy their money towards assets they believe will be winners.

I think there will be a lot more opportunistic M&A, which will probably fall into two buckets. One is the opportunistic buyer that has a strong balance sheet and was already planning acquisitions and now finds itself in a position where it might be able to buy an interesting target for a different value, albeit with a different risk profile. The other category of buyers are ones that have raised funds for exactly these sorts of distressed situations.

**Mergermarket: There are a lot of restructuring and insolvency processes at the moment. Do you expect many of these to end with a sale?**

**Henry Wells, Duff & Phelps:** I think the significant amount of restructuring work we're seeing will have a variety of outcomes and there will be a lot more to come. Some will result in insolvency and businesses being shut down and others will result in distressed or accelerated M&A. Some of the accelerated M&A processes in the next six to eighteen months will come to market because of existing debt, or equity providers changing their views about the business' long-term survival prospects. In those cases, you'll find other investors willing to take a different view for a different return profile. I think that will result in some interesting opportunities in terms of distressed or accelerated M&A.

**Gary McKeown, Imprima:** We traditionally do a lot of work on restructuring deals anyway because, even in good markets, there are always companies who need to restructure. But what you find in a recessionary time is that restructuring deals grow exponentially. Not only that, the time they have to get new investment is significantly shorter. In that regard, one of the good things about some of Imprima's tools – such as Smart Review and Smart Index – is that they can greatly reduce and shorten the time that third parties need to review critical information to decide whether to invest in that company, be it equity or debt.

**Liz Claydon, KPMG:** We have a diverse business at KPMG. In addition to our transaction services business, we also have a large restructuring business. As I mentioned, M&A processes are proceeding in a number of cases, although volumes are down. From a restructuring perspective, we have been having a lot of conversations with businesses in sectors like leisure, retail and aviation.

But to a large extent because of the government schemes that have been introduced, a lot of businesses are battening down the hatches and hibernating – reducing their cost base to an absolute minimum and taking advantage of government initiatives to avoid falling into administration.

In terms of distressed M&A, I do think there will be activity. I was talking to one of our partners in the tech sector, and he told me that he has spoken to many CEOs and CFOs of tech businesses who have already gone through the phase of making sure their own companies are as healthy as possible, and are now focused on opportunities in the marketplace. A number of them are identifying and analysing assets that they believe will be distressed.


# Outlook

**While many governments around the world have begun relaxing lockdown measures, there remains a great deal of uncertainty around the lasting economic impact of the crisis and the effect on M&A markets. Even aside from the economic downturn, the crisis is bound to affect how M&A is done – from MAC clauses to video conferencing meetings. How long these effects will last remains to be seen.**

**Mergermarket: We have seen a few cases of buyers attempting to back out of completed deals, either by invoking MAE/MAC clauses, or through other means. Do you think this crisis is changing the way these clauses/ M&A contracts will be written in future deals?**

**Nicole Englisch, Clifford Chance:** You need to differentiate between countries and markets. In the US, it is market standard to have MAC clauses in M&A contracts. That is not the case in Germany and most other European countries. I've been advising on M&A transactions since 1998, and I have seen many developments – MAC clauses have come in and out of favour. At the moment, they are used very rarely in Europe, but we expect the pandemic to change that.

One issue is that MAC clauses usually would not be triggered by the coronavirus pandemic. Very often MAC clauses are drafted in such a way that developments that affect the entirety of an industry or country do not count as a MAC, instead it is usually defined as something which is specific to the enterprise.

We have seen that, for some of our clients, if the strategic rationale is strong enough, they will proceed with the deal even if the target has been affected by the coronavirus crisis. Other clients think about MAC/MAE clauses, which then need to be adjusted to fit to the pandemic.

**Roger Barron, Paul Hastings:** The market practice in the US has long been to have MAC clauses between signing and closing, whereas it absolutely has not been the practice in the UK. In UK public M&A, it is effectively prohibited. In private deals, it is not yet UK market practice, although that's a trend that we've seen gradually changing on some deals.

If the period between signing and closing extends out over this period of uncertainty, then buyers will think about including MAC clauses but, of course, sellers will resist. A seller may be more accepting of a MAC clause if they understand the risks to the market and their business, but right now they could be taking on a Covid-19 risk and its future implications blindly.

As a potential solution, we've been talking to clients about option arrangements. Effectively, with an option agreement, you agree to the terms of the deal, but rather than actually signing your transaction documents, you enter into an option to do the deal. If the deal gets done, great. If you pull the deal, then the buyer pays a break fee. It's a bit like a deposit on a house. You are securing the opportunity to do the deal, but recognising that it's so uncertain, that it's in both parties' interest to know that they're committed to the deal, but just not right now. The question then arises as to what's the option period? Here we are in June. Is that July, August, September? It's an open question.

**Timothy Galpin, Saïd Business School:** The MAC clause has always been a grey area over the years. It's really difficult for buyers to back out of deals, even with MAC clauses. After 9/11, for example, there were companies trying to back out of deals using the MAC clause – because of material adverse changes caused by the attacks – but these were not approved by regulatory bodies or in litigation.

Essentially, writing an airtight MAC clause is impossible and it will nearly always end up in litigation. Really, it will be for the courts to decide. I think we are in a 'watch this space' moment on MAC clauses. People are going to try to build in clearer definitions, but for the most part, we have to wait to see what the courts say.

**Mergermarket: Even as lockdowns are lifting, some restrictions might remain in place. How will this affect the way that M&A is conducted, for example, if some travel restrictions remain in place? Will M&A practitioners adopt more digital tools?**

**Roger Barron, Paul Hastings:** This is quite an interesting topic. There was quite a lot of change on the technology front happening anyway. For example, at my firm, a new video conferencing system was introduced fairly recently and, of course, the timing was fantastic. Everyone has jumped at the opportunity to use new technology and that has certainly helped facilitate transactions. In fact, across the industry, I think that whole generation of M&A practitioners has embraced new technology so much more quickly than they would have done if this hadn't happened.

Looking to the future, I think people will definitely continue to place an increased emphasis on technology, but I don't think it will replace the need for human contact, relationship building, and some of the discussion that is had around social events.

On the other hand, a lot of the deal activity that is happening right now is based on existing relationships. Let's say this carries on for a much longer period, hypothetically, then you're probably going to have people who are being introduced for the first time over technology and who will then continue those conversations over technology. That's going to be quite a different dynamic to those relationships that were created face-to-face in a previous time. If that happens, we'll see how it will affect dealmaking. There is definitely something to be said on certain deals for making progress with a face-to-face discussion, but even without this possibility M&A practitioners are an adaptable breed and will usually find a solution.

**Gary McKeown, Imprima:** So, I think there will be positive consequences that come out of this crisis in this respect. People are starting now with a blank canvas again and saying, "Actually, well, can I conduct a whole M&A process without physically, A) meeting a person, or B) inspecting assets?" We work with a lot of real estate companies, so you can imagine that a lot of the time, people want to look at the asset. I think people will realise you can do much more over technology. Site visits and in-person meetings are being replaced by virtual tours, use of drone technology and video conferencing solutions. You can look at all of the documentation on a deal in a data room, and you can collaborate more quickly in a data room than you can if you travelled to different locations. You can sign remotely through platforms like DocuSign.

I think this is a wake-up call. These types of pandemics could happen again, whether it is a second wave of Covid-19 or something completely different in a few years. So, we need to realise that there is a chance of this type of event interrupting our normal way of working again. Companies that actively embrace the enforced changes, move flexibly forward and leverage the best technological solutions – including AI and VDR platforms – will, as always, be best placed to succeed.

**Mergermarket: M&A markets are quite quiet at the moment. How can corporates, PEs and advisors best use this time to prepare themselves for the end of the lockdown?**

**Nicole Englisch, Clifford Chance:** Investment bankers, PEs and corporates have time now to optimise internally. Private equity firms, for example, are focusing on their portfolio companies which may be suffering.

Those which don't have much portfolio work are checking the market and looking at different sectors to see which ones could be interesting to them in six months' time. Some of them may need to change their focus a bit. This might be easier for PE than for corporates.

**Henry Wells, Duff & Phelps:** According to Mergermarket, M&A mid-market deal volumes for Europe in April 2020 are about one third of the volumes in April 2019, and that significant reduction is in part explained by the fall in the type of classic M&A that is high-growth businesses being sold for full value. However, that doesn't mean that the community is not busy. I think the community is currently very busy in terms of assessing future opportunities, the needs of clients and the needs of portfolio companies.

My guess is that PE companies over the last two months have never been busier on their portfolio companies, assessing exactly what their needs are and how they can best help. As we come out of lockdown, owners, whether it be private equity or corporates, will look at how they can support their businesses through a different period of change, whether through investments, amending supply chains or looking at contractual provisions.

So, I think there is plenty to do. For us as M&A advisors, we are there to help our clients look for opportunistic acquisitions and help to determine whether and how they can dispose of certain parts of their businesses.

**Timothy Galpin, Saïd Business School:** A lot of investment bankers are being repurposed over to their banks' restructuring area – the same with consulting firms and even legal firms.

As others have mentioned, right now it is important to work on what the future will hold, what clients might be doing as far as selling or buying; and really use the time for analysis that they may not have done while they're busy doing deals. And that isn't just a one-time snapshot – this is going to evolve as the different lockdown restrictions in different jurisdictions are eased on a phased basis around the world. It is going to be a learning process and they will need to dedicate at least some people to monitoring and adjusting their forecasting models.

**Investment bankers, PEs and corporates have time now to optimise internally.**

**Nicole Englisch,** Clifford Chance

# About Imprima

Imprima is a leading Virtual Data Room provider, handling over $1 trillion-worth of transactions in over 160 countries.

Our clients include high-profile corporations, financial institutions, and advisors.

Whether it's a complex M&A transaction, managing portfolios of assets or completing a time-sensitive restructure, our innovative products enable secure and fast deal execution.

- **Imprima Virtual Data Room (VDR)** is a highly secure, fast and intuitive virtual data room that preserves the confidentiality of mission-critical documents and communications during any transaction.
- **Imprima Asset Lifecycle Management (ALM)** empowers you to organise, manage and track your assets in an efficient and cost-effective way, ensuring they are sale-ready at any given time.
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**Mergermarket** is an unparalleled, independent mergers & acquisitions (M&A) proprietary intelligence tool. Unlike any other service of its kind, Mergermarket provides a complete overview of the M&A market by offering both a forward-looking intelligence database and a historical deals database, achieving real revenues for Mergermarket clients.

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