

Challenges and Opportunities for Mergers and Acquisitions in the Post Covid stage

Our current environment has fostered precipitous falls in listed securities due to the coronavirus crisis, and great uncertainty about how the global economy may emerge from the slump. As a consequence, it is highly likely that there will be an increase in mergers and acquisitions (M&A), after the initial slow down observed as many transactions got canceled or postponed. However, crises are also the turning point for creating new opportunities. In fact, this climate of uncertainty should fade, or even be reversed, the devaluation of securities making, de facto, the most fragile companies subject to buyback operations.

Faced with this new reality, in which the need for capital overrules, companies must prepare on several fronts by significantly changing their attitudes. Among others, anticipation, better communication with investors and greater transparency should prevail. Furthermore, a comprehensive communication strategy is vital.

Impact on sectors

While the pharmaceutical, healthcare, food and logistics industries have experienced a slight increase in demand during the lockdown and the social distancing period, the vast majority of companies faced a sudden slowdown in their operations. The tourism and hotel sectors have been particularly affected in Africa.

Although no industry is truly immune to recession, technology sectors may be more likely to resist these shocks. As a result, technology is the sector attracting the most interest among the international investors who approach for opportunities in Africa.

After the crisis, the asymmetric effect of the pandemic in different sectors will lead companies to examine possible mergers and acquisitions from very different perspectives. Some companies will have persistent cash flow problems and may consider dividing non-core assets or divisions to provide additional liquidity; while those who have successfully survived the storm may be more adept at acquiring and seizing M&A opportunities.

The COVID-19 crisis has highlighted the fragility of supply chains. However, strong market players will attempt to harness important supply channels through acquisitions or significantly shorten supply chains at the expense of globalization. This can especially stimulate the M&A market.

Even before the COVID-19 crisis, consolidation was a major concern for recent mergers and acquisitions in the region, particularly among financial institutions. This trend is likely to accelerate in the banking and insurance sectors, as well as in other sectors such as education, where companies with complementary geographic and commercial footprints may find mergers attractive, hence generating synergies.

We can also expect consolidation in the most affected sectors. One could assume that if the crisis persists, there will be a further increase in debt-for-equity swaps. Successful companies but financially affected by the crisis, can be attractive targets especially for certain funds who specialize in the acquisition of companies in difficulty. Financing may also be more attractive due to lower interest rates.

In Morocco, for example, neither the agreements established by the Moroccan government in the context of the health crisis nor the law reform regarding companies in crisis seem to offer a sustainable solution for businesses who are going through a rough time. In this context, the sale of struggling

companies may be the preferred path for Moroccan business leaders who face difficulties that they cannot overcome on their own.

Impact on the targets' audit

The Covid-19 crisis will impact, and is already impacting, the way in which due diligence will be conducted, by transforming its traditional process.

The security of supply chains and other issues considered low risk in times of economic growth will become more decisive.

Acquirers will undoubtedly have a tendency to analyze the information provided in the data-rooms with a new prism by trying to appreciate or identify, for example:

- the consequences of Covid-19 on the operational and financial situation of the target and more specifically on its cash flow and its level of working capital;
- the effects of Covid-19 on the target's partners: suppliers, customers, etc. and the conditions under which the co-contractors would be likely to suspend the performance of their obligations, or even to request their renegotiation or termination;
- the target's ability to meet, in the short and medium terms, the commitments and financial ratios stipulated in the financing documents, etc.

In addition, buyers may wish to ask sellers to update the business plans already communicated to incorporate the consequences of the current situation.

Impact on transactional contracts

The post-crisis M&A transactions will undoubtedly have to adapt to this new context of uncertainty. The parties to the M&A transaction will be in a better position to negotiate contractual terms that better suit their interests; such as price adjustment clauses; earn-out clauses (payment of any price supplement calculated by applying a formula indexed to certain future financial aggregates of the target); contractual clauses that provide for situations similar to Covid-19 ("MAC", clause that allows them to be released from their obligations under the transfer contract in the case of similar events occurring between the signing and closing, the suspensive conditions, the declarations and guarantees, commitments of the parties, deadline), the use of legal concepts (force majeure, unpredictability, good faith execution of the contracts).

The seller, for their part, may require more extensive protections to ensure the availability of the buyer's funds, for example by requiring proof of liquidity of the funds as a prerequisite to signing the contract.

The parties may also wish to consider the availability of Guarantee and Indemnity Insurance for the transactions. However, since COVID-19 is a known risk, it may be that losses related to it are specifically excluded by the insurer, as the insured's knowledge of a situation is generally excluded from policy coverage. If there is an insurance policy for an existing transaction, the parties are encouraged to review the terms of the insurance policy and determine if the insured is adequately protected.

Finally, if the parties agree to a slower schedule, it will be important to consider extending any exclusivity periods on current transactions and negotiate longer exclusivity periods for future transactions.

Impact on sale price

The Covid-19 effect will undoubtedly have an echo in the negotiation of the sale price, probably in favor of a price that can be adjusted according to objective and quantified criteria (ebitda, turnover, net debt, need for working capital), rather than a fixed price, which over the years had become habitual in M&A operations, especially for sellers.

A fundamental aspect to consider when evaluating post-crisis transactions is whether the accounts for the 2020 fiscal year are an adequate basis to accurately reflect the value of the target business. If the company suffered a sharp drop in revenue during the pandemic, the use of a multiple ebitda based on accounts that cover this period can significantly undervalue the company (especially if the company shows signs of a strong recovery). Therefore, it may be more appropriate to use an adjusted ebitda or alternative accounts for periods that do not overlap with the coronavirus recession. There are also alternative calculation methods, such as the use of discounted cash flows or valuations of similar companies that are publicly traded, although these have their own limitations.

Traditional price adjustment mechanisms may also require modifications. For example, normalized working capital levels may need to be adjusted as companies consolidate to minimize future disruptions.

In conclusion, African business decision makers do not have a proven reference manual to navigate this unprecedented global financial and health crisis. Some improvisation will be necessary to survive the crisis and accelerate eventual recovery. For companies with strong balance sheets, mergers and acquisitions will play an important role. Several research studies show that transactions made in times of economic crisis create value for their shareholders. Preparation, patience and the will to dare would be the keys to success.

Text translated from original in Spanish:

<https://www.marruecosnegocios.com/desafios-y-oportunidades-para-las-fusiones-y-adquisiciones-en-la-etapa-post-covid/>

Author - Najwa El Iraki

Biography: <https://www.afsic.net/speaker/najwa-el-iraki-2020-speaker/>