THOUGHTS ON POST-COVID-19 M&A TRANSACTIONS IN FRANCE

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The COVID-19 pandemic has demonstrated an ability to spread rapidly, with major short- and long-term implications for public and private companies, the latter facing supply chain disruptions, office and store closures, a reduction in consumer spending, logistical problems and, more generally, difficulties in making business plans for the short and medium term.

These issues, together with the virus containment requirements, travel restrictions, financial market volatility and general uncertainty, have had and will continue to have a significant impact on M&A activity worldwide. However, there is no doubt that M&A activity will resume. Furthermore, the need to prepare for a post-COVID-19 world, while accelerating the search for economies of scale and synergies, will lead many companies to implement strategic mergers and internal reorganisations.

The question then is, what should buyers and sellers bear in mind in the context of post-COVID-19 M&A transactions in France?

What is the impact on the timing of a transaction?

All stages of an M&A transaction may be impacted and so delayed, including the following:

1. What is the impact on the duration of exclusivity and confidentiality undertakings?

Usually negotiated as part of an offer letter, these typically take 12 to 24 months. Depending on the details of the transaction, their timing may be delayed by the effects of the pandemic; consequently, the duration of exclusivity and confidentiality undertakings may have to be extended in order to better protect the parties and ensure the continuity of the discussions on the transaction.

2. What is the impact on the duration of due diligence?

The gathering of the necessary information for the construction of the data room and organisation of site visits and meetings with the management of the target company will take more time to complete in order to comply with the new health and safety and social distancing measures and to take into account the fact that many employees and the management of the target company, as well as the operational managers from both the buyer's and the seller's side, will be working from home (in France or abroad).

3. What is the impact on the longstop date?

This date has always varied depending on the complexity and number of conditions precedent to be met. Nevertheless, the consequences of COVID-19 will inevitably have the effect of extending the date in order to allow the seller time to meet all the conditions precedent. The satisfaction of certain conditions precedent will depend, in particular, on the French government lifting the deadline suspension; obtaining the release of existing securities; and the agreement of the French Ministry of Economy and Finance (in the case of foreign investment screening) or French Competition Authority (in the case of merger controls).

What is the impact on the stages prior to signing?

4. What is the impact on the valuation of the target company?

This stage of the transaction, usually performed by the financial teams of the buyer and the seller, together with their financial advisors, will be impacted by the pandemic. In particular, the following matters need careful consideration:

- What impact has the pandemic had on the target company's cash flow and working capital requirements?
- How did the target company perform during the period of the pandemic (and more generally during the year 2020)?
- To what extent did the main elements of the valuation vary between 2019 and 2020?
- Was the business plan of the target company updated following the initial impact of the pandemic?
- How does the target company finance its activities and has it been granted payment holidays on loans?
- Has the target company benefited from loans from the *Banque Publique d'Investissement* or regional funds?
- To what extent is the target company able to withstand a cash crunch?
- When is a return to normal operations expected?
- What was the trend in the target company's financial results before the crisis?
- What is the level of the target company's resilience in the market compared to its competitors?

5. What is the impact on the legal due diligence of the target company?

Parties to transactions must pay attention to any changes in laws or regulations resulting from the pandemic and how these changes affect ongoing operations (along with the target company's compliance with such changes).

A few points of attention, detailed below, may need to be given further consideration post-COVID-19:

- **Human resources**
  - What percentage of employees of the target company have benefited from the partial unemployment scheme (*chômage partiel*) and for how long?
  - Which facilities, warehouses, factories, shops and offices of the target company have been closed and for how long?
  - Are there any plans to lay off employees of the target company in the near future due to a decrease in the target company's activities as a result of the pandemic?
  - How has the target company ensured, and how does it intend to continue to ensure, its employees' safety? What are the relations with employees and employees' representative bodies? Has safety at work been called into question?
- **Commercial contracts**
  - What are the anticipated effects of the pandemic on the target company's business operations?
  - Have logistical difficulties been encountered? How have they been overcome?
  - What has been the impact of the pandemic on the target company's contracts with suppliers and customers? Have any contracts been terminated? Have payment terms been requested or granted? Have suppliers been able to continue their operations and provide the requested services or goods? Do the contracts between the target company and its customers and suppliers contain any special clauses (including force majeure, contingency or material adverse change clauses)?
  - What proportion of the target company's turnover comes from abroad? From which countries? What is the share of suppliers located abroad? Are there risks of supply chain disruption? The challenge is to understand the geopolitical context of the target company's operations as well as the dependencies and business risks facing the target company.

- **Insurance**
    - What are the terms and conditions of the target company's insurance policies as regards operational losses?
- **IT systems**
    - How have the information systems been coping with switching to working from home? Was the security of the IT systems maintained during this period?
- **Compliance**
    - What are the risk management protocols? Do they comply with the various regulations that have come into force since the beginning of the pandemic?

The seller will have to take into account the buyer's needs (along with those of the lenders or insurers involved in the transaction) and collect the information required in a timely manner.

6. What is the impact on the financing of the transaction?

One can expect that obtaining financing will be more difficult than usual and that the financial health of the target company and of the borrower will be scrutinised. Reliance on guarantors and/or securities is likely to grow.

What is the impact on contractual documentation?

7. What is the impact on the target company valuation?

The value of a target company is usually based on an estimate of future revenues and earnings and a statement of its indebtedness. At present, it would appear difficult to estimate the short- and long-term impact of the pandemic on these figures, but certain legal mechanisms could be used to secure the sale:

- A post-closing adjustment of the purchase price will allow any variation of certain financial and accounting results of the target company as at the date of completion of the transaction to be taken into account.
- An earn-out would also allow the buyer to make further payments of a portion of the purchase price conditional on the achievement of certain performance objectives after the closing of the transaction, while encouraging the seller to achieve these objectives.
- To prevent excessive price variation between the date of signature and the date of completion of the transaction, the parties may also agree on clauses allowing for a gradual upward or downward adjustment to the acquisition price based on any change in turnover (or other amounts) within an agreed range.

So-called 'locked-box' mechanisms, which do not allow for cash flow fluctuations following the closing of the reference accounts until the date of completion of the acquisition, will no doubt be abandoned for a while.

8. What is the impact on the representations and warranties given by the seller?

It seems likely that representations and warranties will be the subject of even more intensive discussion – in particular, the provisions relating to the absence of significant change, to relations with customers and suppliers, to the accuracy and fairness of financial statements, to the quality of relations with employees, etc.

Moreover, the seller will undoubtedly be less inclined to restate the representations and warranties at closing given the wider economic uncertainties.

9. What is the impact on warranties and indemnities?

Usually in transactions where the sellers are individuals or legal entities with limited financial strength, warranties and indemnities are extended to institutional sellers to provide additional comfort to the purchaser.

Moreover, it is likely that escrows retaining all or part of the purchase price as collateral will also be used more frequently.

10. What is the impact on warranty and indemnity insurance policies?

Although warranty and indemnity insurance has become more common in the M&A landscape, post-COVID-19, it is not expected that these policies will necessarily provide a solution to the crisis. As the impact of the crisis is already partly known, it is likely that they will be excluded from the coverage provided by insurance policies.

An increase in the underwriting of 'key person' insurance policies may also occur.

11. What is the impact on conditions precedent?

As indicated above, it is anticipated that the timing of transactions will be delayed during the current period.

It may be advisable to allow for a longer period between the signing and closing of a transaction. The consequences (cost allocation) of not fulfilling a condition precedent will also need to be agreed between the parties.

12. What is the impact on MAC clauses?

MAC clauses establish the conditions for terminating a transaction between signing and closing in the event of any occurrence that is likely to have a significant and negative impact on the status of the target company.

The MAC clause usually excludes events that have a general impact on all sectors of activity and/or geographical areas without distinction, in order to give priority to the detailed risks relating to the target company (for example, loss of operating permits, loss of customer contracts representing a substantial portion of revenues, or fire at a work site).

In the case of COVID-19:

- It is arguable that the seller will wish to exclude from the scope of this clause the effects of pandemics or other events affecting public health, either domestically or internationally. Such a request appears acceptable as long as the exclusion is limited to events that do not have a disproportionate effect on the target company with regard to its sector of activity or geographical location.
- The teams drafting the contract will endeavour to qualify and specify the consequences of unfavourable changes by expressing them in terms of quantitative criteria (percentage decrease in turnover or EBIT) or qualitative criteria (a break in the supply chain leading to a total or partial inability to produce).

13. What is the impact on events occurring during the interim period?

The seller usually undertakes to continue operating the target company "in the normal course of business" or "prudently", in accordance with past practices, to maintain good relations with employees, customers, suppliers and other stakeholders, and to preserve the business structure, property, equipment, etc.

In the context of COVID-19:

- This wording will have to be adapted in order to take into account the fact that the regulatory authorities may put in place specific measures, which will not allow the seller to continue operating the target company's business operations as before. It will be essential to allow exceptions to this principle of the seller's good governance during the interim period, so that the seller is able to react to unexpected events, without triggering a breach of commitments relating to the management of the business.
- Since commitments during the interim period may also take the form of negative covenants, it is likely that, during this period, the buyer will not want the seller to be able to grant extended payment terms, discounts or rebates, or conclude settlement agreements, without the buyer's prior consent.

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