Maneuvering the uncertainty of transaction closing

Bowing out from a deal gracefully

IGPI Singapore, December 2020

Not all potential transactions complete. Termination or delay of potential transactions could result in soured relationships and in the worst case, legal repercussions. The pandemic has highlighted such pitfall as the closing period between signing of definitive agreement (share purchase agreement, asset purchase agreement, merger agreement etc.) and transaction completion is subject to fluctuation that could adversely and materially change the basis of the initial agreement.

The pandemic has affected business performance and soured deals

In what would have been the largest US$16.2 billion deal in the luxury industry, Tiffany sued LVMH for deliberately stalling completion of the deal agreed in 2019 before the pandemic emerged. LVMH in turn countersued Tiffany for breach of its obligation to operate in the ordinary course of business through "mismanagement of its business", such as taking on additional debt and paying regular dividends during the pandemic even when Tiffany posted losses. LVMH further cited the pandemic as a "material adverse event" that changed the understanding of the agreement in 2019. The parties eventually agreed to settle for a lowered purchase price from US$135 per share to US$131.5 per share (2.6% reduction).

In other news, WeWork sued Japanese conglomerate Softbank Group for backing out of the US$3 billion tender offer, accusing it of succumbing to "buyer's remorse" during the pandemic. Softbank stated that several pre-conditions had not been met and the pandemic had impacted the business of WeWork, among other reasons.

Choosing an appropriate closing structure helps prevent repercussions

There are two general types of closing structure (1) simultaneous signing and closing — where the definitive agreements are signed and the deal closes at the same time, and (2) deferred closing — where the closing occurs after the definitive agreements documents are signed, and there are usually closing conditions to fulfil.

Simultaneous signing and closing is a simpler process and eliminates transaction risk, such as the risk of Tiffany vs LVMH, but it might not be possible if the deal is conditioned on items such as regulatory approval, shareholder approval, bank financing. There is also the sensitivity of leaking the news of transaction prior to signing if there is a need to solicit for approval beforehand (e.g. shareholder approval, change of control for material contracts).

Deferred closing scenario is more complicated as it involves negotiating covenants and conditions, as well as agreement on various key aspects such as termination, restriction on activities, representations and warranties, price adjustment (read up more on locked box and completion accounts mechanism for further information). However, it spells out conditions precedent to

closing, such as gaining shareholder and regulatory approval, which eliminates risk of business operations and continuity upon change of hands. In this deferred closing scenario, there will be negotiations required based on the geography, industry and nature of the business.

Negotiate down to the specifics and pave scenarios for bowing out gracefully

In negotiating the clauses and conditions to be inserted in a deferred closing scenario, buyers will inherently want to be as comprehensive and specific as possible to list "walk-away" scenarios, such as defining what constitutes as material adverse events. Permissible and restricted activities, such as distributing dividends and terminating material contracts, should also be stated. While sellers might not always agree to such terms, a discussion is necessary to state and align the intent of the parties.

In the case of Tiffany vs LVMH, LVMH argued that Tiffany did not specifically mention the prospect of a pandemic in a detailed list of events where LVMH have to bear the consequences, even though there were specific carve-outs such as "Hong Kong protests" and "terrorism". Tiffany in turn argued that they need not anticipate every conceivable cause of an industry-wide decline and specifically identify each of those causes. It is always with the benefit of hindsight that including a pandemic in the list of events would have avoided the argument.

While we cannot prepare for the unexpected, we have to be prepared that deals might not complete and there might be legal repercussions. Even though the court rarely forces a company to go forward with a deal, plaintiffs (usually seller who want the buyer to commit to the deal) might still pursue for more negotiation power for a settlement. It is hence advisable to adopt a prudent approach when evaluating such risks and reflect extensive consideration in documentation.

Continuously navigate transactions in the midst of a pandemic with care

While the pandemic has caused some companies to delay investments, some have chosen to be proactive in identifying opportunities in this crisis. Cross border transactions are still ongoing as virtual discussions and due diligence have replaced traditional physical business trips, with most being quick to adapt. Valuation and pricing are debatable in this volatile environment, with earn-outs and price adjustments used to bridge the expectation gap between sellers and buyers.

As business environment evolves to a new normal brought about by the pandemic, we should be flexible and quick to adapt. Experienced M&A advisory professionals will be able to offer valuable advice to not just guide companies through a smooth transaction, but also to safeguard interests when potential transactions fall through between definitive agreement and transaction closing.

About the Author

Chong Han is a Senior Manager at IGPI Singapore. Chong Han's career started in 2008 in the M&A advisory arm of a global professional services firm, with a focus on valuation advisory relating to mergers and acquisitions, restructuring, financial reporting and litigation support. Thereafter, he joined a SGX-listed regional real estate player, investing in lands for development and properties for redevelopment or holding. His experiences and skills span across a wide spectrum of investment activities such as market analysis, due diligence, valuation, and financial modelling and transaction execution in Singapore and beyond.

About IGPI Singapore

Industrial Growth Platform Inc. (IGPI) is a premier Japanese M&A advisory firm with presence and coverage across Asian markets. IGPI was established by former members of Industrial Revitalization Corporation of Japan (IRCJ) in 2007. IRCJ, a US $100 billion Japanese sovereign wealth fund, is known as one of the most successful turn-around funds supported by the Japanese government.

In 2017, IGPI collaborated with Japan Bank for International Cooperation (JBIC) to form JBIC IG, providing investment advisory services and supporting overseas investment. In 2019, JBIC along with BaltCap has jointly established Nordic Ninja, a €100 million venture capital fund to focus on deep tech sectors such as autonomous mobility, digital health, AR/VR/MR, artificial intelligence, robotics and IoT in the Nordic and Baltic region. In 2019, IGPI established IGPI Technology to focus in the area of science and technology. The company invests in technological ventures and provides hands-on management support. The company also provides business development support and consulting towards commercialization and monetization of technologies

IGPI Singapore was established in 2013 to focus on management consulting and M&A advisory in Southeast Asia across various sectors. Our firm acts as a bridge between Japan and Southeast Asia, having advised on market entry strategy, potential target search, valuation, due diligence, M&A process management, post-merger integration and change management for leading Japanese clients. In addition, we have helped businesses in Southeast Asia enter Japan with consulting services and support. We also provided sell side advisory for SMEs and private equity fund looking to divest.

Get in touch with us on strategy, innovation, portfolio planning and M&A related topics!

IGPI Singapore – contacts:

Kohki Sakata
Chief Executive Officer
+65 81682503
k.sakata@igpi.co.jp

Chong Han Lim
Senior Manager
+65 90692611
c.lim@igpi.co.jp

Kim-Lân Dang
Senior Manager
+65 91000273
k.dang@igpi.co.jp

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