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Distressed M&A in the corona crisis I - Critical success factors

6 April 2020

The corona crisis has recently brought M&A activity almost to a standstill. Only very advanced transactions are currently still being negotiated. Many projects that are in earlier phases are being interrupted, if not immediately cancelled. As a result of the corona crisis, many companies are in crisis mode worldwide. Firefighting has priority. More and more companies are currently stopping all non-essential projects - and that includes many M&A transactions. But the abandonment of any transaction activity also isolates, and can be just as wrong as state isolation policy. Cooperation has always made us stronger.

With our series of articles 'Distressed M&A in the corona crisis' we want to promote further M&A activities. The crisis only changes the rules of the game - and we want to shed more light on these changed rules for you.

What is distressed M&A?

Distressed M&A comprises all transactions involving a company in a crisis phase, both before and during the actual insolvency. There is no generally accepted definition of a crisis: The crisis begins long before insolvency, as soon as a company is threatened with insolvency without far-reaching performance or financial restructuring measures, or it is likely to soon be unable to meet current liabilities or maintain business operations.

Distressed M&A is often negatively associated with the stigma of corporate failure. Wrongly so - distressed M&A transactions have already saved many companies, companies that are now perceived as successful market participants. Instead of the memory of the crisis, the success story that followed the rescue outweighs the memory of the crisis.

These type of transactions have in common that they are negotiated and executed under special conditions. In this article, we show which success factors are particularly critical to make distressed M&A transactions a success.

Time pressure

The time pressure in distressed M&A transactions is high, the completion always a race against the clock. This is partly due to the fact that every day which delays restructuring causes further damage to the company, customers leave, employees quit, supply chains collapse. On the other hand - at least in asset deal scenarios - the insolvency risk of the seller and the risks associated with it, especially the cancellation of the transaction under insolvency law, increase from day to day.

Distressed M&A transactions are therefore typically completed in 4-6 weeks - not comparable to the 4-6 months for conventional transactions.

It is, thus, critical to assess the risks despite the time pressure, to focus the due diligence on the right issues and to set the right priorities in the negotiations.

Stakeholder management

While a normal M&A transaction is often only negotiated directly between buyer and seller and often even the management of the target company is not directly involved, the group of critical stakeholders is larger in distressed transactions: the success of the transaction depends to a large extent on the support of the management of the target company, its employees, but also its creditors (especially banks and credit insurers) and customers. Everyone can and must make their contribution to the success of the transaction; everyone can only win with the transaction if the alternative is the liquidation of the company. The buyer has to inspire the management for his recovery plan, the employee representatives have to believe in this plan and be willing to make concessions, creditors have to agree to a haircut of claims, customers can show their solidarity and promise their further support. When selling out of insolvency, the insolvency administrator acts as an intermediary between the various stakeholders, with the aim and mandate to maximise the insolvency assets for the benefit of creditors.

One of the core tasks of the transaction consultant is to understand the various interests of all stakeholders, to mediate between the stakeholders and to secure support for the transaction.

Trust and confidentiality

The confidentiality of the transaction negotiations is even more crucial in a crisis than it is in any other transaction - the publicity of the crisis can accelerate the downturn and thus jeopardise the transaction. At the same time, as shown, the transaction requires coordination with many stakeholders, which makes confidentiality even more difficult.

Non-disclosure agreements are mandatory, but at best 'nice' - it is crucial that all parties really understand that any information leakage threatens the transaction and therefore the survival of the company. It helps in any case if the parties involved know each other well and - more importantly - trust each other.

Experience and professionalism

As time is of the essence, it is particularly important that the transaction is led by a small, professional and experienced team. The market standards and contractual conditions of distressed M&A transactions differ significantly from normal M&A transactions. Nevertheless, there is room for negotiation. It is crucial to know the market standards and negotiation margins, not to over- negotiate and not to take off-market positions. Anyone who demands operational guarantees from an insolvency administrator in the purchase agreement, for example, and declares this to be a dealbreaker, is manoeuvring himself onto the siding.

Transaction security

Transaction security is an important criterion in all M&A transactions. Basically, the seller always aims to ensure that the transaction is actually completed after its signing, i.e. that the buyer cannot withdraw without good reason and that the purchase price payment is secured at closing.

For the insolvency administrator, transaction security starts even earlier: he must ensure that the transaction is successful at all. Any deal with which he achieves higher proceeds than the liquidation values is better for the creditors than the liquidation. Often the insolvency administrator conducts a bidding process and sells to the highest bidder; however, he will only consider bids where the financing of the purchase price is secured and the payment of the purchase price is not at risk. Therefore the highest bid does not necessarily win, but rather the highest bid with maximum transaction security.

Restructuring know-how

And finally: the buyer needs a plan for the restructuring. In most cases, cutting off liabilities through the transaction is not enough if the business continues to burn money every day. The restructuring know-how of the buyer decides on the success or failure of the transaction and the future of the company.

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