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The impact of the coronavirus pandemic on the M&A market

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As of March 23, 2020, the World Health Organization reports 334,981 cases of novel coronavirus (COVID-19) worldwide. Although the full economic impact of coronavirus remains unknown, we are already observing changes in the M&A market. Rapidly changing federal, state, and local government responses, the effect of social distancing, and mandatory work-from-home policies have created a tumultuous environment for deal making.

Prior to the global coronavirus outbreak, the general sentiment among deal makers was that 2020 would be a robust year for M&A activity on an international and domestic level. We thought it important to provide some anecdotal information as to our observations with respect to the impact of coronavirus on M&A activity.

Observations on the impacts of coronavirus on deal making

Historically, economic uncertainty and market volatility are detrimental to deal making and we are seeing signs that this will certainly be the short-term impact as a result of the growing spread of the coronavirus. For now, transactions that are underway or close to completion appear to be moving forward toward closing. We have not yet seen a spike in signed-deal terminations due to coronavirus, but we anticipate at a minimum that buyers will be looking closely at their contractual rights. Since the coronavirus could detrimentally impact a target's revenues, cash flow and liquidity, availability of raw materials, and supply chain, we do expect that these risks could lead to negotiations between sellers and buyers—including re-pricing the deal or outright terminations.

In comparison, we have seen a higher proportion of deals in the early stages—currently exclusive and in active due diligence review or early negotiations—being paused. In addition, sell-side processes that were scheduled to launch in the near term are also being paused. Although we would expect these deals will be paused until the current uncertainty subsides, it remains to be seen whether these transactions (and processes) will come back on line when things settle down.

Government guidance and mandatory "shelter-in-place" orders have made it inadvisable or impossible for parties to conduct in-person site visits and management meetings. Furthermore, the inability to meet in person may prevent personal outreach and stop deals from starting altogether limiting or eliminating the effects of the parties' ability to "break the ice" with acquisition targets, which we expect will be felt for some time even after the scale of the pandemic has subsided. Likewise, necessary governmental and regulatory approvals and third-party consents have become more difficult to predictably obtain due to coronavirus-related restrictions. The economic effects of coronavirus, including rapidly tightening credit markets, means that it will be difficult for buyers to procure financing for planned transactions.

Purchase agreement focus

We expect to see certain heightened focus on purchase agreement terms to address coronavirus-specific risks. A few focused negotiation points we would expect include:

- "Material Adverse Change" definitions will be a focused negotiation point for buyers and sellers—sellers will look to insert an exception to the definition that provides that the effects of the coronavirus will not constitute a MAC—while buyers will argue that the effects (both short- and long-term) of the coronavirus remain uncertain.
- Representations and warranties regarding emergency planning and business continuity will be under increased scrutiny.
- Operating covenants need to be drafted in a manner that allows sellers to rapidly respond to changes in the coronavirus threat and government restrictions.
- If timing remains uncertain, parties should thoughtfully negotiate adjustment of outside dates, including the potential for automatic extensions.

Looking ahead

We anticipate the impact of the coronavirus in M&A deal making will be felt harder in certain industries. Middle-market M&A activity was already experiencing a slight decline (year-over-year) in nearly all industries, which will only be compounded by the impact of coronavirus. Based upon the short-term data available, we predict the potential for the technology sector to be more resilient in the face of coronavirus challenges. In addition, we expect increased opportunities in certain sectors including telemedicine, direct to consumer/distribution businesses, medical cleaning technology, and various software-based applications (online/remote working technologies, community-based platforms, and online learning for all levels of education).

In contrast, industries being hardest hit by the coronavirus are hospitality, airlines, hotels, auto industry, oil and gas, retail, and entertainment (theme parks, movies, gambling, live sports, etc.). In addition, while deal making in the health care industry was up in 2019, we anticipate that it will likely slow for the remainder of 2020 due to the strain of coronavirus on the internal resources of companies in this sector.

As noted above, we anticipate we will see a delayed wave of terminations (and re-negotiations) of transactions in process prior to the coronavirus outbreak. Currently, attention is focused on the coronavirus response, but once the focus returns to the ongoing deal, parties may no longer have the same incentives to proceed with the transactions.

The impact of regulatory delays caused by coronavirus restrictions will also impact timing of transactions. The U.S. Department of Justice and the Federal Trade Commission have requested additional time to complete reviews of proposed mergers. In the EU, European Commission regulators have asked companies to delay merger notification filings, as the Commission scrambles to respond to the disruptions caused by the coronavirus.

As with most businesses around the country (and the world), we expect private equity firms are preparing their portfolio companies for the full impact resulting from coronavirus disruptions. For example, we anticipate companies across several industries will proactively draw down on lines of credit or other available sources of funding in an effort to shore up cash reserves to weather the upcoming uncertainties. As a result of the uncertainties, we expect businesses will continue their short-term focus on workforce and supply-chain stability, customer engagement, financial stress testing (and specifically ongoing working capital requirements), and strategic alignment of business assumptions across the entire enterprise. We expect that distressed deal making could see an uptick as opportunistic buyers (both financial and strategic) move to position themselves to find value-based targets that have been negatively impacted by the economic uncertainty caused by coronavirus and which are looking for a life-line.

The fallout from the coronavirus will undoubtedly have a short-term impact on the M&A and private equity landscape. Once we see a sustained flattening of the curve and a measured return to normal day-to-day life, we anticipate that the deal-making environment will improve. A critical element of deal-making is face-to-face interaction of principals and their advisors, so once we return to these ways we are confident we can expect acquisition activity to improve.

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