

Pricing Mechanisms during COVID-19: navigating a route to value

Sale and Purchase Agreement
Advisory
Forensic & Integrity Services

Pricing Mechanisms: seeking clarity in uncertain times

- ▶ Which pricing mechanism can provide the greatest clarity on value?
 - ▶ Locked Boxes – challenging given uncertainty in the Locked Box period, but are sector-sensitive
 - ▶ Completion accounts – increasingly the market mechanism of choice in the short term
 - ▶ Earn-outs – a mechanism that will persist, but COVID-19's impact has to be factored in
- ▶ How will buyers and sellers achieve funding certainty?
- ▶ What alternative protection measures may be sought?
- ▶ Growth expected in vendor financing, fixed asset adjustments, escrows, receivables indemnities and other protections

Completion accounts: careful negotiation with greater efforts over smaller details

- ▶ Can an emphasis on specific accounting policies help minimize the risk of disputes?
 - ▶ Prepare for extra focus on areas of judgement (e.g., revenue recognition, credit extension and discounting, implications on bad debts, slow-moving stock, inventory valuation – standard costing and overhead absorption, factory closures, redundancies, furloughed staff liabilities, maintenance and capex underspends, and tax provisions)
 - ▶ Expect closer scrutiny on interpretation of adjusting and non-adjusting post balance sheet events
- ▶ Target Net Working Capital – historical, future, 6+6 ...? Or do you need a fresh approach to 'normal'?
- ▶ Will time-lines be accelerated for mid-month completions? How will Net Working Capital be impacted?

Signing

Is a completion accounts true-up preferred?

Is there pressure to renegotiate terms (e.g., earn-out targets)?

Locked Box mechanisms: a cul-de-sac or still a viable mechanism under the right circumstances?

- ▶ How to approach the critical transaction choices of the Locked Box date and level of diligence?
- ▶ Is value accruing during the value accrual period? Might differential rates apply over different periods?
- ▶ Have buyer expectations increased for robust (and sensitized) cash flow forecasts through to completion?
- ▶ Can leakage risks be appropriately managed?
 - ▶ Prepare for greater focus on the breadth and components of leakage and permitted leakage
 - ▶ Expect more rigor in post-completion leakage reviews

Is a Locked Box mechanism still deliverable?

Earn-outs: what is an appropriate performance target in a changing landscape?

- ▶ Calculating target revenue or EBITDA – static or with a recalibration option? Has a 'bounce-back' period been assumed and, if so, how?
- ▶ How to define normalization and one-off adjustments?
- ▶ Can uncertainties be managed through specific accounting policies for areas of judgement (e.g., revenue recognition, costs and other EBITDA adjustments)?

Completion

Is there pressure to renegotiate terms (e.g., earn-out targets)?

Completion accounts: even more than ever, every penny counts

- ▶ Are the practicalities of preparing opening and closing balance sheets during COVID-19 recognized (impacts of remote working and restrictions on access)?
- ▶ Does the timetable to deliver and review completion accounts need to be extended?
- ▶ How to assess consistency of management judgement in a changing environment?
- ▶ Are parties ready for harder negotiations and disputes?
 - ▶ Expect increased scrutiny and challenge
 - ▶ Prepare to navigate the expert determination process

Are you prepared for increased disputes and claims?

Earn-outs: increased alert – performance optimized or manipulated?

- ▶ Is there pressure to revisit and revise revenue or EBITDA targets in light of COVID-19?
- ▶ Should short, medium and longer term cost-saving measures be factored in? If so, how?
- ▶ How to interpret and adjust for exceptional and one-off impacts?
- ▶ How should consistency be applied in approach on judgemental areas (e.g., revenue recognition, costs and other EBITDA adjustments)?

Preparing for completion accounts: early attention to reduce future pain

- ▶ Can the impact of the changing environment on specific accounting policies be actively monitored?
- ▶ Have operational difficulties in achieving financial close been anticipated (e.g., whether an inventory count at completion is possible)?
- ▶ Are parties becoming more tactical in their approach to pre-completion estimates?
- ▶ Is scrutiny over conduct of business and Material Adverse Change clauses increasing?

Other protections: financial warranties in sharper focus

- ▶ How is market expectation changing as to normal scope, content and duration?
- ▶ What is the Impact of COVID-19 on warranty and indemnity insurance?
- ▶ Are force majeure clauses subject to closer scrutiny?
- ▶ Are buy-side perspectives shifting with respect to completed deals?

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