The outbreak of coronavirus disease (COVID-19) has directly impacted the health of many people across the world. From an economic perspective, the impacts to capital markets and the uncertainty around the future business prospects of companies across all sectors have likely led to new and enhanced risks in mergers and acquisitions (M&A) globally, driven by wild shifts in market capitalizations and the demand for goods and services.

As a result, buyers and sellers alike are navigating more unprecedented challenges on deals than ever before. We encourage buyers and sellers to be mindful of the following considerations in the deal life cycle:

Material changes in a valuation increases the likelihood of disputes and/or damages

- Earnings (and valuations) may be negatively impacted for a variety of reasons, including disruption in the global supply chain, lower revenue and higher costs to conduct business. In other industries, a large COVID-19 related demand may lead to a surge in earnings.
- These changes, especially if they occur before closing, may lead to a discrepancy in enterprise value between seller and buyer. If these cannot be resolved, either side may choose to pull out of a deal, leading to an increased risk of breach of the seller’s representations and warranties as well as the potential for subsequent damages.
- Parties may also further scrutinize termination and other sales purchase agreement (SPA) contractual clauses related to delaying or backing out of pending deals.

Challenging markets increase the risk that fraud and corruption occurs

- Businesses facing economic pressures from issues such as affected supply chain, lower demand and reduced market capitalization may have an incentive or a rationalization to commit fraud to uphold company valuations.
- As the supply chain is impacted, companies and their agents may have incentive to make improper payments to facilitate cross-border sales.
- There may be more pressure/incentive for acquired companies with earn-out structures to commit accounting fraud in order to uphold their projected earnings.
- Goods manufacturers may switch suppliers (perhaps without telling customers), affecting the quality of their products and impairing the value of their brand.
Logistical challenges to completing effective ethics and compliance due diligence

- Diligence may need to be reduced or performed on a more remote or virtual basis due to restricted travel to high-risk countries.
- Travel suspensions may present delays in the availability of critical data or access to key personnel. With delays and limitations in the availability of key information, there will be modifications to the way fraud risk assessments and anti-bribery and anti-corruption (ABAC) diligence can be conducted.
- The presence of COVID-19 may result in the closing date of the deal to be extended or delayed, and if that occurs, it may influence the purchase price and the way the parties approach the deal.
- Companies may quickly pursue transactions that they view as underpriced due to the current market factors, which may be strained by these logistical challenges as well.

Standard post-acquisition process may be significantly changed

- COVID-19 may increase the concern around the post-closing purchase price adjustment mechanism. There may be a possible increase in more “contingent” or “true-up” pricing elements beyond those present in a typical net working capital adjustment mechanism.
- Buyers may consider true-up mechanisms for inventory or other assets that may be difficult or impossible to access and assess during diligence.
- SPAs with expected earnout calculations determined before the COVID-19 outbreak may need to be recalculated or adjusted based on projected impact to the supply chain and consumer demand.
- Locked Box/Fixed Price deals may be delayed or changed to use a completion accounts approach based on availability and access to financial information.
- A buyer’s timeline to file a warranty and indemnity claim may increase, resulting in a delayed recovery of any damages.
- Pending deals with SPAs with “outside date” provisions that initiates the termination of a deal if not closed by a specific date may need to be revisited or extended, due to government office closures in affected countries and other delays caused by COVID-19.

These risks will likely be applicable to most deals in at least the near future, regardless of where any of the parties are located or operate. EY can assist in carefully examining the terms of the SPA; we can also help buyers and sellers assess and mitigate any financial risks related to COVID-19.

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