How Has the COVID-19 Pandemic Affected Mergers and Acquisitions?

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Here at Levenfeld Pearlstein (LP), the first question that we get from a current or potential client looking to either a sell-side or buy-side M&A transaction is: What changes has the COVID-19 pandemic had on such transactions? Like every answer a lawyer tends to give, we usually respond with: "It depends."

When the pandemic started, most potential participants in an M&A transaction were largely concerned with the downside risks in operating a business, such as adapting to various shutdown orders, remote workforce transitions, and changes in customer behaviors. However, now that companies have had the benefit of over a year of operating during a pandemic, the focus has shifted to helping our clients who are actively pursuing M&A transactions to identify and highlight the upside impacts from the pandemic on their business, such as changes in primary markets and customer behavior leading to increased revenue or filling a void from competing businesses not being able to obtain the capital necessary to make the necessary adjustments to survive. These positive changes may not be readily apparent by reviewing a company's financial statements.

For example, a company that outpaced their competitors should highlight comparative metrics which illustrate growth in market share. For businesses that may not have fared as well, they should be prepared to explain their relative underperformance and perhaps highlight some other positive differences in how their business can operate in a post-COVID. For example, a business experiencing a decrease in sales may also be benefitting from an offsetting reduction in commission expenses if they had to cut their sales force due to modified demand for their products.

Another impact of COVID-19 on M&A transactions was the creation of a new deal pricing metric called "EBITDAC". Prior to the pandemic, the financial metric used to value middle-market businesses was a measure of cash flow knows as Earnings Before Interest, Taxes, Depreciation, and Amortization or "EBITDA". As the COVID-19 pandemic spread, adding the 'C' to the traditional EBITDA metric was done to quantify a company's losses attributed to the pandemic. Examples of potential "coronavirus"

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adjustments to earnings included the costs associated with employee severance or "combat pay" bonuses, lease termination costs, increased commodity prices and freight costs as well as the impact of general declines in efficiency due to remote work environment.

When evaluating the 'C' in EBTIDAC, it is critical for all parties to obtain support for proposed coronavirus adjustments to the financial statements of the company which is a target of an M&A transaction. A company looking to sell may attribute its lost revenues to the COVID-19 pandemic instead of other problems or issues occurring in the business. Therefore, Buyers will need to perform careful due diligence to determine if there are other reasons for the losses and potential sellers, even if not presently contemplating a transaction, would do well to think about how COVID-19 has impacted their business and take steps to document its effects.

If you are contemplating an M&A transaction and wish to analyze how the COVID-19 pandemic may affect you, please call David Solomon or one of the other members of LP's Corporate Practice Group.

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