What's market for M&A?

Lawyers | McCullough Robertson

McCullough Robertson's integrated corporate and tax team, led by 15 partners, has analysed its public and private deals over the last 18 months, focusing on the evolution of the commonly used "standard market clauses".

Prepared specifically for in-house counsel and executives, we are pleased to share with you a practical summary of the key considerations that will impact your next transaction.

Bridging the price gap

While it is traditionally the case for a buyer to pay for a company or asset by way of cash (or a combination of cash and shares in the buyer), parties are now fine-tuning the way in which the purchase price is structured. For example, contingency payments through capped "earnouts" and royalties are a common feature in recent M&A documentation. The main purpose for this is to limit post-closing operating risk for buyers, while maximising the exit price for sellers.

"Anti-embarrassment" protection

Also becoming popular are "anti-embarrassment" or "face-saving" clauses, designed to ensure a seller shares in unexpected post-closing profits and, in the process, is not embarrassed by being seen in the market as mistiming the sale or underestimating the genuine worth of the company or asset. These clauses address the possibility of the buyer on-selling a company or asset at a higher price within a short period post-closing. In recent times, these clauses have required the recalculation and upward adjustment of the original purchase price to ensure the seller shares in any unexpected uplift in value that the buyer achieves on its on-sale.

Pre-completion conduct - what is the "ordinary course"?

Buyers are trying to control the conduct of a company or asset by imposing an extensive list of obligations and restrictions on the seller pre-closing. For example, there is generally an obligation for the seller to ensure the company or asset is conducted "in the ordinary course of business". However, what is "ordinary" has become somewhat of a grey area in recent times. In a period which cannot be described as "ordinary", parties will need to examine whether it is realistic for a seller to conduct a company or asset in its usual course of business, and whether this requires specific consideration by the parties on a case-by-case basis.

Transaction insurance

A recent uplift in the demand for warranty and indemnity (**W&I**) insurance indicates that parties are looking externally at options to de-risk their investment in, or exit from, a business. Sellers can exit from their business with minimal (if any) post-closing liability, whereas buyers can rely on potentially higher indemnity caps and extended warranty periods than a seller may ordinarily be willing to offer. However, W&I insurance is becoming more expensive. For a long time, this type of insurance ranged between 1% and 2% of the transaction value, but we're now seeing premiums priced at 3% and 5% of the transaction value.

What's market for M&A?

Lawyers | McCullough Robertson

Material adverse changes

Where a company or asset is materially affected prior to transaction closing, many buyers are now taking comfort by imposing and relying on "material adverse change" (**MAC**) clauses in transaction documents. The effect of a MAC clause allows a buyer to walk away from a transaction, either as a condition to closing or as an express termination right. Sellers are looking to counter this by expressly carving out the effects of economic or industry-wide events (such as pandemics or global conflicts) which would constitute a "MAC" giving rise to termination.

Limitations of liability

Most sellers continue to impose limitations on their exposure to liability for warranty breaches and indemnity claims. These limitations are generally couched by time and monetary thresholds. Recent trends show that warranty claims are being capped, by agreement, at between 30% to 50% of the purchase price and are required to be notified to the seller within two years of completion (although warranty breaches which relate to ownership of shares or assets can extend to 100% of the purchase price).

Electronic execution

The use of digital signatures and digital signing platforms to execute transaction documents has become increasingly commonplace. Following several temporary measures, on 10 February 2022 the Federal Government permanently brought into force laws which permit companies to execute documents electronically.

Secured indemnities

Buyers are always looking to reinforce their indemnities against a seller if that seller is not able to meet a claim for breach of warranty. This is particularly the case if the seller does not have the financial capability to meet such a claim. Common forms of indemnity protection sought by buyers in recent times range from retention of part of the purchase price, parent company guarantees, and warranty and indemnity insurance.

Due diligence

Before committing to a deal, buyers are now managing their risk profile by undertaking more extensive due diligence beyond traditional legal, accounting and tax investigations. Sellers should now be prepared for buyers to undertake due diligence in areas such as market sustainability, workplace health and safety, and to the extent to which there has been (and it will be possible to maintain) Environmental, Social and Corporate Governance compliance.

Key contacts

McCullough Robertson is a leading adviser on M&A transactions in the mid-market. If you would like to discuss any of these considerations, please contact our partners:

Key contacts

Damien Clarke
Partner - Corporate
dclarke@mccullough.com.au
+61 412 853 444

Melinda Peters
Partner - Tax
mpeters@mccullough.com.au
+61 424 788 190

Ben Mortimer
Partner - Corporate
bmortimer@mccullough.com.au
+61 402 890 720

Corporate & Tax team

Duncan Bedford
Partner - Tax
dbedford@mccullough.com.au
+61 433 568 286

Andrew Bukowski
Partner - Corporate
abukowski@mccullough.com.au
+61 419 174 449

Aaron Dahl
Partner - Corporate
adahl@mccullough.com.au
+61 419 174 449

Louise Horrocks
Partner and Head of McR ESG
lhorrocks@mcresg.com.au
+61 411 965 864

David Hughes
Partner - Tax
dhughes@mccullough.com.au
+61 419 773 415

Stephen Iu
Partner - Corporate
siu@mccullough.com.au
+61 402 911 112

Natalie Kurdian
Partner - Corporate
nkurdian@mccullough.com.au
+61 439 027 734

Meg Morgan
Partner - Corporate
mmorgan@mccullough.com.au
+61 434 191 256

Naomi Omundson
Partner - Corporate
nomundson@mccullough.com.au
+61 407 171 068

Reece Walker
Partner - Corporate
rwalker@mccullough.com.au
+61 412 657 535

Tim Wiedman
Partner – Corporate (FSR)
twiedman@mccullough.com.au
+61 412 331 059

Ben Wood
Partner - Corporate
bwood@mccullough.com.au
+61 416 820 423