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COVID-19:
IMPACT ON MERGERS AND ACQUISITIONS IN MALAYSIA

In October 2019, research and consultancy firm Oxford Economics expected the number of mergers and acquisitions (M&A) transactions in Malaysia to increase up to 221 deals in 2020, from an expected 218 deals in 2019. It was also observed and anticipated that Malaysia may be a beneficiary of the change in supply chains arising from the trade tensions between the US and China due to Malaysia's open trading economy.

However, that was a few months ago before the outbreak of the coronavirus (**COVID-19**) around the world. Since then, analysts have forecasted a slowed growth for China due to the outbreak – 3.5% in the first quarter of 2020 as compared to 6% in the fourth quarter of 2019.

The present situation is uncharted waters, and the outbreak has resulted in economic disruption in Malaysia. Most businesses are suffering due to their inability to operate as usual and its overhead running. It is too early to tell whether the M&A outlook in Malaysia is still as bright as analysed before the outbreak. Around the world, there are deals that have been aborted due to the outbreak of COVID-19.

Outside of Malaysia, Xerox withdrew its $34 billion hostile takeover bid for HP Inc. due to market unrest caused by the COVID-19 outbreak, Warner Music Group Inc. temporarily postponed its planned IPO due to the outbreak and several airlines in the US and the UK have collapsed due to travel restrictions as a result of the outbreak. In Malaysia, the airlines too are hit hard by the outbreak and it has been reported (in a local newspaper based on information provided by someone who asked not to be identified due to the confidentiality of this issue) that the government is considering encouraging mergers between some of the carriers. It has also been reported that talks between Axiata Group's biggest shareholder, Khazanah Nasional Berhad and Norwegian operator Telenor ASA that were re-opened earlier this year have come to a standstill due to many factors, with the outbreak reported to have added to the uncertainties around the deal.

In this unprecedented situation, there will be many entities that will not be able to meet their financial commitments, and if the aid from the government does not come on time, we may see the giants acquiring some smaller entities at a lower price. On the other hand, we may also see some businesses which are riding high in this economic downturn being offered / acquired at a high price when this unrest is settled.

Some companies may already be finding for opportunities for an M&A in this challenging time. In this article, we highlight some issues that will now be considered in a different light by the parties in negotiating M&A deals after this outbreak.

1. Purchase Price

Usual Practice	**Fixed** In a typical M&A transaction, the purchase consideration is fixed when the definitive agreement is signed. **Adjustment** • In some deals, adjustment to purchase price is allowed after the acquisition is completed, based on the situation of the target company as at completion. • The most common reason that allows for post-completion purchase price adjustment is change in working capital (i.e. current assets less current liabilities) of the target company. Having a certain working capital is a good measure of the target company's requirements to operate its business as a going concern. • There is also a practice that allows for a purchase price to be adjusted due to Material Adverse Effect (MAE), though this practice is not that common as MAE usually provides the parties an option to terminate or proceed with the contract, which is usually to the benefit of the purchaser.
COVID-19 Situation	**Material Change** • If some of the companies are already in the talks for an M&A but then realise that due to the COVID-19 outbreak, their valuation has increased way higher, what should they do? For example, while some businesses are suffering due to their inability to operate because of the lockdown, some businesses such as delivery businesses, online businesses and those who fall under the definition of "essential services", especially food supply services and postal and courier services, are riding high. • This situation is in contrast to the MAE concept that usually benefits the purchaser. This situation is a material change to the target company which is not adverse, but is in fact good for the target company.
Seller's Position	**Can I increase my selling price?** In this situation, a seller who intends to dispose its asset would think that it should be getting more from the purchaser, if, on the day of the completion, the target company is valued 2 times more than when the agreement was signed.
What to Do	**Negotiate this event from the beginning** A seller in an M&A transaction should negotiate for the right to initiate a purchase price adjustment based on parameters agreed with the purchaser should the value of the target company increase between the time of signing until the completion due to pandemic/epidemic outbreak, lockdown, restriction of movement and the like. This is not an easy point to negotiate but if the parties have an equal bargaining power, as a concession, the seller may wish to consider allowing for a purchase price reduction based on parameters agreed with the purchaser should the value of the target company decrease due to a not temporary MAE which includes a pandemic outbreak.
Alert	**Intention must be clear** Though parties are free to contract this term to increase the purchase price, the intention of the parties must be clearly worded and reflected in the agreement. If the language to allow for the adjustment upward is not clear and parties bring this dispute to the court to decide, the seller may be seen by the court as trying to gain unjust enrichment in this situation.

2. Ordinary Course of Business

Usual Practice	**Business must be operated as usual** • It is a typical covenant in an M&A transaction that the seller must ensure that the business of the target company is conducted in the ordinary course of business from signing until completion. • If the target company has to depart from its ordinary course of business, then prior written consent of the purchaser must first be sought.
COVID-19 Situation	**Consent will disrupt business** • In this lockdown situation, a departure from the ordinary course of business may be required. For example, most business premises are required to be closed and employees have to work from home. • In this situation, it will be hard for the seller to ask for the purchaser's consent especially when a quick decision is needed to maintain the business.
What to Do	**Good emergency plan must be in place** • The parties may agree to do away with the purchaser's consent every time the target company needs to act outside the ordinary course of business (which may not be viable at the present time) if the purchaser is satisfied that the target company has a business contingency plan/ disaster recovery plan/ emergency plan framework and other crisis-related guidelines that would be adopted by the target company in this kind of situations. • The purchaser must also be satisfied that the target company has a proper security system that protects the target company's data when the employees are required to work from home and protects against hacking or fraud attempts. • This issue has always been treated lightly in many M&As as compared to other issues, and there are even M&As that disregard having this term in their definitive agreements because the seller may not have all of the above in place or the purchaser is confident that it knows the acquired industry very well and that it can manage any challenges to come.
Alert	**Review the usual terms in a different light** All terms under the M&A that may seem as "usual term" or "just a boilerplate" must now be looked at differently with a fine toothcomb.

3. Insurance policy

Usual Practice	**Minimum requirement** Usually, the purchaser will be satisfied with the insurances maintained by the target company if the properties, assets and employees of the target company are well covered by insurances up to the completion date. The purchaser will not usually go beyond these 3 in its due diligence exercise in deciding whether to proceed with the M&A.
COVID-19 Situation	**Businesses are fragile** The present situation will make people realise how fragile a business is and that things can change overnight. Just because a business is running good today, there is no guarantee that it won't suddenly be not in operation tomorrow.
What to Do	**Minimum may now be more** In this situation where businesses and supply chains are disrupted, the purchaser should consider requiring the target company to take additional insurances in anticipation of this situation, for example, business interruption insurance, especially when the target company doesn't have a comfortable level of gun powder to cushion the impact of the present situation.
Alert	**Exclusion clause is crucial** Purchaser must go through the exclusion clause in the insurance policy carefully. The insurance policy must not exclude pandemics and related events or change of shareholders from its coverage.

The points highlighted above are just some of the key issues that will have to be considered differently in an M&A transaction post-COVID-19. Certainly, COVID-19 has already affected the way M&A transactions are being looked at, from the initial due diligence stage until its completion. The usual due diligence checklist is now no longer good enough and must be expanded and the sellers will be more cautious than usual when providing representations and warranties (**R&Ws**) as they will, as much as possible, try to carve out COVID-19 related effects from the R&Ws. This is just the beginning of a new development in M&A transactions and until the vaccine is found, we will see many more issues which are usually considered as "non-deal breakers" to be now considered as points of importance.

Important Information

Azmi & Associates has set up Azmilaw Task Force to look into all issues arising from COVID-19 and MCO. Clients are welcomed to contact their usual Partner who will bring their issues to Azmilaw Task Force for our further action.

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We hope that the above discussion is of assistance to you and your company. If your operations or contractual obligations are affected by the COVID-19 outbreak, we are ready to assist you on any queries you have.

Corporate Communication
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