COVID-19 AND WHAT IT MEANS FOR M&A TRANSACTIONS AND EARN-OUTS

In some M&A transactions, an earn-out mechanism is agreed upon between the buyer and the seller, under which payment of part of the purchase price is deferred in tranches, falling on agreed dates (typically at an annual frequency).

An earn-out is most typically agreed upon when the buyer and the seller cannot agree on the purchase price, and hence they bridge a gap in expectations to the purchase price by way of deferring part of the purchase price subject to target's performance following the acquisition, typically the financial performance, e.g. turnover, EBITDA or similar key figure.

COVID-19's IMPACT ON EARN-OUTS

The outbreak of COVID-19 will most likely have a significant negative impact on the financial performance in 2020 for many companies across industries whose shares have been transferred and where part of the purchase price is subject to an earn-out mechanism.

The COVID-19 outbreak particularly gives rise to the question whether the earn-out is based on (and will be decreased together with) the actual negative financial performance of the target or if a "normalized" financial performance measure will apply instead.

Under normal circumstances, if a decrease in the target's financial performance (revenue, EBITDA or other key figure) occurs during the earn-out period, the economic risk will rest with the buyer (having taken over the company), but – with an earn-out mechanism applied – also with the seller (relying on target's performance) since target's performance post-closing will usually be based on target's actual performance rather than financial forecasts.

If, however, a normalized financial performance measure has been agreed upon, the earn-out calculation may not necessarily be calculated on target's actual financial performance post-closing, but on a normalized basis, had certain events not taken place.

Such events are typically events which are within the control of the buyer, e.g. integration, expansion or corporate restructurings, but also unforeseen events outside the control of target, and the buyer may be covered. If so, the earn-out may be calculated not based on target's actual financial performance, but on a financial performance as it would have been if there had been no unforeseen event, e.g. the outbreak of COVID-19.

Whether the actual or a normalized financial performance measure will apply, including whether the outbreak of COVID-19 and its impact is to be disregarded or not, depends on what has been agreed upon between the buyer and the seller under the transaction documents, and how the provisions regarding earn-out have been drafted.

EARN-OUTS IN CONTEMPLATED M&A TRANSACTIONS

In relation to current negotiations and contemplated transactions, an eventual earn-out should be carefully drafted, especially with the current COVID-19 outbreak taken into consideration.

The outbreak may have long-lasting impacts on target's financial situation, and when drafting the provisions governing any adjustments of the earn-out, both buyer and seller must be diligent in drafting the provisions on the adjustment of the earn-out, so that these provisions are not burdensome or onerous on any of the parties.

IF YOU WOULD LIKE MORE INFORMATION, PLEASE CONTACT:

Mattias V. Warnøe Nielsen

PARTNER

Tel. +45 33 77 90 95

Mob. +45 30 37 96 95

MVN@mwblaw.dk

Niels Christian Andersen

JUNIOR ASSOCIATE

Tel. +45 33 77 90 11

Mob. +45 30 37 96 11

NCA@mwblaw.dk