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Iterative Diligence: Information in Real-Time is Crucial for Buyers During COVID-19

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COVID-19 and its disruptions are not going away anytime soon. Buyers in M&A deals are wise to keep their pulse on real-time financial and business relationship information given the almost daily changes in the “new normal” business landscape. Buyers with the most up to date financial and business information and who use an iterative approach to processing this information will be better positioned to anticipate and navigate issues. Real-time information is necessary for negotiating valuation, allocating risk in the deal and managing the business going forward.

Financial Diligence.

Before COVID-19, buyers would typically review a seller's past two to four years of annual financials, and interim financials for the past few months. Similar periods would be used for a quality of earnings analysis, and some attention would be paid to a seller's projections for its future growth. Depending on the timing of a transaction, interim financials might be updated but often were not.

Given the exceptional rate of change across all businesses lately, buyers are wise to access the most current financial information as possible throughout the course of a transaction. Buyers and their financial advisors should thoughtfully consider the value of historical financial information in light of any changes in the industry or market, generally, and within the target's particular business. New revenue and supply chain issues may not be visible in the historical financials. Cancellations and increased costs of doing business may be just starting to appear on financials.

Similarly, the assumptions used for budgets and projections even a month ago should be evaluated in light of the most current information. In almost every industry, the future is a bit uncertain. Past performance may be less important than the adaptability of a target's business to the changing future. Having as near real-time financial data as possible will also enable buyers to critically assess assumptions used in budgets and projections.

Contract and Key Customer/Vendor Diligence.

We are seeing more sellers in need of immediate capital or other resources and buyers may feel time pressure to close deals quickly in this new normal. However, just as there is no one-size fits all approach for negotiating contracts, time allowing, buyers should take a similarly nuanced approach to evaluating a target's contracts and relationships with

key customers and vendors.

Understanding termination rights, minimum purchase commitments, and other restrictive covenants in written agreements will help a buyer assess a target's legal exposure and flexibility rights (or risks) in this new normal. Long term commitments from customers or suppliers may be an extremely valuable legal right for a particular target. Or, shorter-term flexibility may be necessary for pivoting a target's business to capture new opportunities or mitigate losses going forward.

Buyers should also focus on understanding recent interactions between a target and its key counterparties. Requesting recent correspondence and interviewing business leads about the current state of relationships can unearth useful information for assessing stability and legal rights (or risks) with vendors and customers. A deteriorating relationship with a key third party may not be apparent in the target's financials or on the face of a contract. Understanding the current state of affairs in these key relationships can illuminate legal risks that are lurking in the shadows. In particular, it is important to know if either party has signaled an inability or unwillingness to perform, an intention to terminate or taken any other action that may indicate the relationship may be changing. Alternatively, the acquisition may be the right opportunity to renegotiate unfavorable terms or leave certain liabilities behind. At a minimum, a bit more focus on these key relationships in diligence will help buyers assess business and legal risks. It could also illuminate opportunities to manage or improve a situation that will have a direct and near-immediate impact on a buyer's return on its investment.

Conclusion.

Due diligence has always been an iterative learning process. While the sources of financial and business information may not be new, in order to successfully assess and manage the ever-changing impacts of COVID-19, buyers must be vigilant in accessing current data and adapting their analysis throughout the transactional timeline.