

Legal aspects of mergers and acquisitions in volatile markets

A glimpse at legal challenges in mergers and acquisitions within an uncertain business environment.

15 November 2023

Mergers and acquisitions play a vital role in companies' lives – serving both as a tool to boost business growth by adding new components to existing structures, but also as a means of creating new synergies between the 'old' and the 'new'.

When the market cycle goes into a downturn

Luckily or sadly (the latter certainly applies to those who are involved with the M&A business), just like the market grows and shrinks in cycles, so too does M&A activism occur in waves. This means that after a dynamic period of growth and prosperity, it is inevitable to expect a slowdown along with an increase in market uncertainty and volatility, which we are apparently experiencing as we draft this article. We will not be carrying out an in-depth analysis of the economic factors that result in market volatility. Surely, however, said factors are a combination of different elements, including rising inflation, political and geopolitical tensions and instability (such as with the continuing war in Ukraine and the recent outbreak of violence in the Middle East) – to name a few. All in all, it is safe to say that in tough times companies tend to become more cautious and reluctant to take the risk of investing in external growth. This naturally impacts the number of transactions executed, decreases the value of those which do take place anyway and severely impacts the market and its players.

And so, as the market 'atmosphere' deteriorates and enthusiasm (which is so characteristic in times of market prosperity) vanishes, the number of mega-deals drops substantially. This usually is the first of many signs which indicate that a new cycle has just begun. Sadly, this phenomenon is hardly ever sufficiently visible when it actually begins.

Small and mid-market deals do not become scarce all at once, but parties tend to navigate pending processes to successful completion rather than launch new ventures.

When this happens, do all market players simply sit and wait until the market picks back up?

Cherry-picking connoisseurs' time

It may seem to be a paradox, but despite the fact that times of uncertainty generally discourage investors from engaging in M&A projects, they also create great opportunities too. Why is this? Well, under certain conditions, market volatility may do away with highly favourable factors encouraging market players to engage in high quality M&A. There are a number of reasons for that. Bidders' perspectives are surely self-explanatory for the most part. Limited market activity often means that those who are somehow

forced to sell will seek sale opportunities at any cost. This creates cherry-picking opportunities for those who wish to buy. If the 'cherry' in question is somehow rotten, it may still form an attractive goal for a bidder who knows how to handle distressed asset acquisition. When it comes to sellers, the perspective is usually less of a 'connoisseur' style one. Hardly ever do they decide to pursue a transaction at a low price and in a buyer-friendly environment unless they are actually forced to. Sometimes, however, a disposal at a volatile time may prove to be a perfect opportunity to mend a portfolio, get rid of what is not necessary and focus on the remainder with the help of proceeds coming from a sale.

A need to adjust

M&A lawyers certainly have a limited impact on the state of the market at any given time and – from that perspective – are rather 'reactive' to what the market situation is like. What they can offer clients though is the proper structuring of transactions that do take place despite volatility and the adjustment to an ever-changing reality.

There is nothing novel about that general rule. Last years' practice definitively proved that this is what M&A lawyers do. Take a look at the COVID-19 example. In terms of pursuing M&A transactions, there was indeed a certain moment in time when many thought the market would remain frozen for quite some time. And yet, that only lasted a week or two (!). It literally boomed shortly thereafter. During the pandemic, one had to adapt. Lawyers did change and adjust the manner in which deals used to be processed. While performing due diligence processes had already been standard practice in the past, limiting negotiations to an online form was a novelty for some. However, what proved to be an actual challenge – and we write this as Polish lawyers (Polish law requires old-fashioned wet-ink signatures, notarisations, and other formalities involving physical meetings for many legal instruments) – was completing the transactions. And yet, it turns out that with a little creativity from the parties and their counsels, the formal (and technical) obstacles can be overcome. The result? 2020 and 2021 where two remarkable years in M&A despite the fear and hassle felt during the pandemic.

Special prudence and diligence

The situation is quite similar today. Or, more specifically, the need to adjust and seek solutions triggered by current market volatility is still the name of the game– but differently.

The growing number of distressed asset deals means that counsels' prudence both at the time of due diligence and project implementation is more important than ever. Actual diligence as such also gains new meaning and significance, as it gives the bidder an actual (and often the only) chance to thoroughly investigate the target and thus reduce the risk of acquiring toxic assets. Alternatively, it provides the opportunity to buy such assets with a proper discount.

There seems to be more space for bidders to carry out greater scrutiny prior to engaging in transactions. Unlike during both pandemic and early post-pandemic times, the market is simply no longer seller-friendly. Therefore, bidders have a better chance to run more in-depth reviews of targets.

Market volatility also means that the impact of economic circumstances is now greater than before. In some cases, it has been proven that even a healthy business may quite instantly become a casualty of volatility. Thus, in transaction planning, one needs to neatly structure proper protective measures such

WT

as material adverse change provisions (and similar rescission rights) and take into account various (even strongly hypothetical) phenomena that may occur between signing and closing, and may affect not only deal feasibility but also its value.

Navigating mergers and acquisitions in volatile times certainly requires proper identification of potential adverse impacts and legal risks. It also involves more out-of-the-box thinking when structuring deals.

About Wolf Theiss

Wolf Theiss is one of the leading European law firms in Central, Eastern and South-Eastern Europe with a focus on international business law. With more than 360 lawyers in 13 countries, over 80% of the firm's work involves cross-border representation of international clients. Combining expertise in law and business, Wolf Theiss develops innovative solutions that integrate legal, financial and business know-how.

For more information, please contact:



Maciej Szewczyk
Partner

E maciej.szewczyk@wolftheiss.com
T +48 22 378 8937



Izabela Zielinska
Partner

E izabela.zielinska@wolftheiss.com
T +48 22 378 9016

