

# **MERGERS & ACQUISITIONS - MANAGING RISK AND DEAL PROTECTION**

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**LASA National Congress 2017**

# OVERVIEW



What are some of the key risks in executing and completing an aged care M&A transaction?

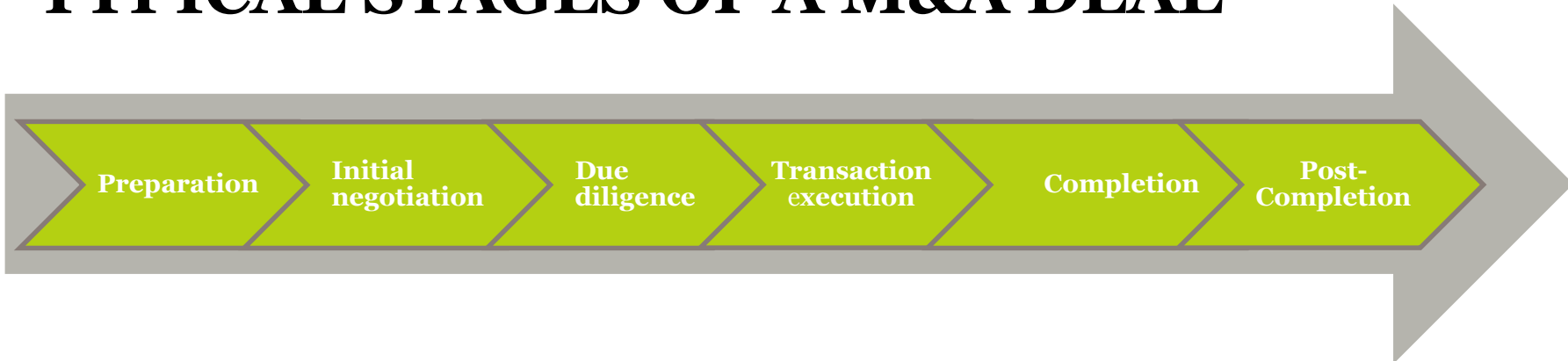


What are mechanisms for managing those risks?  
(ie. "deal protection")



What are our key lessons from recent transactions?

# TYPICAL STAGES OF A M&A DEAL



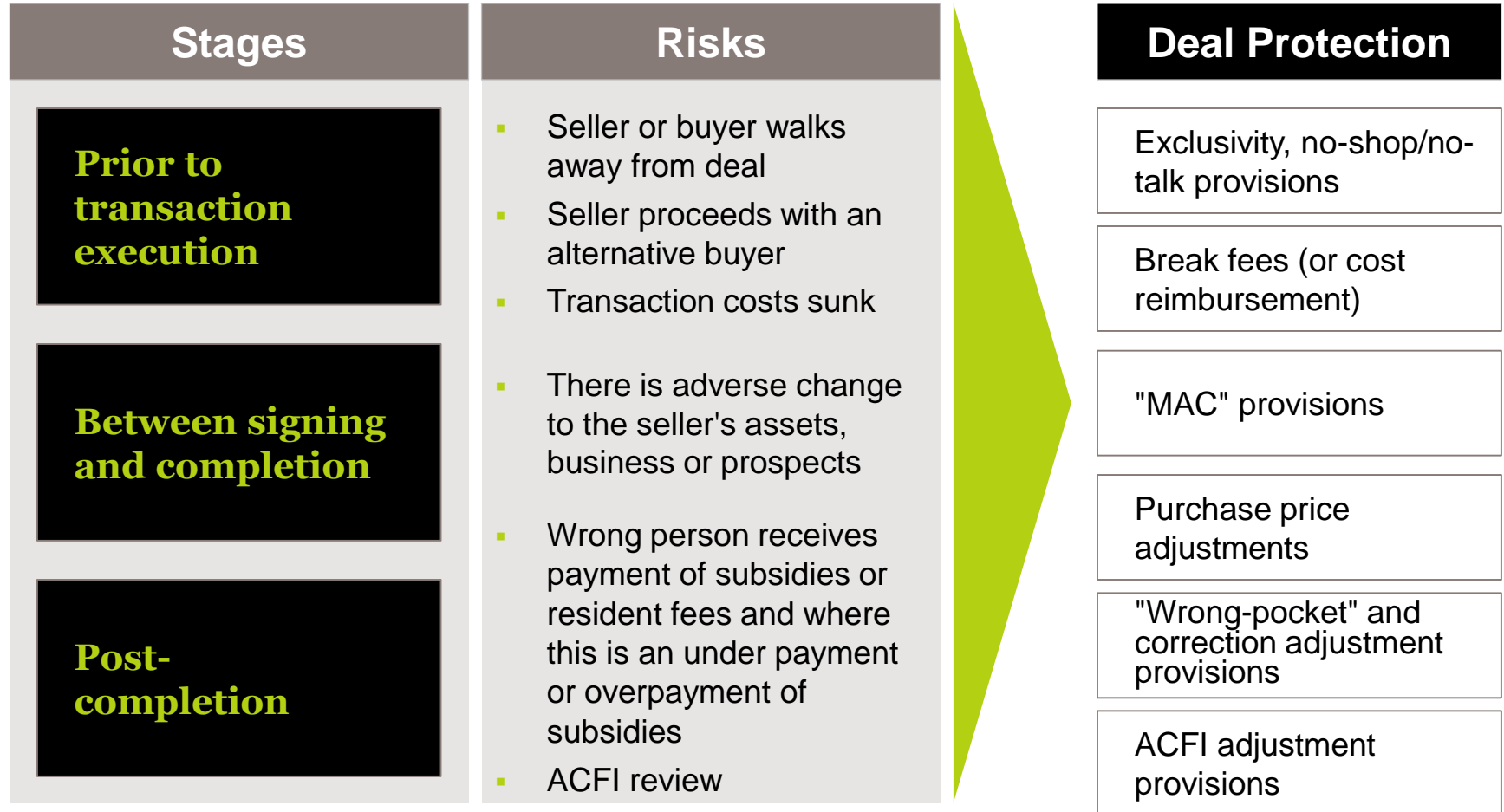
## Seller

| Preparation:   | Initial negotiations (no auction):  | Due diligence:   | Transaction execution:   | Completion:   | Post -Completion:   |
|--|---|--|--|---|---|
| <ul style="list-style-type: none"> <li>Identify targets and preliminary terms for deal</li> <li>Prepare information memorandum (auction)</li> <li>Prepare for due diligence</li> </ul> | <ul style="list-style-type: none"> <li>Sign term sheet/heads of agreement with exclusivity</li> </ul> | <ul style="list-style-type: none"> <li>Facilitate due diligence</li> </ul> | <ul style="list-style-type: none"> <li>Assess bids (auction)</li> <li>Sign exclusivity agreement (auction)</li> <li>Settle and sign transaction documents</li> <li>Announce transaction (if ASX listed)</li> </ul> | <ul style="list-style-type: none"> <li>Satisfy conditions precedent</li> <li>Close transaction</li> <li>Announce transaction</li> </ul> | <ul style="list-style-type: none"> <li>Post-closing price adjustments, filings and other matters</li> </ul> |

## Buyer

| Preparation:  | Initial negotiations (no auction):   | Due diligence:  | Transaction execution:  | Completion:   | Post -Completion:   |
|---|--|---|---|---|---|
| <ul style="list-style-type: none"> <li>Review information memorandum (auction)</li> <li>Sign confidentiality agreement with seller</li> </ul> | <ul style="list-style-type: none"> <li>Non binding offer</li> <li>Sign term sheet/heads of agreement with exclusivity</li> </ul> | <ul style="list-style-type: none"> <li>Review due diligence</li> <li>Attend site visits</li> <li>Attend management presentations</li> </ul> | <ul style="list-style-type: none"> <li>Submit bid (auction)</li> <li>Sign exclusivity agreement (auction)</li> <li>Settle and sign transaction documents</li> <li>Announce transaction (if ASX listed)</li> </ul> | <ul style="list-style-type: none"> <li>Satisfy conditions precedent</li> <li>Close transaction</li> <li>Announce transaction</li> </ul> | <ul style="list-style-type: none"> <li>Post-closing price adjustments, filings and other matters</li> </ul> |

# SOME KEY RISK ISSUES IN AGED CARE M&A DEALS



# PRIOR TO TRANSACTION EXECUTION: EXCLUSIVITY AGREEMENTS

- ▶ Seller agrees for a period of time to not solicit or engage in discussions with another party
- ▶ Two most common exclusivity agreements:

**No-shop**

Will not solicit any third party bids during the exclusivity period

**No-talk**

Will not engage or negotiate with anyone other than the buyer during the exclusivity period

- ▶ Exclusivity agreements play a key role in deal protection

# PRIOR TO TRANSACTION EXECUTION: BREAK FEES (OR REIMBURSEMENT FEES)

- ▶ A “break fee” is a fee that is usually payable by the seller to the buyer if a specified event occurs - normally outside the control of the buyer - which prevents the transaction from proceeding to completion

## Rationale?

A break fee represents compensation for the time and costs incurred by the buyer in pursuing and negotiating a transaction with the seller

- ▶ Established part of public M&A landscape but relatively uncommon in private M&A transactions
  - However, may be obtained where the seller is perceived to be at high risk of entertaining a competing offer before the transaction becomes binding or the buyer is concerned about significant transaction costs
  - Break fees are approximately **1%** of the total value of the deal in public markets. In private treaty M&A, more often a break fee is an agreed \$\$ based on an estimate of potential transaction costs

# PRIOR TO TRANSACTION EXECUTION: REVERSE BREAK FEES

A "reverse break fee" is a fee payable by a buyer to a seller if an acquisition does not proceed, usually due to an event within (or sometimes outside) the control of the buyer

Reverse break fees are becoming increasingly common in public Australian M&A deals with targets becoming conscious to stem loss resulting from a failed acquisition

*Examples of examples where reverse break fees are payable could include:*

- *Material breach of the terms of the deal (as set out in the term sheet/heads of agreement)*
- *Failure to obtain regulatory approval (eg. FIRB or Department approval to become an Approved Provider, etc.)*
- *Deal specific factors (eg. failure to obtain places in the Aged Care Approval Round)*

# BETWEEN SIGNING AND COMPLETION: USUAL MECHANISMS

Mechanisms to manage risk between signing and completion:

- ▶ Restricted conduct provisions
  - » Seller must conduct the business in the ordinary course consistent with its usual business practices
  - » Seller must not undertake certain matters without the consent of the buyer (eg. incur capex of more than \$\$, enter into material contract, etc.)
- ▶ "Bring-down" of warranties on completion
  - » Warranties are provided at signing and immediately prior to completion
  - » It follows that if a warranty is incorrect at completion the buyer should have a claim for breach of warranty



# **BETWEEN SIGNING AND COMPLETION: USUAL MECHANISMS, ETC.**

Mechanisms to manage risk between signing and completion, etc.:

- ▶ Purchase price adjustments (including completion account mechanisms)
  - » For example, purchase price reduced by the actual amount of RAD/accommodation bond balances as at completion
  - » Post-completion adjustment for movements between assumed base financial position and actual financial position as at completion

# BETWEEN SIGNING AND COMPLETION: USUAL MECHANISMS, ETC.

Mechanisms to manage risk between signing and completion, etc.:

## Unique considerations between share v asset sale

- ▶ In respect of land and buildings, there are certain protections under NSW Conveyancing Act/ VIC Sale of Land Act/ QLD Property Law Act, etc.
- ▶ Insurance
  - » If share sale, standard insurances remain in place
  - » If asset sale, consider obtaining insurance from signing



# BETWEEN SIGNING AND COMPLETION: MATERIAL ADVERSE CHANGE

- ▶ MAC clauses typically take the form of:

**condition**

a condition to completion

**warranty**

a warranty that no MAC has occurred since the relevant accounting date

- ▶ Typically, in the second situation, the buyer will try to negotiate that the warranty is repeated immediately prior to completion and give itself the ability to terminate the agreement if the warranty, when repeated, is not true
- ▶ Common place in public M&A deals but traditionally resisted in private treaty M&A deals

# BETWEEN SIGNING AND COMPLETION: MATERIAL ADVERSE CHANGE, ETC.

- ▶ A MAC trigger will generally be drafted as being an event that arises between signing and closing that has, or might be reasonably expected to have, a "material" and "adverse" effect on the assets, finances or business prospects of the business being acquired
- ▶ MAC clauses can be drafted generally or by reference to specific, quantifiable triggers, or both. They can be also drafted subjectively or objectively, although in the M&A context they are almost always drafted objectively

**For example, decreases in the business' revenue, EBITDA or net assets or increases in the business' debt to EBITDA ratio will be "material" and "adverse".**

# BETWEEN SIGNING AND COMPLETION: MATERIAL ADVERSE CHANGE, ETC.


- ▶ MAC triggers are increasingly sought in private deals
- ▶ In this context, consider:




**Break fee payable to the seller if the buyer terminates for MAC**

**Can help make a MAC trigger more commercially acceptable to the seller as it becomes a cost (and, therefore, a deterrent) on the buyer to rely on the MAC trigger and effectively reallocates some of the cost and risk associated with a MAC occurring**

# POST COMPLETION: "WRONG-POCKET" AND CORRECTIONS

- ▶ Common in aged care M&A transaction to include "wrong-pocket" and correction adjustment provisions
- ▶ Principles:
  -  Seller entitled to resident fees and subsidies up the date of completion

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  -  Buyer entitled to resident fees and subsidies after completion

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- ▶ Mechanic no. 1  $\longrightarrow$  For an agreed period of time after completion (usually, 6 months), if the "wrong" party receives resident fees or subsidies to which they are not entitled, the amount must be paid to the party entitled to those payments

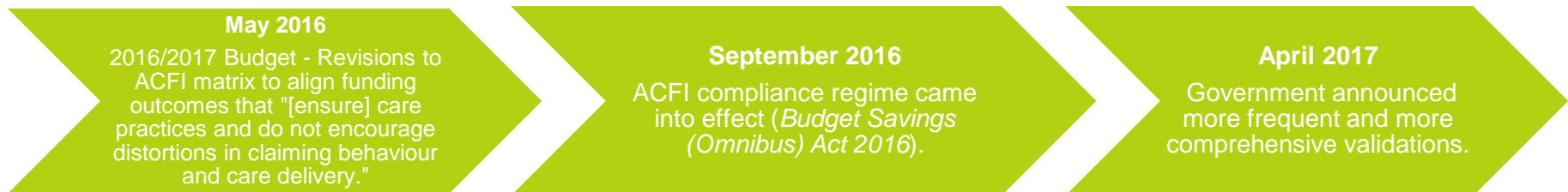
# POST COMPLETION: "WRONG-POCKET" AND CORRECTIONS, ETC.

- ▶ Mechanic no. 2. —————> If, after completion, the Department makes an adjustment to an amount paid or payable in respect of allocated places (including subsidies) in respect of the period up to completion, for an agreed period of time after completion (usually, 6 months):
  - » if the adjustment has the effect that the buyer receives an underpayment, the seller must pay to the buyer the amount of the underpayment; and
  - » if the adjustment has the effect that the seller receives an overpayment, the buyer must pay to the seller the amount of the overpayment.

# POST COMPLETION: ACFI ADJUSTMENT PROVISIONS

- ▶ The Aged Care Funding Instrument (**ACFI**) assesses the relative care needs of residents and is the mechanism for allocating the Government subsidy to aged care providers for delivering care to residents
- ▶ As part of the 2016-17 budget, the government announced funding cuts of \$1.2 billion over four years to the aged care sector. A substantial portion of these cuts will be achieved through an overhaul of ACFI – the result of which became effective earlier this year. In addition to the redesign of the ACFI framework, the way claims are audited has also changed.

## Timeline: Trend towards enhanced compliance regime





# POST COMPLETION: ACFI ADJUSTMENT PROVISIONS, ETC.

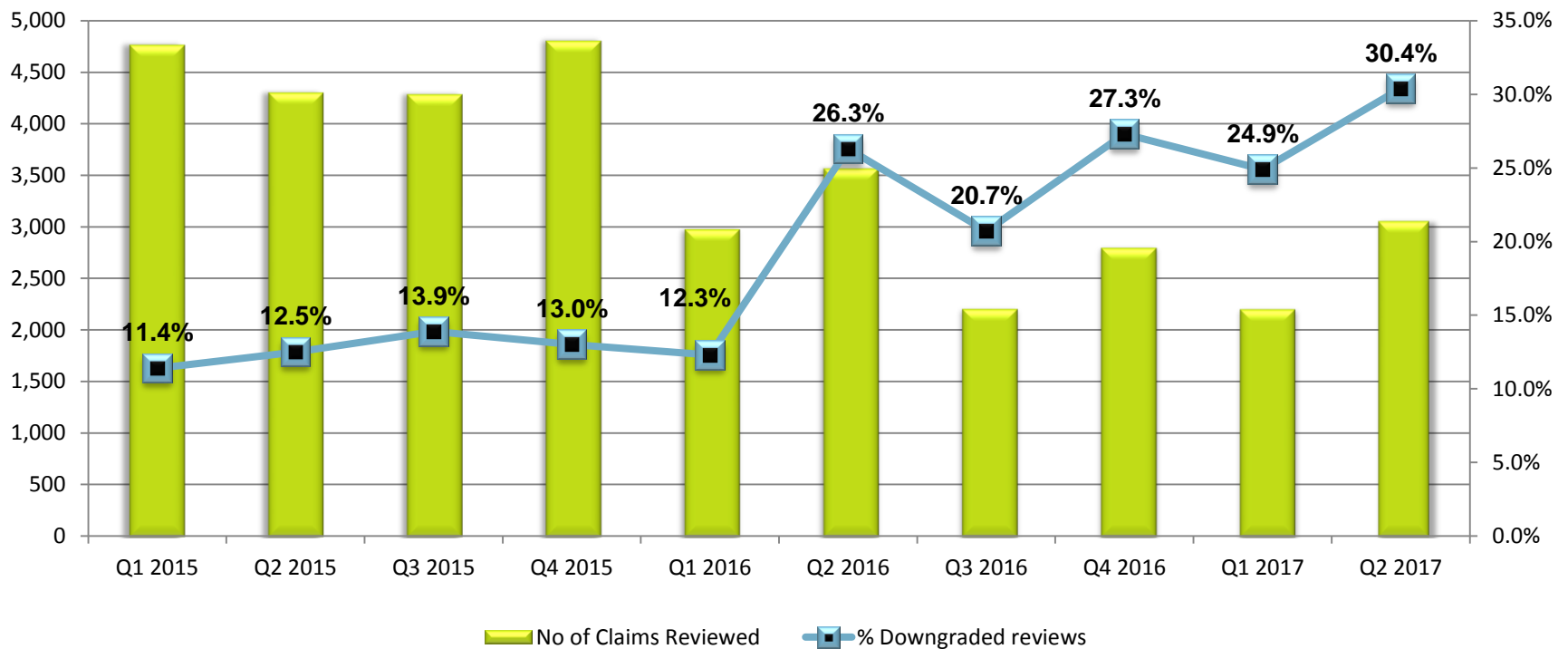
The most recently available ACFI review data illustrates the increase in downgrades, creating a significant risk in any aged care M&A transaction

| ACFI Review Statistics by State: 1 April 2017 to 30 June 2017 |            |              |              |              |           |             |              |                 |
|---|------------|--------------|--------------|--------------|-----------|-------------|--------------|-----------------|
| STATE   | DOWNGRADED |              | UNCHANGED    |              | UPGRADED  |             | Total        | No. of Services |
|   | Reviews    | %            | Reviews      | %            | Reviews   | %           |              |                 |
| NSW/ACT   | 431        | 27.0%        | 1,156        | 72.4%        | 10        | 0.6%        | 1,597        | 130             |
| VIC   | 108        | 19.8%        | 435          | 79.7%        | 3         | 0.5%        | 546          | 75              |
| QLD   | 219        | 50.0%        | 216          | 49.3%        | 3         | 0.7%        | 438          | 51              |
| WA  | 78         | 30.5%        | 170          | 66.4%        | 8         | 3.1%        | 256          | 28              |
| SA/NT   | 64         | 40.8%        | 93           | 59.2%        | 0         | 0.0%        | 157          | 23              |
| TAS   | 30         | 49.2%        | 30           | 49.2%        | 1         | 1.6%        | 61           | 6               |
| <b>Total</b>  | <b>930</b> | <b>30.4%</b> | <b>2,100</b> | <b>68.7%</b> | <b>25</b> | <b>0.8%</b> | <b>3,055</b> | <b>313</b>      |

\*Source: Aged Care Funding Instrument (ACFI) Quarterly Report - June 2017

# POST COMPLETION: ACFI ADJUSTMENT PROVISIONS, ETC.

## NO OF ACFI REVIEWS & DOWNGRADE OUTCOMES (2015 - 2017)



Source: Aged Care Funding Instrument (ACFI) Quarterly Reports - January 2015 to June 2017

# CONCLUSIONS:

**1.** No single solution to deal protection

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**2.** Keep deal protection front of mind during each stage of a deal

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# QUESTIONS



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