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IN
THE
CITY

BIG MACS AND SUPERSIZED REVERSE BREAK FEES

Deal certainty post covid

Keen readers of M&A in the City will know we've observed targets increasingly flexing their muscle on deal protections. We've written about this in the **pre-deal phase**. However, fresh analysis of Scheme Implementation Deeds ("**SIDs**") reveals a similar trend once a deal has been struck. Targets are particularly focussed on ensuring that bidders are held to their bargain and have only very limited abilities to pull out of public M&A deals.

WE THINK THERE ARE A COUPLE OF REASONS FOR THIS

1 COVID symptoms linger

The COVID pandemic (and associated volatility in global M&A markets since) has forced bidders and targets alike to stress test their SIDs, and carefully consider the triggers and consequences which apply if a bidder attempts to walk.

2 Cold-feet frustration

We've seen a number of high-profile deals where bidders have gotten cold feet after signing a deal. Elon Musk's failed attempt to abort his acquisition of Twitter is an obvious example. There was also the Pental / Perpetual transaction, where Perpetual attempted to argue (unsuccessfully) that its reverse break fee acted like an option fee – i.e. it could simply pay it and walk if it found a better deal, despite not having an express right in the SID to do so. The court in that instance ultimately disagreed, but the effect of that decision has been to shine a spotlight on how reverse break fees, MACs and other deal protection mechanisms are drafted in SIDs.

So how have we seen targets' focus on deal certainty manifest itself?



THERE ARE 2 KEY TRENDS

- **Big MACs:** The first is what we're calling "Big MACs". Since Covid, we've observed a general increase in the quantitative net asset thresholds which are required to trigger a material adverse change ("**MAC**") condition precedent. These essentially make it more difficult for a bidder to rely on a MAC event to walk from a deal.
- **Reverse Break Fees:** The second trend is in relation to reverse break fees (RBFs). Reverse break fees are becoming increasingly common in the Australian market and have typically hovered at around 1% of equity value (consistent with target break fees). However, since Pental we've started to see a trend particularly in ultra-high value deals in the Australian market for "supersized" reverse break fees being accepted.

BIG MACS

Bidders will typically insist on a MAC condition precedent or termination right in SIDs, which is typically triggered if an event occurs which significantly and detrimentally impacts the target company.

MACs can be quantitative (ie triggered by an event which has a dollar impact on balance sheet and/or revenue/earnings items) or qualitative (ie defined by reference to a material impact on the target). Our focus here was on quantitative MACs.

We conducted an analysis of 111 SIDs/takeover documents between 2017 – 2024, representing large deals over \$500 million in the pre and post covid eras.

Based on our data set, we found that:

For deals with net asset MAC triggers:

- In 2017 -2019 (the pre-covid years), the average MAC net assets threshold, relative to the target's last reported net assets, was **10.5%**
- In 2020 – 2021 (covid years), this average increased to **14.3%**
- In 2022- 2024 (post covid), the average has remained at approximately **15.3%**

For deals with earnings MAC triggers (ie EBITDA/revenue other income measures), we have observed a general uptick post covid, albeit the statistics are more volatile across the data set.

- In 2017- 2019, the average was **14.3%**
- In 2020- 2021, the average was **14.13%**
- In 2022- 2024, the average was **18.7%**

We think the above shows that target boards have become more concerned with MACs during COVID and have generally required higher thresholds but that since COVID there has been no reversion to the mean.

SUPERSIZED REVERSE BREAK FEES

A reverse break fee is essentially a fee paid by the bidder if the deal does not proceed in certain scenarios, for example where there has been a material breach by the bidder, failure by the bidder to obtain a regulatory approval. The ostensible intention is to compensate the target for time and resources spend on a deal which does not proceed. They are also great tools for increasing deal certainty by incentivising the bidder to comply with its obligations.

Importantly, whilst reverse break fees aren't new, we have seen an increase in their use over the last few years (particularly where a target break fee has been negotiated).

Interestingly, our data set also reveals an increase in the quantum of reverse break fees - something we **predicted** after the Pandal decision.

Historically, reverse break fees have typically hovered at 1% of equity value in line with break fees payable by the target (consistent with Panel guidance). While reverse break fees aren't subject to Panel guidance, we've often seen similar sized fees being negotiated in the interests of reciprocity.

Since Pandal, a key trend which we've observed in recent transactions has been larger or "supersized" reverse break fees in a number of high value transactions, namely:

- Newcrest/ Newmont – which had an RBF at 2.01% of equity value;
- Altium /Renesas – which had an RBF of 4.55% of equity value;
- Alumina/Alcoa – which had a 2.27% reverse break fee; and
- Boart Longyear (Target)/ AB Acquisition Corporation US – 3.85% of deal value



REVERSE BREAK FEES – MORE AND BIGGER

- 64.3% of deals over \$500 million included a reverse break fee in 2023, remaining fairly consistent with prior year (60% in 2022).
- In 2023, the majority of deals that had target break fees also had RBFs - about 81.8% (or 9 out of 11).
- This compares with 36.4% of deals in 2019, and 41.7% in 2020.

CRAVING CERTAINTY

What's driving this trend? We think it comes down to targets' desire for deal certainty.

Looking at this from first principles, the different in size between a break fee and a reverse break fee is often justified because the impact of a failed deal on the target is generally much worse than for the bidder, as the target's business has been disrupted by the control transaction, potentially for many months. A 1% reverse break fee can at times, leave the target in particularly vulnerable position.

From a target's perspective, higher reverse break fees can also serve as a meaningful "stick" to deter bidders from breaching their obligations. Pental showed us that if a bidder attempts to walk from a deal in breach of its obligations (for example, to pursue alternate transactions), it will usually be open to the target to seek an order of specific performance to compel them to complete (a point the court in Pental made clear). However, these orders are ultimately at the discretion of the court, and in practice may be difficult to obtain, particularly if the deal is in its early stages or there are significant conditions outstanding. By contrast, enforcing payment of a reverse break fee will usually be a much easier remedy for the target to obtain.

Finally, a higher RBF may be justified where a target does accept it effectively as an option fee – eg. where the bidder has negotiated a termination right which allows it to walk if it receives a superior control proposal for itself, which the bidder board wishes to pursue instead in order to satisfy its fiduciary obligations.

THE FUTURE

In summary, in our view both COVID and Pental reshaped target's desires to prioritise deal certainty in ways we had not anticipated previously. This has led to both Big MACS and supersized break fees becoming increasingly common in high value M&A transactions in this market. For reverse break fees, this has primarily been in the ultra high value end of the market. But we expect to see this become more prevalent in the years ahead.



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