Weil

Brexit – the aftermath
17 things to think about right now

The legislative changes to be imposed following the Brexit vote are complex and difficult to predict, and the precise outcome of political negotiations will not be known for many months, if not years. This is certainly not a reason to panic and once the fog clears the uncertainty may give rise to opportunity. Meanwhile, we set out below 17 things to think about now, both on current deals and for existing portfolio companies.

Live transactions

Not yet signed

Certain funds – whilst Brexit should not have an impact on the drawdown of funds and commitments of limited partners, sellers should confirm this with buyers. Customary market debt provisions to date would not give banks the ability to walk away, but again, terms should be checked. Check that from a finance perspective there is real certain funds at time of signing (unconditional except as to the sale and purchase agreement completing and no other conditions which the financing banks may use to try to avoid funding).

Interest rates – the immediate impact on interest rates in the light of the market volatility remains to be seen, whether up or down. Apart from the actual cost of funding, borrowers should consider any impact on financial covenant compliance if there were to be rate rises.

Completion accounts adjustments – for businesses which have a significant component of revenues in sterling and/or euros, any cash, debt and working capital positions in a completion accounts mechanism denominated, for example, in dollars are likely to fluctuate much more than they usually would. Recalculating numbers estimated at signing immediately prior to completion will reduce any post completion adjustment and caps and collars on adjustments should be considered carefully. For the same reasons, care also needs to be taken when considering earn-out provisions.

Limits on liabilities – where elements of the business operate out of the UK, as a seller consider the appropriateness of various financial limits in transaction documents (e.g. de minimis, basket and gap covenants in sale and purchase agreement and vetoes in investment agreement). Consider raising these thresholds or changing to a more appropriate currency. As a buyer, consider raising a sterling/euro cap on liability as in real terms this will be a lower amount.

Due diligence – this should be conducted with a view to the forthcoming changes to the legal landscape, for example country of origin of employees and whether there is sufficient intellectual property protection if the protection of European IP registration falls away.

Deal timing – transactions involving a UK component are likely to take longer to sign due to more diligence being done (including into the contingency planning of the target business around and repercussions of Brexit) and the difficulty in raising finance; to be taken into account when signing/closing date is time sensitive (e.g. before quarterly public announcement/money from sale needed for another commitment of seller) and when calculating projected IRR. Exits by way of the public markets are unlikely to be possible for a number of months, potentially increasing the hold period for certain assets.

Pensions – increased likelihood of deficit of defined benefit schemes; market volatility may lead trustees to request increased contingent security on a change of control. Also, funding levels (and therefore deficits) are going to be even harder to determine given market and currency volatility.

Tax - the UK remains an extremely competitive jurisdiction taking into account its low corporation tax rate of 17% (from 2020) and its large double tax treaty network to relieve the effect of withholding taxes on cross-border payments. If a business plan anticipates the future migration out of the UK of a UK business, this could trigger corporation tax exit charges which will need to be factored into the economics.

W&I insurance – the broker community does not anticipate changes to underwriting supply, pricing and terms. If anything, a short term reduction in deal flow is likely to lead to overcapacity and a better negotiating position for those seeking insurance. When choosing an underwriter, consideration should be given to their credit profile (where listed) given the fluctuations in the listed markets.

Signed but not yet closed

Certain funds (again) – as a buyer, can any equity commitment given in a currency different to the one you draw down from your funds in, still be satisfied? Likely only to affect limited partners who fund in sterling and give equity commitments to seller in another currency. Similarly, has a hedge been put in place for any bank debt being drawn in a currency other than that of the consideration for the business being purchased?

Material adverse change – sale and purchase documents with MAC clauses may have these tested by buyers and/or financing parties seeking to renegotiate or walk away from the transaction. In public transactions, the Panel on Takeovers and Mergers is unlikely to view Brexit as a MAC; in private transactions market MACs are rare, but where given the terms of each provision need to be analysed in detail to understand whether they are triggered.

Repetition of gap covenants and warranties– gap covenants should be reviewed to ensure that permission does not now need to be sought for actions. Also, that any warranties repeated on closing are not inadvertently breached (whilst this is unlikely to be an issue they should be double checked).

Regulatory – as the FSA (the precursor to the FCA and PRA) was the driving force behind much of the European financial regulations, it is unlikely that the FCA and PRA will change their approach to making change of control decisions or suitability of purchasers. They are likely, however, to insist that financial information provided to them as part of the process is refreshed more frequently than normal and also will be more interested in an acquiror's plans around governance and stress/scenario testing (in particular around the exchange rate risk analysis resulting from the weakened currency).

Portfolio companies

Review of Finance documents - to be conducted to consider implications for financial covenants of FX volatility, impact of FX movements on any facilities that are rebased periodically to a base currency, implications of any downgrades of banks for facility agreements, implications of movement of any mark to market in any swaps, etc..

(Non-sterling/euro) cash is king – to the extent that revenue is generated in non-sterling/euro currencies and regularly converted into sterling/euro, then to the extent such cash is not needed for immediate operating purposes, consider suspending any cash sweep as a natural hedge against further currency fluctuations.

Review of key contracts - Consider whether termination rights (including illegality and material adverse change clauses) in existing key contracts are likely to apply. However, unlikely to be triggered without specific reference to Brexit.

Futureproofing documents – without a clear path ahead this will be difficult, but parties negotiating long term contracts should start to think about building into them some flexibility to amend terms to bring them in line with the resulting legal landscape post Brexit as it becomes clearer. Also, consider if specific termination rights are required should certain events occur as a by-product of the exit process.