# An Overview of the Main Stages in a Typical Private M&A Transaction

Selling or buying shares in a company, or selling or buying a business, is colloquially known as an “M&A transaction” (“**M&A**” being the acronym for “mergers and acquisitions”).

If the transaction involves shares which are listed on a stock exchange, the transaction is called a "public M&A transaction". If the transaction does not involve listed shares, it is called a "private M&A transaction".

If you have not been involved in a private M&A transaction before, this note will give you a broad overview of the main stages which you can expect to see in such a transaction. Please note, though, that few private M&A transactions are identical and that the stages are not always followed rigidly.

## 1. Approach Stage:

This is where the potential buyer (“**Buyer**”) and the potential target company / the potential seller (“**Seller**”) start exploratory discussions about the Buyer possibly buying the Seller’s shares or business (“**Transaction**”).

The Buyer and Seller (“**Parties**”) will focus mainly on the following key considerations at this early stage:

- The business of the Seller which the Buyer is interested in acquiring (“**Target Company**”).
- The proposed purchase price and its payment terms.
- Any fundamental points which arise at this early stage (such as whether the Buyer wants to buy shares in the Seller or wants to buy the actual business from the Seller).

A prudent Seller will, before it discloses any sensitive information regarding the Target Company to the Buyer, insist that the Buyer signs a Non-Disclosure Agreement (“**NDA**”). A NDA will prevent the Buyer from disclosing any confidential information relating to the Target Company which the Buyer learns as a result of the Parties’ discussions.

These exploratory discussions normally take place at a high level, e.g. at CEO to CEO level or at CFO to FD level. One designated person on each Party's side will normally drive the process at this stage.

The Buyer will usually only do a high level business review of the Target Company at this stage (rather than a full-blown legal, financial and operational due diligence). ("Due diligence" is the term used for the Buyer's investigation of the Target Company's affairs).

## 2. <u>Memorandum of Understanding, Heads of Agreement or Letter of Intent:</u>

If the Parties are still both interested in proceeding with the Transaction, and they have reached general consensus on the main elements of the Transaction (i.e. what is to be sold and for how much), they usually sign a document which records the essence of the Transaction which they have in mind.

That document is inter-changeably called a Memorandum of Understanding, Heads of Agreement or a Letter of Intent (collectively known as a "**MOU**").

The MOU is generally not legally binding and is expressly stated not to be legally binding, except for a couple of clauses which are specifically made legally binding up-front, namely:

- Any confidentiality provisions in the MOU.
- Any "exclusivity" provisions in the MOU, under which the Seller is not permitted to negotiate with a third party for the sale of the business for a stipulated period.
- Although not common in South Africa (but fairly standard market practice in the UK), a "break fee clause". A "break fee clause" says that if the Transaction does not proceed, the Seller must pay a stipulated amount of money to the Buyer as a "break fee".

Although the bulk of the MOU is not a legally binding document, it is a useful point of reference for the Parties as they negotiate the actual Sale and Purchase Agreement ("**SPA**") under which the shares or business is actually sold by the Seller to the Buyer.

3. **When to do the Due Diligence:**

It is obviously prudent for the Buyer and its specialist advisers to carry out a proper due diligence on the Target Company. Buyers who conduct a full blown due diligence (in other words, properly investigate the Target Company's legal, financial (including tax) and operational affairs) do so either:

- in parallel with the negotiation of the SPA; or
- only once the SPA has been finalised and signed. In that case the completion of a satisfactory due diligence is a suspensive condition (normally called a "Condition Precedent") to the SPA. The effect of that is that the SPA does not fully take effect nor does it become fully enforceable unless the due diligence has been completed satisfactorily.

4. **Negotiating and Signing the SPA:**

The Parties will then, with their advisers' assistance, negotiate and finalise the SPA. The Parties' lawyers will do their best to protect their respective clients' interests as well as they can. Essentially the Seller wants to have as little liability under the Transaction as possible, whereas the Buyer wants the Seller to have as much liability under the Transaction as possible. This process normally entails various drafts of the SPA being exchanged between the Parties and their lawyers, and those drafts usually being debated in face-to-face meetings.

Once the Parties have reached consensus on the SPA, they enter into (sign) the SPA.

5. **Conditions Precedent:**

If the SPA is subject to any Conditions Precedent, the stage between signature of the SPA and the time that the Conditions Precedent have all been fulfilled (or, if applicable, waived) is known as the "**Interim Period**".

During the Interim Period the Parties will use their reasonable endeavours to have the Conditions Precedent fulfilled. The Seller will normally also be under an obligation to conduct the Target Company's business only in the ordinary course during the Interim Period.

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## 6. Completion / Implementation:

Once the SPA has become unconditional (in other words, the Conditions Precedent have been fulfilled or, if applicable, waived), the SPA is of full force and effect. Essentially:

- The Buyer then pays the purchase price to the Seller.
- And the Seller then delivers the shares sold / the business sold to the Buyer. (Delivery of a business is more complex than delivery of shares.)

That is normally the end of the formal legal Transaction process. But then the real business world considerations come into play more prominently, in that the acquired business needs to be optimally integrated into the Buyer or the Buyer's group.

Change management is absolutely key in this regard. Seller's remorse is also not uncommon either, and often needs to be managed appropriately.

The post-implementation stage is also the stage during which the proverbial worms, if there are any, come out of the woodwork. Sometimes a Buyer finds that what it thought it had bought and what it actually got are two very different things.

If that unfortunate outcome comes about, the protection afforded to the Buyer by the SPA becomes of critical importance. This is so because of the basic sale contract rule in our law, which is called *caveat emptor*. Literally translated that rule means "let the buyer beware".

In practice the rule means that the law gives a Buyer very little protection except for the protection which the Buyer had actually written into the SPA.

This means that if a Buyer did not seek or obtain competent legal advice when it negotiated the SPA, the SPA is unlikely to give sufficient recourse to the Buyer if things go wrong. And that is a very good incentive for Buyers to seek and obtain competent legal, financial and tax advice on their Transactions and SPAs. It is money well spent.

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