

Legal Herald

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Overview of Mergers and Acquisitions

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While global mergers and acquisitions (M&A) activity slowed in 2017, Malaysia is reported to have experienced its highest M&A activity in the past five years, totalling a transaction value of US\$17.57 billion (approx RM68.24 billion) in 2017 alone.¹ This can be attributed to the surge in inbound investments in various economic sectors including financial services, energy, construction, consumer and real estate. The number of M&A deals in Malaysia is expected to rise over the next two years, with the dealmaking cycle to peak in 2019 before easing back in 2020.²

M&A is a favoured business strategy for companies to gain a competitive advantage, extend into new markets or territories, or secure new technologies and skill sets.

In the Malaysian context, M&A generally refers to the acquisition of shares of a company, consolidation of businesses or takeovers. This special issue focuses on M&A involving private companies,³ and is intended to provide an overview of the M&A process.

1 Yen Nee Lee, "Mergers and acquisitions slowed globally in 2017, but Malaysia was an exception" (11 December 2017) <<https://www.cnbcm.com/2017/12/11/malaysia-bucks-ma-slowdown-says-duff-phelps-transaction-trail-2017.html>>; "Transaction Trail Annual Issue 2017" <<https://www.duffandphelps.com/insights/publications/valuation/transaction-trail-annual-issue-2017>>

2 "2018 Global Transactions Forecast: Deal appetite rising" <https://www.bakermckenzie.com/-/media/files/insight/publications/gtf/global_transactions_forecast_2018.pdf>

3 Note that the acquisition of shares of companies listed on the Malaysian securities exchange may be subject to the provision of the Malaysian Code on Take-Over and Mergers 2016

M&A process

Once a target is identified and initial communication between buyer and seller takes place, the process that ordinarily follows includes:

- Preparation of a timeline;
- Finalisation of preliminary agreements;
- Circulation of a due diligence checklist;
- Carrying out the due diligence exercise;
- Drafting and negotiating the definitive agreement;
- Fulfilling conditions precedent;
- Completion.

Transaction structures

The two principal forms of acquisition structures in respect of private companies in Malaysia are share acquisitions and asset/business acquisitions. Various considerations would drive the decision to adopt a particular deal structure for an M&A transaction, such as liabilities of the target, tax considerations, integration and other costs and the need for third-party consents/approvals.

The decision of structure is commonly made at the outset, or after a preliminary due diligence is carried out by the buyer, and would influence the approach taken in seeing the deal through.

Share acquisitions

In a share sale and purchase transaction, ownership of the shares is transferred to the buyer, while assets and liabilities remain with a target company. Such transactions are seen as being more straightforward, as the buyer would effectively assume control of the business of the target company, its assets and management. However, in situations where the target company has a number of shareholders (particularly minority shareholders), it may be more cumbersome and time-consuming to negotiate a purchase of shares.

Table 1 illustrates a typical share acquisition structure:

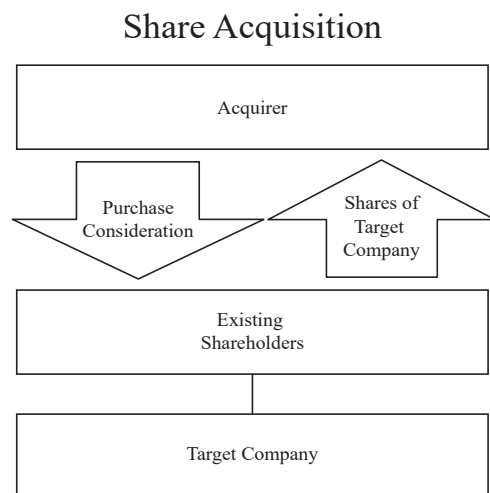


Table 1

Asset/business acquisitions

If an acquirer is seeking to acquire a specific portion of the target company's business or assets (including selected key management personnel), an asset/business acquisition would be a more suitable option.

In an asset/business acquisition, only assets and liabilities specifically listed in the definitive agreement would be transferred to the buyer. While providing some degree of flexibility, an asset/business acquisition may be more tedious as some classes of assets require additional formalities to be complied with in order to effect a change of ownership (for instance, real property, contracts and trademarks).

Table 2 illustrates a typical asset/business acquisition structure:

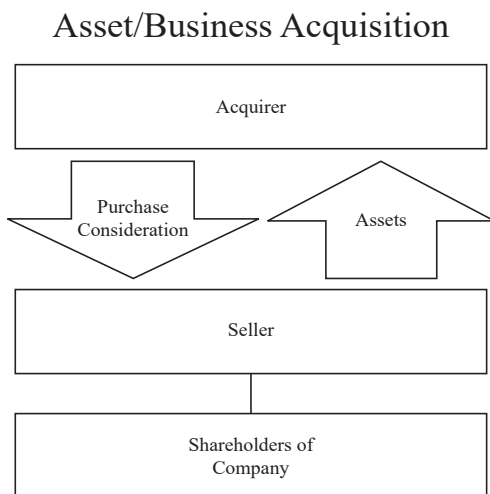


Table 2

Preliminary agreements

The prelude to the M&A process is ordinarily the entry into a preliminary agreement. This may take the form of a letter of offer, term sheet or memorandum of understanding.⁴ A preliminary agreement is intended to capture broad terms of the transaction (including deal structure, consideration, timing for signing of the definitive agreement and corporate approvals) and would lay down the fundamental terms for parties' to commence negotiations prior to the drafting of the definitive agreement. Provisions that are sometimes overlooked, which are of significance, are as follows:

- Exclusivity — which seeks to ensure that the seller does not enter into concurrent negotiations for sale of the subject shares/business/asset
- Non-disclosure — which places restrictions on confidential information exchanged between the parties during the course of negotiations and the due diligence review (this is particularly important to protect the seller/target)
- Non-solicitation of employees of the seller/target.

The due diligence exercise

This crucial component of the M&A exercise revolves around the buyer (together with its professional advisers) undertaking a comprehensive review and analysis of the target company's business, within a pre-determined period. For a further discussion of due diligence exercises, please see "The Due Diligence Process" on page 5.

⁴ Whether or not these are binding in nature would depend on the intention of the parties as expressed in the document, and by applying principles of contract law

Negotiating the definitive agreement

The definitive agreement should comprehensively detail the transaction, parties' obligations and time for performance. The transaction structure would dictate the form of agreement, and the outcome of the due diligence exercise would translate into the parties seeking to incorporate specific provisions relating to the business — a seller would, for instance, seek to limit representations and warranties, while a buyer would seek to incorporate wider indemnities for issues uncovered during the due diligence exercise. Please see “The Definitive Agreement” and “Representations and Warranties” on pages 8 and 12, respectively.

Once finalised and signed, parties should take steps to fulfil the conditions precedent (if any), and attend to completion items in accordance with agreed provisions of the agreement.

Conclusion

While M&A transactions differ from industry to industry, the overall process in which an acquirer and a seller accomplish and finalise a transaction does not generally deviate from the above. The success of an M&A transaction could therefore be said to hinge on whether an acquirer and a seller have a solid understanding of the overall process and the steps to be taken. Adopting a clinical and solution-oriented approach would allow for parties to achieve the intended result in a cost-effective and timely manner.

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