

RETAIL AND CONSUMER M&A INSIGHTS

KEY CONSIDERATIONS FOR DISTRESSED AND STRATEGIC DEALS

Store closures and sharp declines in discretionary consumer spending are anticipated to affect non-essential retail (e.g. non-food, apparel, fashion, and luxury products). Although the picture is mixed, some retailers have already had to make tough choices, including temporarily or permanently closing doors, creating new partnerships, liquidating assets or entering distress scenarios. On the other hand, some retailers have been uncovering opportunities to enhance value proposition, unlock cost synergies and provide better service to end consumers, through acquisitions of new business models and capability tuck-ins.

Against a backdrop of rising interest rates, heightened inflation and competition, 2023 is likely to see a similarly divided picture. In light of this, we have set out the key legal and practical considerations to take before gearing up for either a distressed or strategic M&A transaction.



DISTRESSED DEALS

STRUCTURE – Sales will be structured differently depending on the insolvency procedure used by the Seller or target. Some sales may also be negotiated in advance of an insolvency procedure, or 'pre-packaged', in order to minimise business disruption. Consider also whether to structure the sale as an asset sale or a share sale. Where it is an asset sale a price will need to be apportioned to each category of sale asset (e.g. real estate, IP rights etc.). Sometimes the office holders will allow the Buyer to dictate this in the sale agreement, but they will not agree to be bound by it if it needs to be changed subsequently (e.g. if a valuable but unknown sale asset is discovered post-completion).

PRICE – Depending on the competition, this can be one of the Buyer's most effective points of leverage. Consider if any retentions are required if sale parameters change. Consider also whether the consideration will be in cash or if it could be structured by way of credit bid. Office holders may wish to incorporate an anti-embarrassment clause to cover the event that the business is subsequently sold at a significantly higher price.

PRE-PACK REGULATIONS – For administration sales to a connected party purchaser, consider whether the approval of creditors or an independent evaluator's report is required prior to completion, pursuant to the Administration (Restrictions on Disposal etc. to Connected Persons) Regulations 2021 (SI 2021/427). The Buyer will need to commission an independent evaluator required to provide a report.

CONTRACTS AND PR – Identify and review all key contracts early to determine the Seller's obligations, expiry dates, change of control and assignment restrictions, retention of title, third party rights, and any other terms which may pose an issue to the Buyer. Once suppliers, customers, and employees find out about the sale, each stakeholder will be interested to urgently clarify their position going forward. This can result in e.g. ROT claims, amended terms of supply, TUPE claims, purported terminations and ransom payments. Consider planning early to manage PR in the immediate aftermath of the sale.

BOOK DEBTS – If book debts are being acquired, consider the cut-off time for transfer, and who will be collecting debts. This can be made complicated by unfulfilled orders and returns post-completion. It may be an option for the Buyer to act as collection agent for the Seller to avoid business disruption post-completion caused by the office holders pursuing debts.

REAL ESTATE – Particularly on retail sales where there is a large store portfolio, there may be insufficient time to acquire landlord consent to an assignment of the Seller's leases prior to completion. In this case, the Seller typically grants the Buyer (at the Buyer's cost) a licence to occupy, with the Buyer taking possession on completion and seeking Landlord consent after the event. Consideration may be deferred until such consent is obtained.

EMPLOYEES – Consider whether the sale will constitute a transfer of the business as a going concern. If it does, then TUPE is likely to apply. This will have cost implications for the Buyer which will need to be factored into pricing. Also, clarify at an early stage which employees you would like to adopt e.g. only certain stores or parts of the business. There is typically insufficient time to inform and consult employees ahead of the sale in accordance with TUPE, and the office holders will usually ask the Buyer to indemnify against any loss suffered as a result.

INDEMNITIES – Office holders typically require a series of indemnities against loss incurred as a result of the transfer of assets. These will be framed as widely as possible in the initial draft SPA, and the scope for negotiation is limited.

DELIVERABILITY/DAY ONE – Particularly with respect to stock, office holders will seldom agree to physically deliver assets to the Buyer, but will make them available for collection for a limited time. The Buyer will need to make its own arrangements. Consider also other day one arrangements required such as putting in place adequate insurance policies. If there is time, try to arrange a viewing of the head office, key sites etc. with the office holders to obtain a first-hand perspective of all ongoing business functions.

STRATEGIC DEALS

DEAL STRUCTURE – Tax treatment and the commercial risks often dictate the transaction structure. However, as macroeconomic conditions remain uncertain and large deal financing becomes less accessible, smaller bolt-on or tuck-in acquisitions to accelerate value creation or unlock new geographies should be considered. In addition to conventional share or asset purchases, alternative transaction structures such as minority deals, joint ventures and partial disposals can facilitate such deals.

DILIGENCE – There are various aspects of a retail business including its people, real estate, intellectual property, supplier and customer contacts and consumer data. Identifying and allocating the associated risks through comprehensive due diligence, contractual drafting (e.g. warranties and indemnities) and/or purchase price adjustments is key. Even where W&I insurance is being considered, insurers will not cover known or high-risk liabilities such as wage/hour claims and pension underfunding, so comprehensive diligence is the best protection.

REAL ESTATE – Particularly on asset deals where there is leased property and the target is the tenant, the terms of each lease should be considered. For example, lease break options that may require the target to move from the property, and dilapidations obligations at lease termination should be assessed. Buyers may consider dilapidations a pre-transaction cost that should be included as a net debt item on the balance sheet (reducing the consideration payable).

DATA – In addition to the target company's current data protection compliance and identifying any data leaks, the requirements and impact of any data transfers during the due diligence process and post-completion integration should be considered. On asset deals where personal data may need to be transferred, specialist advice should be sought, particularly in relation to the processing and transfer of consumers' data.

EMPLOYEES – Buyers should pay attention to any existing or potential issues with past and present litigation, benefits and incentive plans, employment and other labour contacts, working hours and overtime, unions and labour organisations (where relevant), employee handbooks, TUPE, and immigration. Where a Seller can resolve or limit these issues prior to the transaction, the Seller may significantly increase its bargaining power and limit the need for heavy negotiation over potential liabilities.

INTELLECTUAL PROPERTY/BRAND – As consumer behaviour and demand for digital offerings continues to grow following the pandemic, retailers are increasingly acquiring and investing in valuable intellectual property. For example, in November 2022 Next acquired Made.com's brand and IP as the online furniture retailer entered in to administration. To assess the value of the IP, Buyers and Sellers should undertake comprehensive trademark/IP searches, assess ownership issues generally, evaluate infringement history both by and against the target, and assess the enforceability of exclusivity provisions in agreements and licences.

ANTI-TRUST – Where the target business operates within the same subsector/industry as the Buyer, failing to follow proper procedures during the deal or obtain the relevant regulatory approvals prior to closing may be detrimental. For example, in May 2020 the Competition and Markets Authority (CMA) required JD Sports to sell Footasylum and unwind its 2019 acquisition of the company, and the parties were also fined £4.68m in February 2022 for sharing commercially sensitive information. Specialist advice should be sought to assess the closeness of competition between a target and Buyer in the relevant jurisdictions, and to ensure that appropriate safeguards are in place during the deal.

POST-CLOSING AND INTEGRATION – For post-completion integration it is important to develop an efficient timetable to merge or consolidate suppliers, vendors, practices and policies in order to eliminate inefficiencies, and consider any potential termination costs. A detailed separation or integration plan, transitional services agreement, logistics arrangements and/or other commercial agreements should be considered before closing.

GET IN TOUCH

BCLP has extensive experience and is well placed to advise on all aspects of strategic and distressed acquisitions and disposals for prospective Buyers and Sellers, including providing specialist legal advice. If you would like further information, please reach out to us directly using the information below.



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