COVID-19's impact on M&A deals

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EBITDA's role in commercial negotiations

Following the impact of COVID-19 on equity and M&A deals in the offing, adjustments to EBITDA are likely to become one of the most negotiated points in a deal, believe Saumya Ramakrishnan and Ruchir Sinha of Nishith Desai Associates.

Promoters negotiating for such deals will want more add-backs while the investors/acquirers will restrict for such add-backs, said the duo in a report on "M&A Impact: Should Corona losses be added-back in EBITDA computation in PE/M&A Transactions?" released 28 Apr 2020.

Ramakrishnan and Sinha elaborate. The COVID-19 and its impact on such private deals is yet to be tested. While, from a short-term perspective, the impact on valuation may be temporary, it is certain to change the manner in which adjustments to EBITDA are commercially negotiated between parties and documented.

With the global economy and world at large reeling under the impact of COVID-19, the impact on the private equity and M&A market will be seen in the coming months.

However, it appears that a pandemic of this nature has managed to get the investors and promoters into a huddle, to discuss the manner in which businesses are valued for the purposes of private equity and M&A deals.

EBITDA and its multiples are a common benchmark in private equity and M&A deals to determine the fair valuation of a company; therefore, to determine earn-outs and other post-closing adjustments.

Ramakrishnan and Sinha examine the basic tenets of EBITDA, the common adjustments made to EBITDA, including the manner in which COVID-19 losses are likely to be treated and the manner in which adjustments to EBITDA will be negotiated, going forward.

EBITDA provides an insight into the profitability of a company, eliminating entries that may be specific to such company, enabling a comparison with other companies operating in the same sector in the same jurisdiction; thus, assisting in the valuation exercise.

Besides, EBITDA also provides an insight to the investor into the debt repayment capacity of the company.

In a private equity or M&A deal, EBITDA's relevance is not limited to determining the deal value, but also with respect to determining the value of other components like promoter payouts and working capital adjustments.

While a higher EBITDA is more beneficial to the promoters, if EBITDA is inflated in an unrealistic manner, the resultant impact may be unfair to the investor/acquirer.

Conversely, leaving out certain irregular and one-time losses from EBITDA may be unfair to the promoters, as this may reduce the valuation substantially, though such events are extraordinary and may never occur again.

It is, therefore, essential that the nature, scope and extent of adjustments be narrowly identified and such clauses be interpreted strictly. *fiinews.com*