Wrestling the bear
M&A Market Monitor
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- Key structure terms
- Limitations of liability
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Our global presence

**Europe**
- Austria: Vienna, Budapest
- Belgium: Brussels, Dublin
- Bulgaria: Sofia
- Czech Republic: Prague
- Estonia: Tallinn
- Finland: Helsinki, Oulu, Tampere, Turku
- France: Paris, Lyon, Marseille
- Germany: Berlin, Hamburg, Munich
- Greece: Athens
- Hungary: Budapest
- Ireland: Dublin
- Italy: Milan, Rome
- Latvia: Riga
- Lithuania: Vilnius
- Luxembourg: Luxembourg City
- Netherlands: Amsterdam, Rotterdam
- Poland: Warsaw
- Portugal: Lisbon, Porto
- Romania: Bucharest
- Slovakia: Bratislava
- Spain: Madrid
- Sweden: Stockholm
- Switzerland: Berne, Geneva, Zurich

**Africa**
- Angola: Luanda
- Mauritius: Port Louis
- Mozambique: Maputo
- South Africa: Durban, Johannesburg, Pretoria
- Tunisia: Tunis

**Middle East**
- Iraq: Baghdad, Erbil
- Jordan: Amman
- Qatar: Doha
- Saudi Arabia: Riyadh
- United Arab Emirates: Abu Dhabi

**Asia**
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- India: New Delhi
- Japan: Tokyo
- South Korea: Seoul
- Singapore

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- San Francisco
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INTRODUCTION

Eversheds Sutherland: M&A Market Monitor

01
Headline analysis on current features and trends in the 2021 M&A market

02
Analysis of the differences between the UK, continental Europe, Middle East, US and Asian markets

03
The horizon - are the current themes in the market here to stay
Global headwinds

– inflationary pressures driving up underlying business costs
– governments around the world have increased interest rates which pushes up the cost of debt used to finance acquisitions
– supply chain issues because of the COVID pandemic, lockdowns in China, Russia’s war on Ukraine and high energy prices

However:
– while the M&A market was down 20% in the first half of 2022, it could still be one of the strongest markets in the last 20 years
– businesses still need to provide returns for shareholders
– volatility provides opportunities
– market leaders continue to use M&A to add new capabilities and scale businesses
– a strong dollar provides opportunities for US buyers in the UK and Europe
Locked box or completion accounts

- Continued move towards completion accounts deals in 2022 (a trend which we have seen develop since COVID)
- Completion accounts continue to be much more commonly used in the US than the UK and continental Europe
- Locked box adjustments have grown in usage over the past 10 years and are particularly popular in upper-mid market deals
- In Asia, historically a higher proportion of deals had no purchase price adjustment at all when compared with other regions. In recent years, the overall proportion of deals which included purchase price adjustments, whether completion accounts or locked box - has increased
How does a buyer protect against downside risk:

- rebalancing towards completion accounts – though locked box remains popular with PE sellers / auction deals where sellers can dictate terms
- pay the right price – we have seen that deals are more likely to fall over as a result of difference of opinion on price/ diligence issues
- diligence

What other mechanisms exist to ease valuation uncertainty?

- warrant the accuracy of specific financial information – with more volatility in underlying economic drivers e.g. inflation and the financial markets, we have seen buyers requesting e.g. sales data be warranted
- seller roll-over or reinvestment
- deferred consideration mechanisms – e.g. earn out (addressed on the next slide)
Wrestling the bear
M&A Market Monitor

Earn-outs

Was there an earn-out?

- we are seeing more earn outs
- earn-outs are more common in the US across the board
- more common in lower value deals than in upper-mid market deals in the UK and Europe
- statistics for Asia fall in between UK/Europe and the US
We have seen a move towards longer earn-out periods, giving sellers a longer opportunity to achieve earn-out targets in an uncertain economic climate.

- Middle East
- UK
- Europe
- Asia
- US
DOWNSIDE PROTECTIONS

Retention provisions

Was there security for warranty claims and/or for completion account adjustments?

- the most common reason for a retention are for warranty claims and indemnity claims (e.g. litigation) and for completion accounts adjustments
- roughly a third of deals in Asia have retention or some form of security for claims
- in the UK “retentions” typically take the form of an escrow held with a third party provider. In the US buyer retentions are more common

UK (£50m-£500m)
- 90% Yes
- 10% No

Upper-Mid Market (£500m-£2bn)
- 99% Yes
- 1% No

Europe
- 91% Yes
- 9% No

US
- 31% Yes
- 69% No

Asia
- 70% Yes
- 30% No

Middle East
- 45% Yes
- 55% No
Shorter retention periods are more common in the US as security is more often linked to completion accounts adjustments.
we have seen an increase in buyers deferring or staggering consideration payments (even if there are no substantive conditions attached other than the passage of time)

this is dependent on relative bargaining power (buyer mitigation of risk and preservation of cash vs seller need for a quick and clean exit)

some instances of deferrals turning into retentions (requests for security in relation to deferred consideration – either by escrows or by way of set-off)

more earn-outs

use of a broader range of trigger events (beyond revenue or profit targets) – e.g. renewal of a key commercial contract

negotiation focused on conduct of business during the earn-out period with buyers wanting to drive group revenues benefit from synergies and integrate effectively and sellers seeking to protect their ability to achieve the earn-out
### KEY STRUCTURE TERMS

Were exchange and completion split?

<table>
<thead>
<tr>
<th>Region</th>
<th>Exchange</th>
<th>Completion</th>
</tr>
</thead>
<tbody>
<tr>
<td>US</td>
<td>85%</td>
<td>15%</td>
</tr>
<tr>
<td>UK</td>
<td>26%</td>
<td>74%</td>
</tr>
<tr>
<td>Europe</td>
<td>57%</td>
<td>43%</td>
</tr>
<tr>
<td>Middle East</td>
<td>75%</td>
<td>25%</td>
</tr>
<tr>
<td>Asia</td>
<td>68%</td>
<td>32%</td>
</tr>
</tbody>
</table>

Upper-Mid Market (500m-2bn)

- **Yes**: 90%
- **No**: 10%
Foreign investment and national security regimes

- in last two to three years we have seen key jurisdictions across Europe, Asia and North America either introducing or significantly expanding their regimes
- a number of regimes substantially expanded their foreign investment ("FDI") thresholds (or introduced new regimes) as a response to COVID-19 and these changes have largely remained in place
- historically, foreign investment regimes have primarily focussed on military and defence, but the concept of ‘national security’ has expanded to include key computing and other technology and critical infrastructure such as energy and telecoms, and is broadening further into sectors such as life sciences and food

EU and UK merger control and FDI regimes

- in the EU (EU and national regimes) FDI cases have more than quadrupled since 2019 from 109 to over 550
- 24 of the 27 EU countries have or are implementing FDI regimes (as a result of the October 2020 EU Cooperation Mechanism being implemented). The transactions under review vary widely in terms of value, ranging between €1,200 to €34 billion (the majority fell within the range of €10 million to €100 million)
- there has also been an expansion in the EU merger control regime which gives the EU powers to investigate deals which fall below EU thresholds
- in the UK the UK Competition and Markets Authority (CMA) is particularly active at present, intervening in deals with arguably a limited UK nexus. Its level of intervention means that it is difficult to treat the CMA as a purely voluntary regime
  - the CMA has a mergers intelligence function that has become even more proactive in contacting companies
  - the CMA does investigate deals after they have closed and where they do this the impose a burdensome and costly “hold separate” regime which prevents the buyer from having any influence or information on the Target without CMA consent
REGULATORY HURDLES

Impact on M&A

- assessing filing requirements early in the deal timetable and due diligence
- deal certainty
  - assessing risk of obtaining clearances
  - assessing risk of post-closing filing obligations
- conditionality
  - increased negotiation as to what purchaser will do to obtain clearances (hell or high water provisions)
  - cooperation provisions are key
- break clauses
- deal timetable and long stop dates

Practicalities of dealing with multi-jurisdictional regimes

- consider if filings may be required at an early stage of the transaction - failure to notify can result in significant fines
- be aware of variations between jurisdictions (particularly in terms of trigger events, timelines, and ultimately the substantive impact on each Member State’s interests)
- treat as another step before closing – often regimes are triggered without there being substantive risks attaching to the transaction

Two-thirds (66%) of business leaders believe the rise of protectionism is creating an unstable environment for M&A – rising to 70% in the energy sector.
## REGULATORY HURDLES
Key changes that we have seen

<table>
<thead>
<tr>
<th><strong>Global trend</strong></th>
<th>Means that FDI screening is not just an US issue - it needs to be considered in many other jurisdictions as well</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Broad sector coverage</strong></td>
<td>Clear trend is that FDI screening regimes are being designed to capture a wide range of sectors</td>
</tr>
<tr>
<td><strong>Deals of all sizes</strong></td>
<td>Governments intend their regimes to capture investments in small or start up companies as well as large deals</td>
</tr>
<tr>
<td><strong>Impacts acquirers of all nationalities</strong></td>
<td>Regimes are not targeted at specific countries but capture all foreign investors (e.g. in the UK two recent deals requiring remedies involved US and EU purchasers)</td>
</tr>
</tbody>
</table>
Material Adverse Change clauses

Was there a MAC clause?

Buyer protection between exchange/signing and completion/close.

Was there a MAC clause?

<table>
<thead>
<tr>
<th>Region</th>
<th>Yes (%)</th>
<th>No (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>US</td>
<td>93%</td>
<td>7%</td>
</tr>
<tr>
<td>UK</td>
<td>25%</td>
<td>75%</td>
</tr>
<tr>
<td>Europe</td>
<td>20%</td>
<td>80%</td>
</tr>
<tr>
<td>Middle East</td>
<td>55%</td>
<td>45%</td>
</tr>
<tr>
<td>Asia</td>
<td>58%</td>
<td>42%</td>
</tr>
</tbody>
</table>

Upper-Mid Market (500m-2bn)

- Yes: 92%
- No: 8%
LIMITATIONS OF LIABILITY
Use of de minimis/throwaway

- De minimis provisions are included in the majority of UK deals.
- De minimis provisions are much less common in the US.

Use of de minimis provisions in deals:

- **UK**: 28% Yes, 72% No
- **Europe**: 20% Yes, 80% No
- **US**: 35% Yes, 65% No
- **Asia**: 58% Yes, 42% No
- **Middle East**: 20% Yes, 80% No

Maximum cap for warranties: 10%-100%
Threshold/basket: 1%
De minimis: 0.1%
# LIMITATIONS OF LIABILITY

**Liability caps – warranty provisions**

**De minimis/throwaway range**

- Usually applies to general business warranties only (not fundamental warranties)
- Most common de minimis limit for individual claims is less than 0.1% of consideration
- Baskets and de minimis provisions are becoming less common due to nominal £1 caps in W&I deals making them redundant

<table>
<thead>
<tr>
<th>Deal range</th>
<th>Average “de minimis” in £s</th>
</tr>
</thead>
<tbody>
<tr>
<td>£0–£50m</td>
<td>£5k–£20k</td>
</tr>
<tr>
<td>£50m–£500m</td>
<td>£20k–£50k</td>
</tr>
<tr>
<td>£500m+</td>
<td>£50k+</td>
</tr>
</tbody>
</table>
LIMITATIONS OF LIABILITY

Basket/threshold for claims

In the US, a basket is very common but is typically low, with 95% of deals with a basket of <1%

70% of deals in the US were “excess only” recovery, which is significantly opposed to the traditional “tipping basket” UK/European/Asia approach

Yes  No

98%  2%
US

68%  32%
UK

68%  32%
Europe

46%  54%
Asia

92%  8%
Middle East
LIMITATIONS OF LIABILITY
Maximum cap under warranties

- **Lower-Mid Market** (up to £50m):
  - 76-100% of consideration: 50%
  - 26-75% of consideration: 30%
  - 0-25% of consideration: 20%

- **Mid Market** (£50m - £500m):
  - 76-100% of consideration: 45%
  - 26-75% of consideration: 35%
  - 0-25% of consideration: 20%

- **Upper-Mid Market** (£500m - £2bn):
  - 76-100% of consideration: 90%
  - 26-75% of consideration: 95%
  - 0-25% of consideration: 5%

- **US**
  - 76-100% of consideration: 95%
  - 26-75% of consideration: 28%
  - 0-25% of consideration: 5%

- **Europe**
  - 76-100% of consideration: 51%
  - 26-75% of consideration: 21%
  - 0-25% of consideration: 4%

- **Asia**
  - 76-100% of consideration: 13%
  - 26-75% of consideration: 52%
  - 0-25% of consideration: 1%

- **Middle East**
  - 76-100% of consideration: 71%
  - 26-75% of consideration: 9%
  - 0-25% of consideration: 20%
The general trend for non-tax warranty periods has been a move to 18-24 month warranty periods. The argument usually being that this covers a full audit period. In Upper-Mid Market deals warranty periods are usually shorter - between 12 and 18 months.
### W&I INSURANCE

Is W&I insurance considered?

<table>
<thead>
<tr>
<th>Region</th>
<th>0%</th>
<th>10%</th>
<th>20%</th>
<th>30%</th>
<th>40%</th>
<th>50%</th>
<th>60%</th>
<th>70%</th>
<th>80%</th>
<th>90%</th>
<th>100%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Middle East</td>
<td>18%</td>
<td>35%</td>
<td>47%</td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Asia</td>
<td>7%</td>
<td>13%</td>
<td>80%</td>
<td></td>
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<td>UK</td>
<td>25%</td>
<td>52%</td>
<td>23%</td>
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<td></td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Europe</td>
<td>14%</td>
<td>46%</td>
<td>40%</td>
<td></td>
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</tr>
</tbody>
</table>

- Use of W&I / R&W insurance has increased since the pandemic across the board
- W&I is now a consideration on every deal in the US, Europe and UK in mid-market deals

#### W&I insurance categories:
- W&I insurance taken out
- W&I insurance considered but not taken out
- W&I insurance not considered
W&I INSURANCE

W&I Insurance - key factors

01
Zero recourse / £1 liability cap for sellers

02
Policy limit generally around 30% of EV

03
Underwriting premium between 0.75% to 1.65% of the policy limit

04
Policy excess/retention 0.25% to 1.5% of EV

05
Policy enhancements (knowledge scrape, top up for fundamentals)

06
1 in 6 policies get a notification
W&I INSURANCE

Types of breach reported

- Financial statements warranties: 33%
- Tax: 24%
- Compliance with laws: 21%
- Material contracts: 10%
- Others:
  - Employee related: 10%
  - IP Litigation: 10%
  - Operations related: 10%
  - EHS: 10%
- Fundamentals: 24%

Other: c.2%
W&I INSURANCE

Key themes

01 Focus on valuation

02 Profitability

03 Financial/accounts DD focus

04 Fire sales or liquidations

05 Deals are moving more slowly
IN CONCLUSION

US vs Europe (continental and UK) vs Asia comparison

<table>
<thead>
<tr>
<th>US</th>
<th>Europe (continental and UK)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Purchase price adjustments</strong></td>
<td>Completion accounts are the norm. Locked box is much less common.</td>
</tr>
<tr>
<td><strong>Deal conditionality</strong></td>
<td>Risk only passes to the Buyer on completion: - MAC - completion accounts - reps and warranties materiality accurate at completion</td>
</tr>
<tr>
<td><strong>De minimis</strong></td>
<td>Much less common in the US (35%).</td>
</tr>
<tr>
<td><strong>Basket/threshold</strong></td>
<td>Occurs in almost all US deals (98%). 70% operate as “excess only”. Tend to be lower than in Europe (95% were 1% or less as a % of consideration).</td>
</tr>
<tr>
<td><strong>Seller liability cap</strong></td>
<td>95% have a cap of 25% or less of purchase price. Typically secured by a cash escrow or retention of 10%-15% of purchase price, which is often the same as the cap.</td>
</tr>
<tr>
<td><strong>Disclosure</strong></td>
<td>Specific disclosure schedules. Vendor due diligence is uncommon.</td>
</tr>
<tr>
<td><strong>Buyer’s knowledge</strong></td>
<td>Buyer knowledge limitations are not common. Neither are reverse warranties. “Sand-bagging” is negotiated.</td>
</tr>
<tr>
<td><strong>Materiality scrape</strong></td>
<td>Buyer is entitled to disregard materiality qualifications in the warranties for the purpose of establishing whether the de minimis or basket thresholds have been met.</td>
</tr>
<tr>
<td><strong>W&amp;I/R&amp;W Insurance</strong></td>
<td>R&amp;W insurance taken out on 30% of deals. Premiums are more expensive and coverage tends to be more fulsome that in the UK market.</td>
</tr>
</tbody>
</table>

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### IN CONCLUSION

US vs Europe (continental and UK) vs Asia comparison

<table>
<thead>
<tr>
<th>Asia</th>
<th>Middle East</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Purchase price adjustments</strong></td>
<td>Majority of deals have completion accounts. Locked box structures have become more popular in recent years.</td>
</tr>
<tr>
<td><strong>Deal conditionality</strong></td>
<td>Split exchange and completion seen on the majority of deals. Conditionality tends to be mainly linked to regulatory approvals/mechanics and third party consents. MAC outs (in favour of buyer) are relatively common on split/completion deals but are heavily negotiated.</td>
</tr>
<tr>
<td><strong>De minimis</strong></td>
<td>Very common. Used on vast majority of deals.</td>
</tr>
<tr>
<td><strong>Basket/threshold</strong></td>
<td>Occurs in almost all deals in the region. First dollar recovery/tipping baskets are very common.</td>
</tr>
<tr>
<td><strong>Seller liability cap</strong></td>
<td>Majority of deals have caps somewhere in between 26% to 75%. Retentions/escrows (of around 10-15% of the purchase price) are frequently used with variable periods.</td>
</tr>
<tr>
<td><strong>Disclosure</strong></td>
<td>General disclosure of data room has become common. Vendor due diligence is typically used on auction processes only.</td>
</tr>
<tr>
<td><strong>Buyer’s knowledge</strong></td>
<td>Buyer’s knowledge qualifies the warranties but typically limited to actual knowledge of deal teams. Buyers commonly give reverse warranties (again subject to actual knowledge qualifiers).</td>
</tr>
<tr>
<td><strong>Materiality scrape</strong></td>
<td>Not used.</td>
</tr>
<tr>
<td><strong>W&amp;I/R&amp;W Insurance</strong></td>
<td>A less developed market than in Europe and the US. W&amp;I is taken out on around 14% of deals.</td>
</tr>
</tbody>
</table>

**Historically a higher proportion of deals had no purchase price adjustment at all. In recent years, the overall proportion of deals which included purchase price adjustments whether completion accounts or locked box - has increased.**

Majority of deals are split exchange and completion (68%). Conditionality varied across our sample but included competition law, other regulatory approvals, shareholder and third party consents. MAC conditions appear more frequently in Asia (58%) than Europe (20-25%), but less than the US (93%).

Basket/threshold limitation was in 46% of deals in Asia. Where a basket/threshold was used, 79% have first dollar recovery.

52% of deals have a cap of 76% - 100% of consideration. Material portion of deals (30%) have retentions or cash escrows as security for warranty claims.

General disclosure of the dataroom is common. Vendor due diligence is uncommon except for auction processes.

Buyers knowledge qualifications are not common. Buyer’s reverse warranties and “sand-bagging” are uncommon.

Materiality scrape is not used in Asian deals.

A less developed market. W&I policies taken out remain low at 7%, but the number of deals on which W&I is considered has increased from just 14% of all Asia deals covered to 21% for deals since 2020.
THE M&A MARKET

Key themes

Global headwinds
- inflationary pressures
- increased interest rates making borrowing more expensive
- volatility in the global markets (stock and currency)
- cost of commodities (energy prices, supply chain issues)

Reasons to be positive
- the market is still buoyant
- volatility means opportunity
- with less opportunity for organic growth M&A becomes more important
- certain macro factors are starting to ease
- recessions are not global
- historic levels of capital

Key takeaways
- plan ahead – consider any potential regulatory hurdles
- diligence
- timelines
- ESG
- integration/value
- Environmental, social and governance (ESG) issues and sustainable business structures are no longer just regulatory concerns. They are board-level strategic issues.
- Companies will come under increasing pressure to not only report on climate risk, but also to quantify the climate risks and opportunities their business faces, and document their plans for climate action within the organization and across their supply chains.
- Key stakeholders, such as investors, customers, and business partners, will want to see a defined strategy from companies with whom they engage in order to satisfy their own climate risk and decarbonization agenda including whether a particular investment or transaction should be made or whether to exit.
- ESG regulation is increasing and developing rapidly. Companies will have to adapt quickly to comply with new legislation and initiatives such as this.
IN CONCLUSION

Questions?