De Belgische M&A praktijk in internationale context

16.11.2021

Michael Heene

M&D Seminars

Global M&A Intelligence Report

2021

DLA PIPER

Introduction

1. Deal type and process

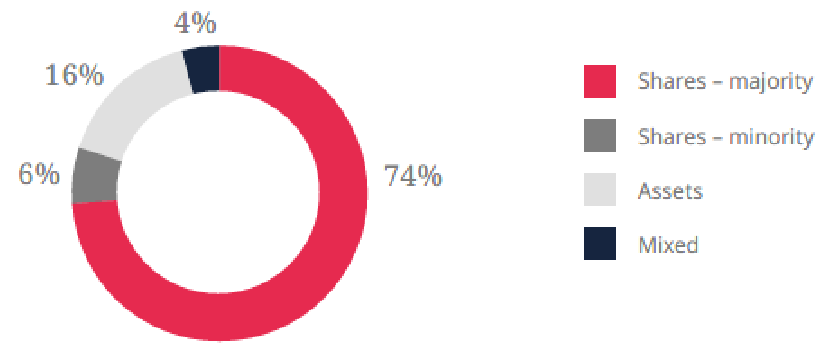
In 2020, the mix of deal types stayed broadly the same as previous years.

Around 75% of the deals surveyed continued to be structured as an acquisition of all or the majority of the shares of a target company (referred to as majority share deals in this report).

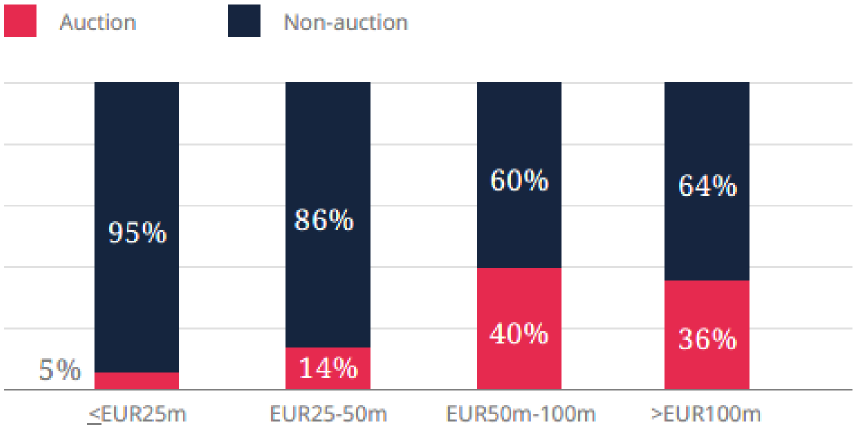
The 2020 M&A market did not see the widely predicted increase in assets deals. Many expected this in anticipation of a significant rise in distressed M&A, whereas in many jurisdictions government support and intervention on an unprecedented scale meant that far fewer businesses became insolvent than commentators thought. It will be interesting to see how this plays out in the coming months as government support packages unwind in most jurisdictions.

Overall, we saw a slight reduction in auctions in 2020. There was a lower level of confidence from sellers in the market, meaning that auctions were being used for only the most attractive assets, where sellers and bidders were likely to be prepared to invest in up-front costs.

Deal types



Deal process by deal value



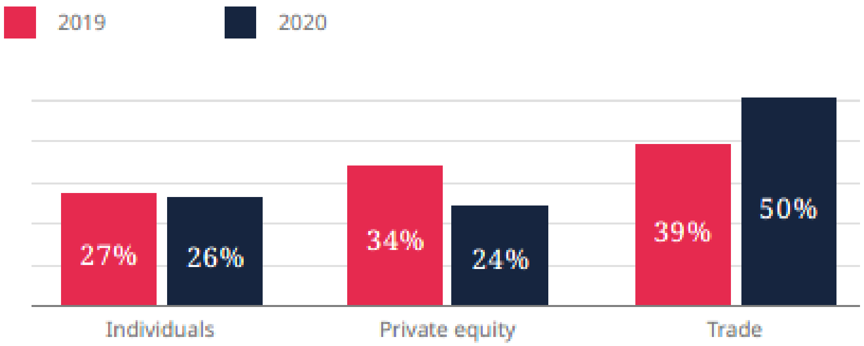
We saw a significant shift in the use of auctions as we go up the value chain. Auctions on smaller deals (sub EUR50 million) were significantly down, with an increased use of auctions in higher value deals. Interestingly, we saw a significant increase in the number of EUR50 million plus deals where trade sellers opted to transact by way of auction (up from 19% in 2019 to 39% in 2020).

Overall, private equity and trade sellers conducted the same proportion of their sale processes as auctions as they did in 2019 – private equity sellers at 43% and trade sellers at 14%. However, trade was a more active participant in the market in certain parts of the year.

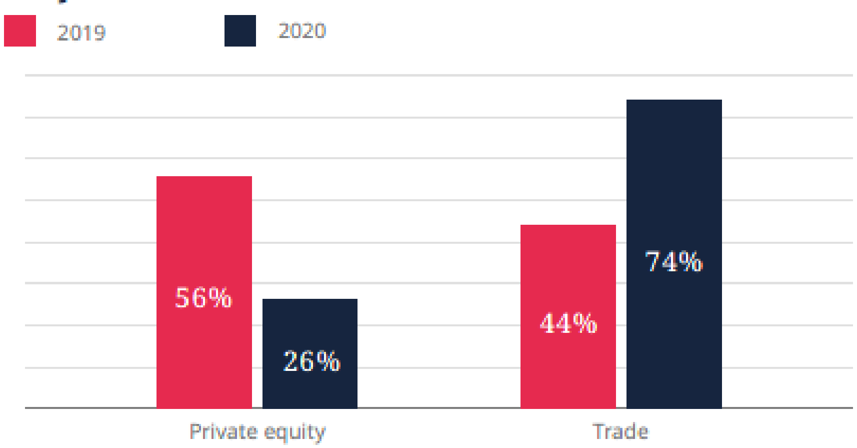
Auctions remain the process of choice for private equity sellers, given the ability for a seller to obtain the best price and deal terms.

However, as the pandemic hit across the globe, private equity owners were forced to focus on protecting their existing portfolios. In the first half of the year, this led to a reduced number of private equity exits, although there was a significant increase in activity after the summer.

Sellers in auctions



Buyers in auctions



Pricing Mechanisms

2. Closing pricing mechanisms: Majority share deals

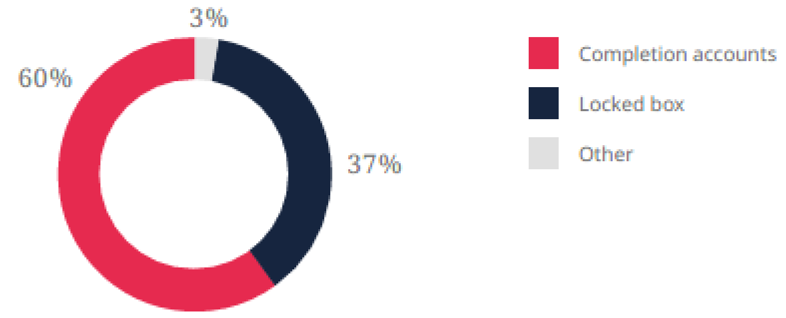
Completion accounts continued to be the favoured pricing mechanism globally, heavily influenced by the continued prevalence of completion accounts in non-European deals.

The most common completion accounts adjustment remains net debt and/or working capital, with these adjustments being included in 80% of completion accounts transactions in 2020. Net assets adjustments remain standard on the acquisition of real estate SPVs.

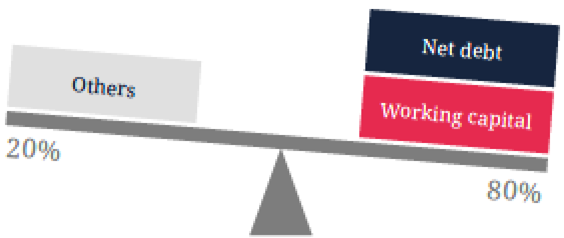
We had expected the growing use of locked box in European deals over recent years to be reversed by the pandemic. However, that was not the case. Locked box mechanisms in the European M&A market actually increased to 52% of non-fixed price majority share deals (up from 43% in 2019).

Two constants remain, however – there is a steady minority of locked box deals in Asia Pacific (at around 25%) and they remain rare in the US.

Closing pricing mechanisms: Majority share deals



Completion accounts criteria



3. Locked box in Europe: Majority share deals

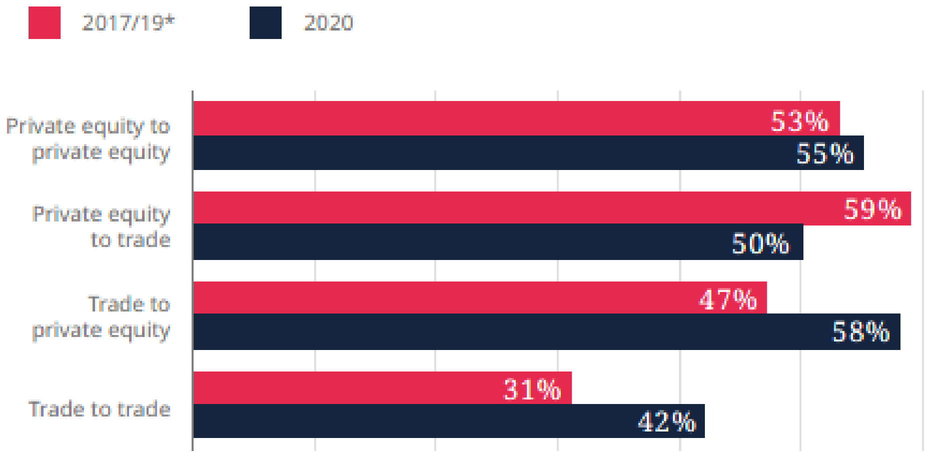
Locked box mechanisms are widely used in Europe but, interestingly, there is considerable variation between jurisdictions. Locked box is most commonly used in France, Benelux, Germany, Spain, the UK, Poland and the Nordics. Elsewhere, it is established but far less common.

Locked box mechanisms were prevalent in auctions, being used in two-thirds of the 2020 auction deals surveyed.

With increasing familiarity and use by trade parties in Europe, the expansion of the use of locked box mechanisms in non-auction deals continues – seen in 50% of European non-auction deals in 2020 (up from 43% in 2019).

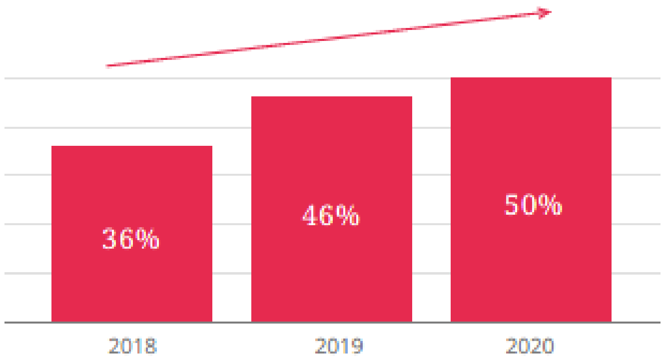
The increased use by trade sellers of locked box mechanisms continued. Trade sellers typically opted for a locked box mechanism when selling to private equity – up to 58% (compared to 47% over the previous three years). While we saw an 11% increase in the use of locked box in trade-to-trade deals, completion accounts remained the preferred pricing mechanism.

European locked box by parties



* 3 year average

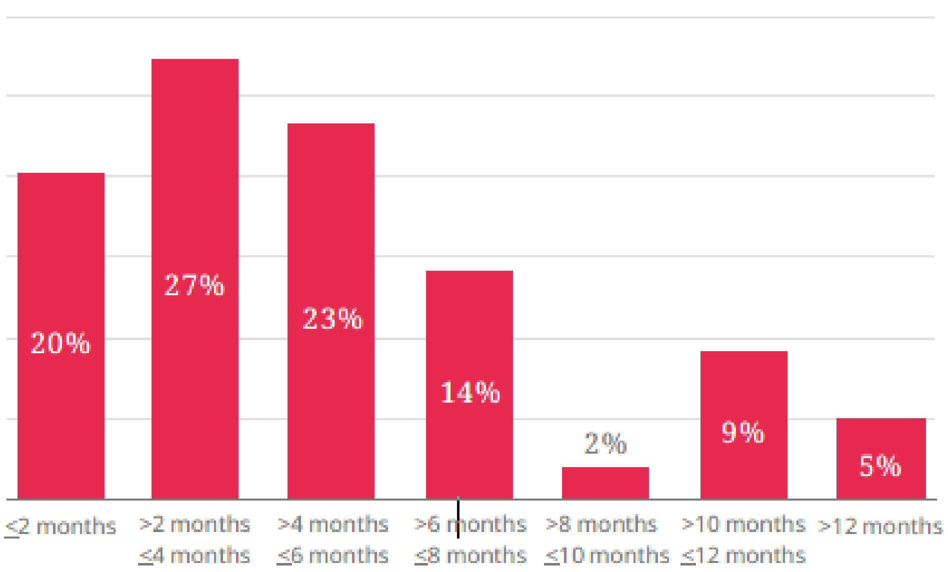
Locked box in European non-auctions



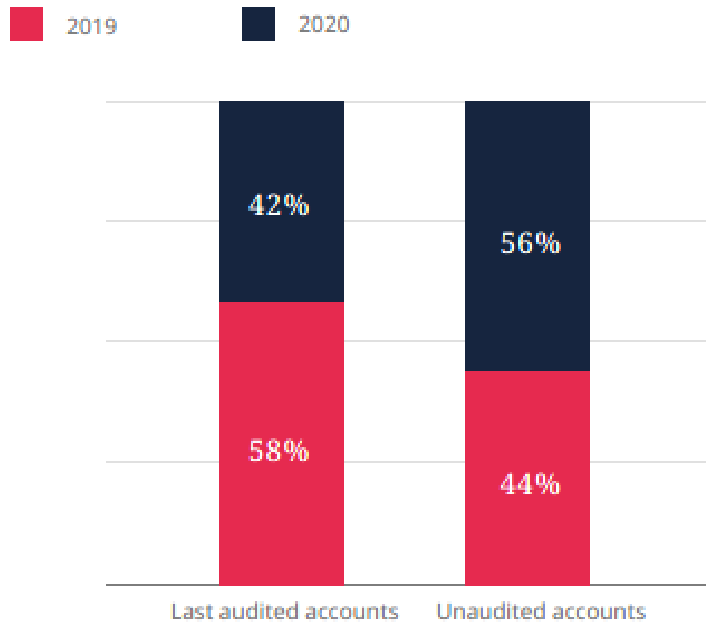
In a change from 2019, the majority of locked box accounts were not the last audited accounts. This may be an effect of COVID-19 on the M&A market, given that many jurisdictions extended audit deadlines. However, there has been little change in the age of locked box accounts compared to 2019.

When unaudited accounts were used, in two-thirds of deals these accounts were warranted to a standard that was higher than a typical management accounts standard warranty and closer to audit standard to provide additional buyer protection. In insurance backed deals, it is often not possible to get an insured warranty on unaudited accounts to an audit standard.

Age of European locked box accounts



Type of locked box accounts in Europe

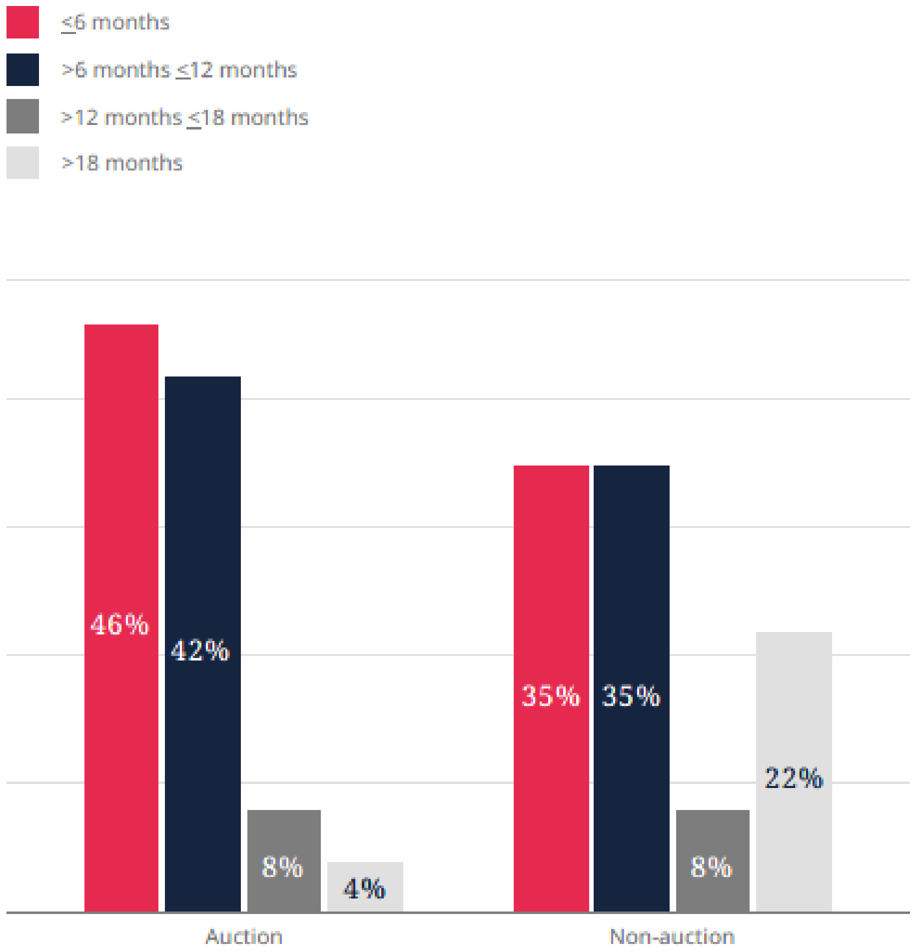


There was a slight shift to shorter time periods for leakage claims. 75% of leakage claim periods were 12 months or less in 2020 European locked box deals, compared to 66% in 2019. Otherwise, leakage claim periods have remained relatively consistent.

The slight reduction in leakage claim periods is interesting given the reduction in the number of auctions and the uncertainty caused by COVID-19. What it shows, though, is that where auctions continued after the start of the pandemic, they were often competitive.

As you would expect, auctions continued to drive shorter leakage claim periods than non-auctions.

European leakage claims by deal process



4. Earn-outs

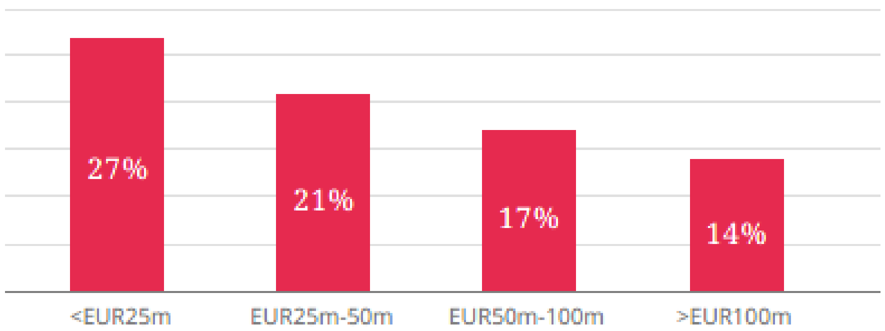
We saw an increase in earn-outs in the 2020 deals surveyed – up from 20% to 24%. This was probably driven by greater uncertainty over post-closing performance and the need to bridge pricing gaps between buyers and sellers created by valuation difficulties due to the COVID-19 pandemic and the continued strength of the Technology sector, where earn-outs have historically been more common.

Earn-outs were seen in a wider range of sectors than in 2019. They were most common in the Technology, Media Sports and Entertainment, Infrastructure, Construction and Transport, and Life Sciences deals surveyed.

Earn-outs were most common in sub-EUR25 million deals (at 27%, compared to 14% for deals over EUR100 million). This deal size typically includes early stage deals, sales by founders and smaller businesses that are more likely to be dependent on key individuals.

Deals with earn-outs

% of deals with earn-outs by deal value Global



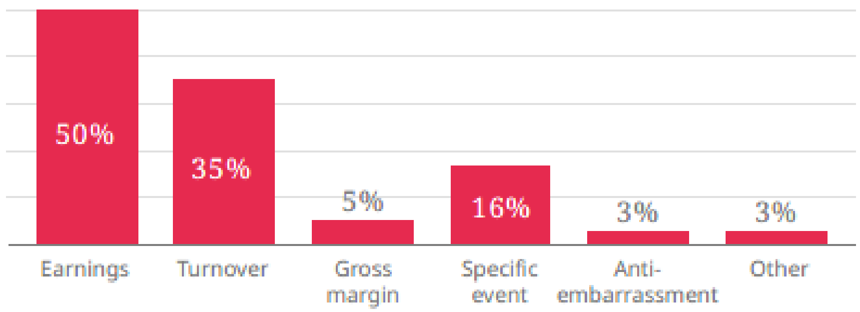
The majority of earn-outs remained based on earnings. However, we saw a 14% increase in the use of turnover based earn-outs. This increase may be as a result of buyers and sellers agreeing a simple earn-out mechanism to deal with the uncertainty caused by the pandemic on transactions that, in more usual times, would not have had an earn-out.

Approximately 15% of earn-outs used more than one criterion.

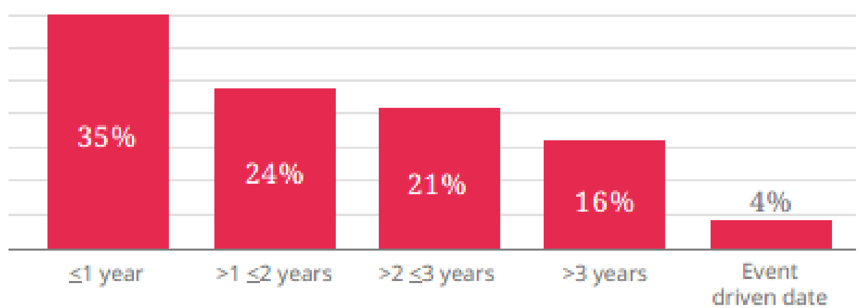
In the deals surveyed for our COVID-19 report, we had seen a significant shift from earn-outs of under two years to earn-outs of over three years, which we believed was due to the uncertain duration of the impact of the pandemic on certain businesses. However, this shift has not been borne out over our 2020 deals as a whole, where we have seen a slight reduction in the length of earn-out periods. An earn-out period of up to one year remained prevalent globally.

This change may be as a result of buyers gaining increased confidence over the duration of the pandemic's impact as the year progressed, with earn-outs being used to deal with near term performance uncertainties. We also suspect that earn-outs may have been included in a number of transactions that, in a more usual market, would not have included an earn-out, with sellers reluctantly accepting them only on the basis that they were short term.

Earn-out criteria



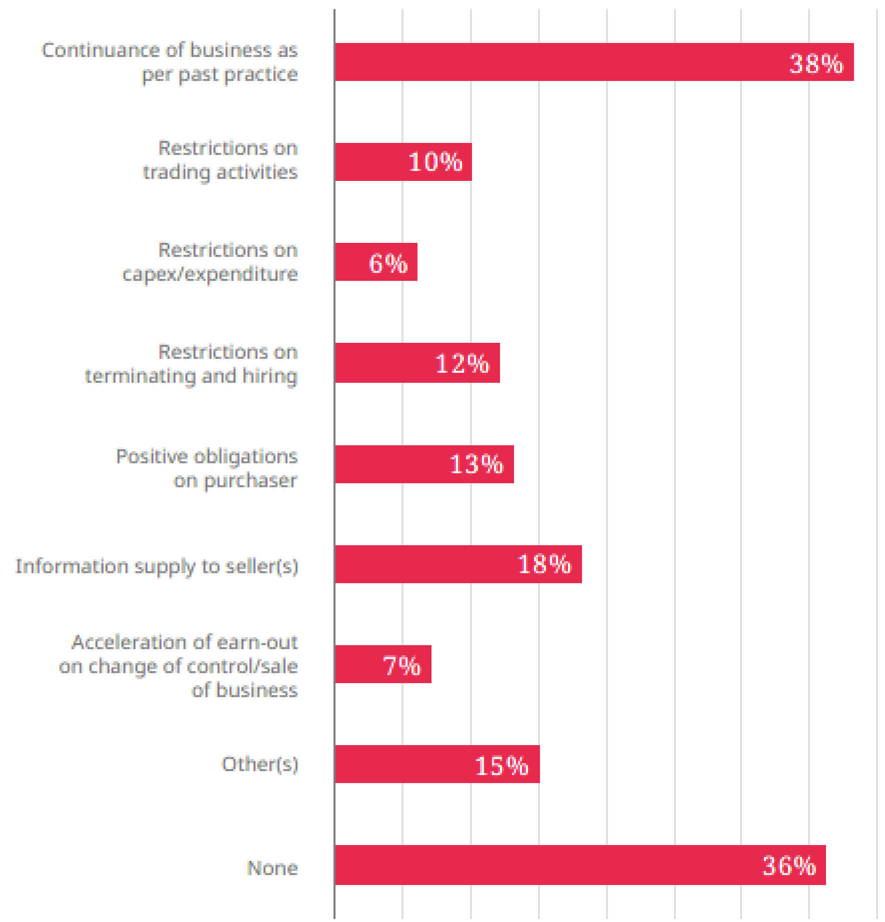
Earn-out periods



Sellers typically seek earn-out protections, ranging from broad statements of intent to specific restrictions or obligations placed on the buyer. These continued to be heavily negotiated between buyers and sellers – in part driven by the earn-out criteria, the significance of the earn-out in relation to the overall deal consideration and the relationship between the parties.

However, despite the increase in earn-outs in 2020, fewer earnouts offered seller protections than in previous years – perhaps a reluctance on buyers to restrict their operation of the business in uncertain times.

Seller earn-out protections



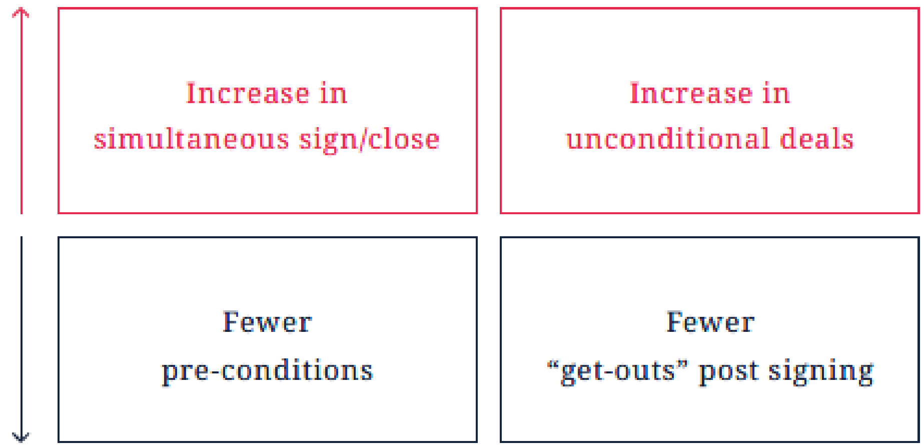
Conditional Deals and Common Conditions

5. Conditional deals and common conditions

As highlighted in our COVID-19 report, in uncertain times, buyers and sellers have looked for greater deal certainty and this trend continued through the remainder of 2020.

This was reflected in a number of ways:

- an increased number of deals with simultaneous signing and closing (49% of the 2020 deals surveyed (up from 46% in 2019)) particularly in Asia Pacific, where historically split signing and closing was seen in the vast majority of deals;
- fewer conditional deals (17% of deals with a split signing/closing were unconditional (up from 10% in 2019)) particularly in the Nordics and the US;
- a reduction of, or shift in the types of, conditions to closing – conditions were more limited to those that could not be readily avoided (such as regulatory approvals and key third-party consents) than in 2019; and
- a reduction in a buyer's right to walk away after signing (see section 7).

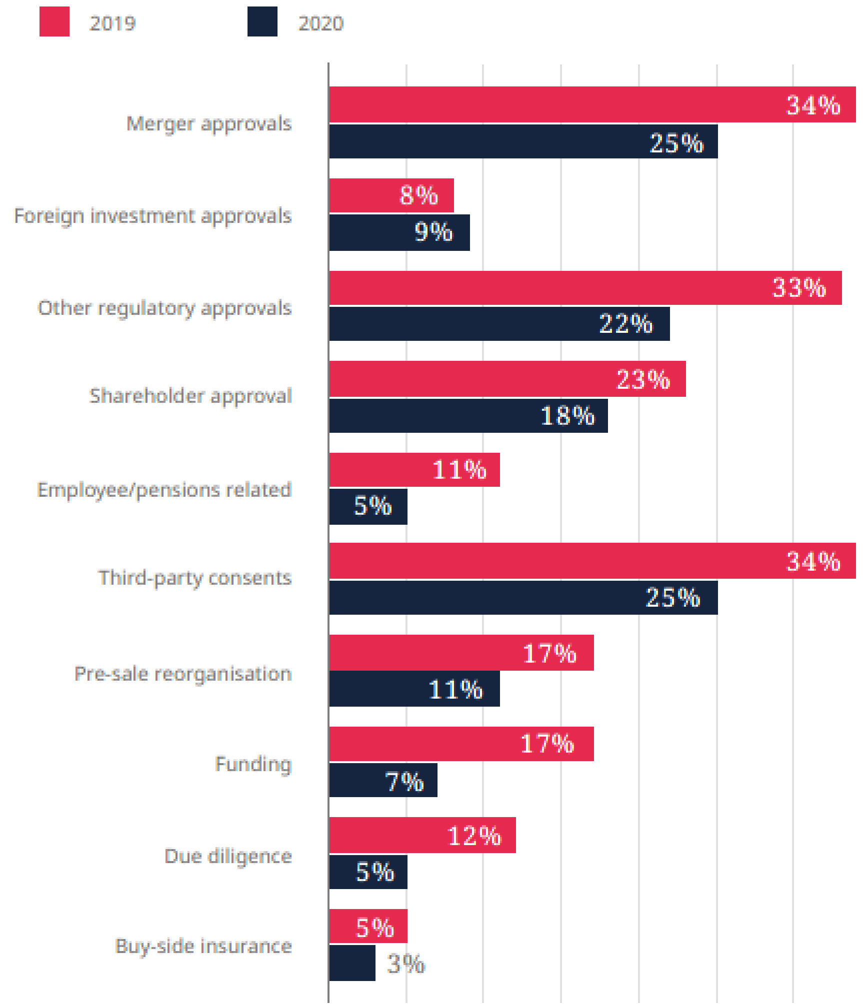


The main pre-conditions remained regulatory approvals and third-party consents. However, we saw a general reduction in the prevalence of effectively all categories of condition.

We saw a reduction in deals with merger approvals compared to 2019, in part driven by parties delaying deals which required merger approvals / scrutiny while authorities were affected by lockdowns.

Foreign investment approvals remained fairly static. Some governments (especially in Central and Eastern Europe and Australasia) extended the requirements for foreign investment approval by lowering thresholds and extending their scope, which may have discouraged buyers in an already difficult climate.

Common conditions (all deal types)



Protections

6. Protections between signing and closing, including MAC

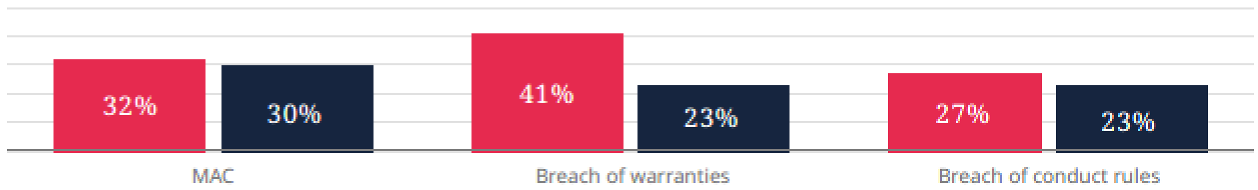
European sellers pushed hard for greater deal certainty once deals were signed by reducing buyers' rights not to close for post signing events:

- There was no increase in formal material adverse change (MAC) protection post signing compared to previous years (contrary to what many had predicted).
- MAC clauses are designed to protect buyers against unexpected events occurring between signing and completion. Once the pandemic hit, a number of MAC clauses explicitly excluded the impact of COVID-19 given it was, by then, a known event. Buyers either decided not to proceed with deals as a result of COVID-19 or looked for other specific protections or changes to deal terms.
- We saw a significant reduction in rights to terminate for breach of warranty, which was coupled with a 10% increase in deals with repetition of warranties at closing, with a right to damages if the warranties were no longer correct.
- While there was no material reduction in rights to terminate for breach of conduct rules after signing, we did see a general relaxation of some typical conduct rules to provide sellers with the required flexibility to manage their businesses during the pandemic.

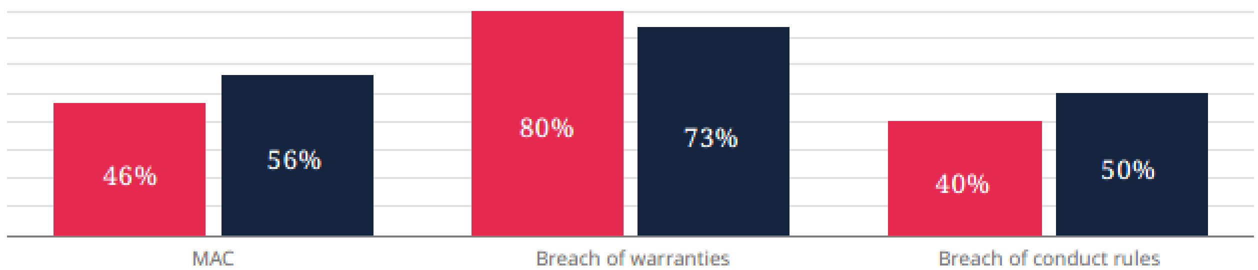
Elsewhere:

- Repetition or "bring down" of warranties with the ability to terminate if breaches had a material adverse effect remained the market standard in US deals.
- In the US and Asia Pacific, we saw greater use of formal MAC provisions and an increase in rights to terminate for breach of conduct rules (although, as in Europe, these rules were negotiated to deal with issues arising from the pandemic).

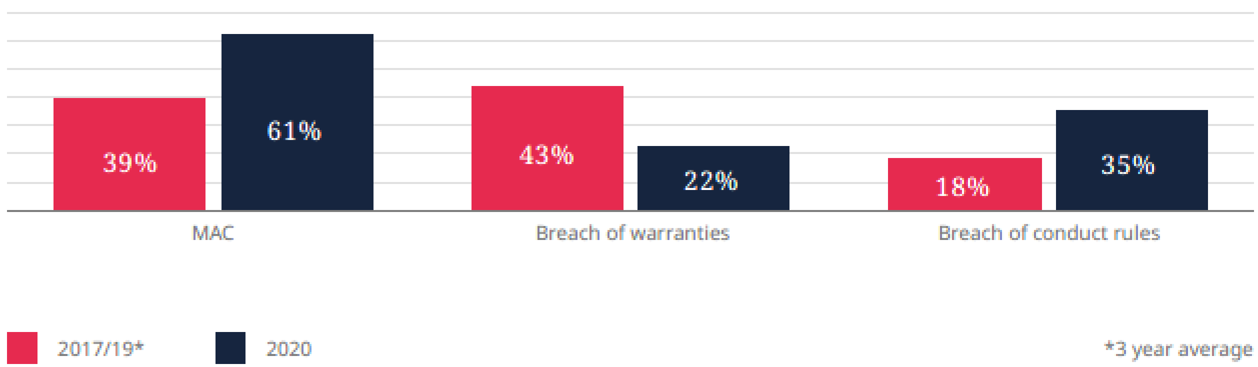
Europe



US



Asia Pacific



7. Commercial warranties: Time limits

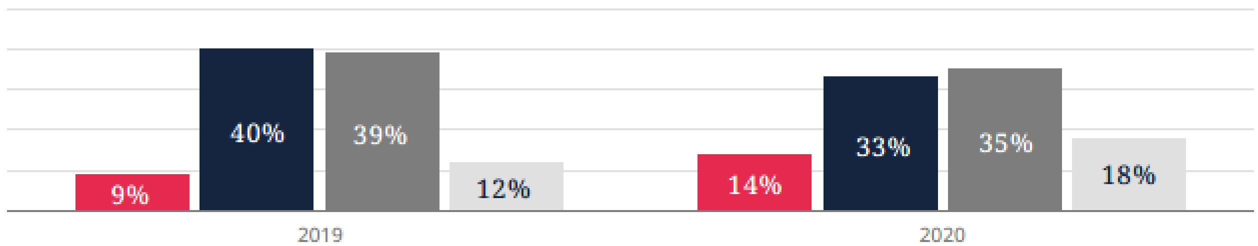
As in 2019, the majority of deals in all regions had a time limit for commercial warranty claims of two years or less. Asset deals typically had a shorter time limit than share deals due to the limited liabilities that typically transfer on asset deals.

Time limits remain the shortest in the US, with over 75% of deals having a period of 18 months or less compared to 47% for Europe and 40% for Asia Pacific. We saw no material change in European deals.

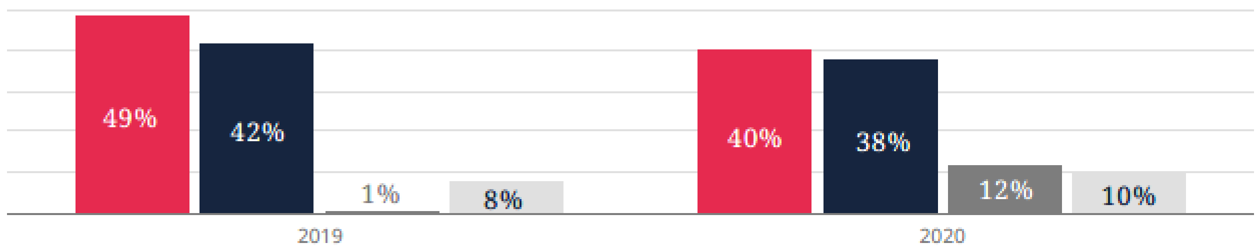
Auctions drove shorter time limits than non-auctions, with a greater differential compared to 2019 deals.

In some jurisdictions, longer time limits were negotiated for some categories of commercial warranties – driven by relevant local laws and the related risk exposure and the target’s key assets. IP, employment, environmental and data privacy were the most common.

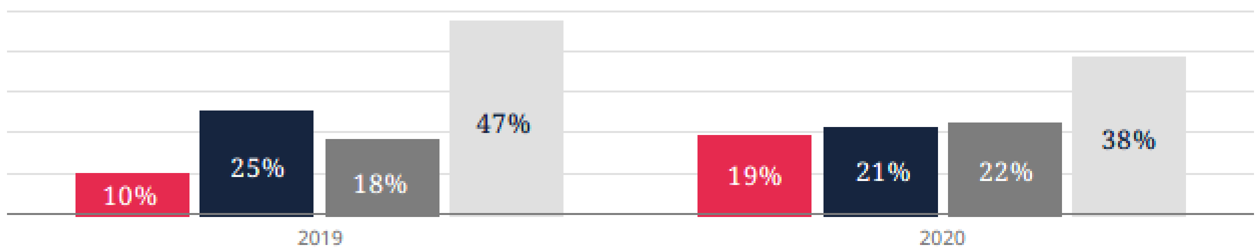
Europe



US



Asia Pacific



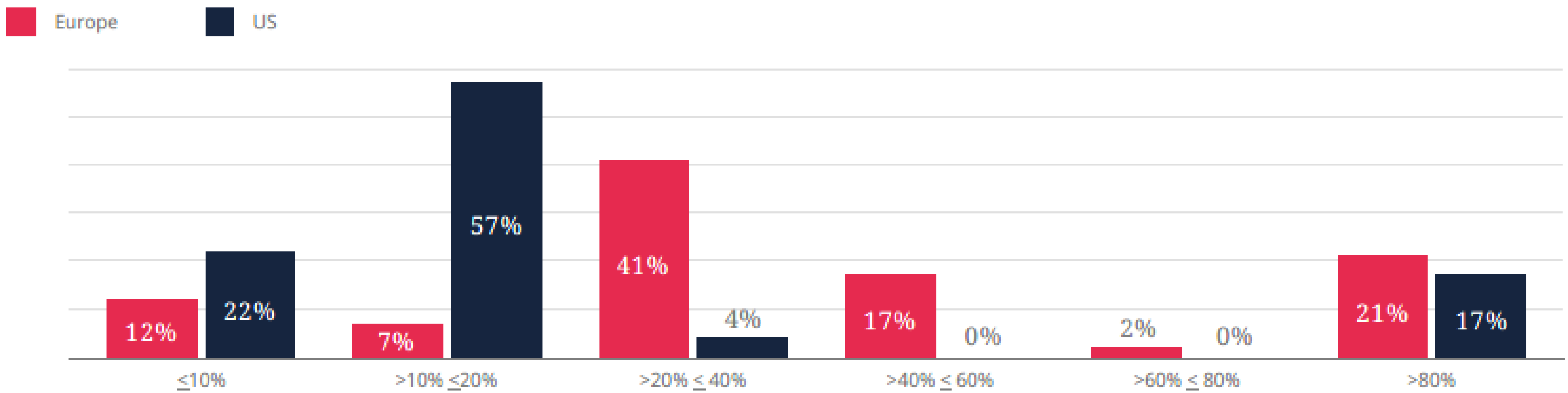
≤12 months   >12 months ≤18 months   >18 months ≤2 years   >2 years

8. Commercial warranties: Financial cap (excluding buy-side insured deals)

Outside the US, deal size and (to a lesser extent) deal process drove the level of the financial cap on commercial warranties. Caps in non-US deals were commonly between 40% to 100% of the price for small deals, 40% or less for mid-sized deals and 20% or less for large deals. Auctions continued to achieve lower caps than non-auctions, with the gap widening compared to 2019.

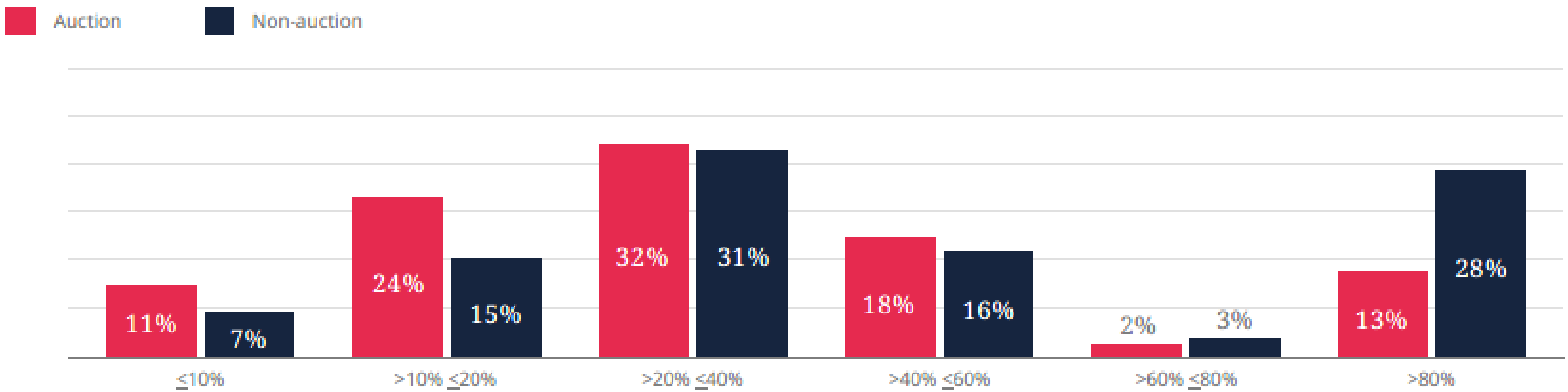
By contrast, financial caps in US deals on commercial warranties continued to typically be 20% or less of the price, irrespective of deal size or process.

Europe v US*



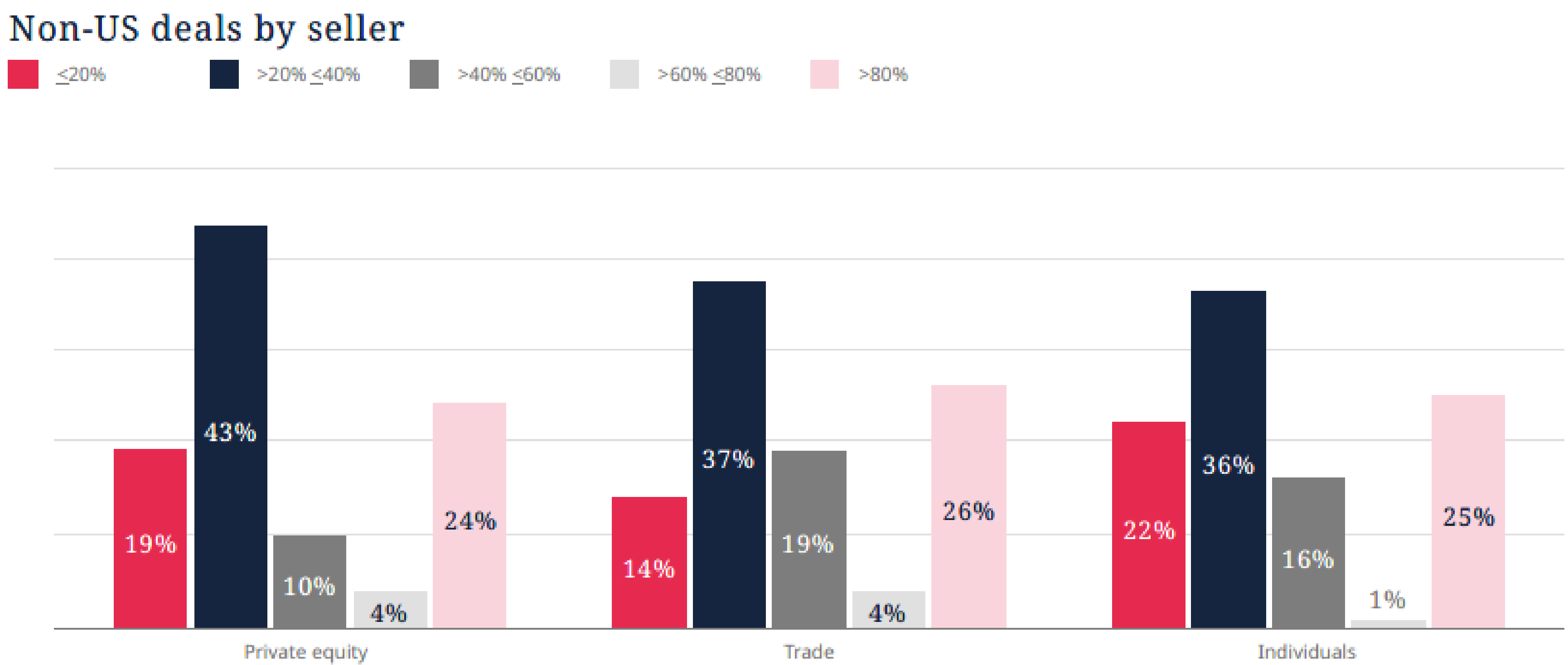
* Deals over EUR25 million

Non-US deals commercial warranty cap by process*



* 2018 to 2020

Outside the US, private equity sellers remained the seller class that achieved the lowest commercial warranty cap on uninsured deals. They generally resist giving commercial warranties and management are, therefore, required to give the warranties in these circumstances. For this reason, private equity sellers generally utilise deal insurance on their exits.



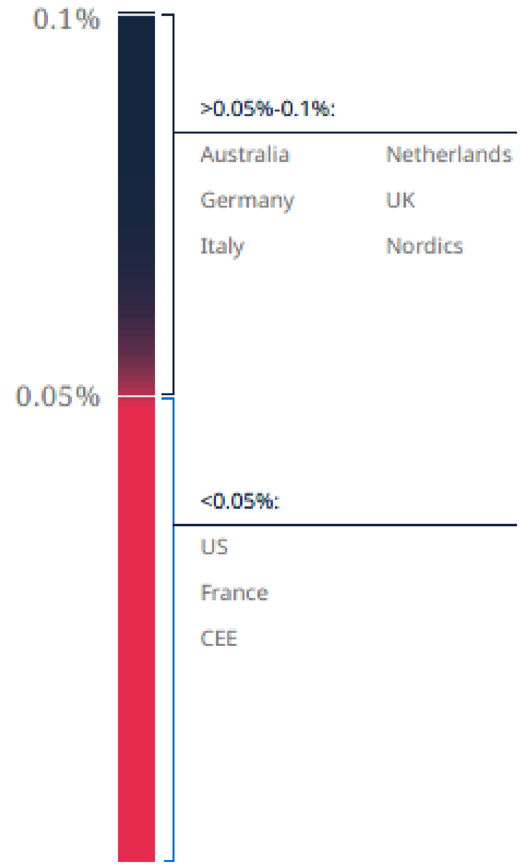
9. Small claims exclusion or 'de minimis'

When commercial warranties are being given, many jurisdictions outside the US include a small claims exclusion or de minimis (ie claims below a specified amount which are ignored completely or which are ignored in calculating whether any claims threshold or basket has been reached). It is standard market practice in most European jurisdictions (particularly in the UK, Benelux, Germany, Hungary, Italy and the Nordics) and in Asia Pacific.

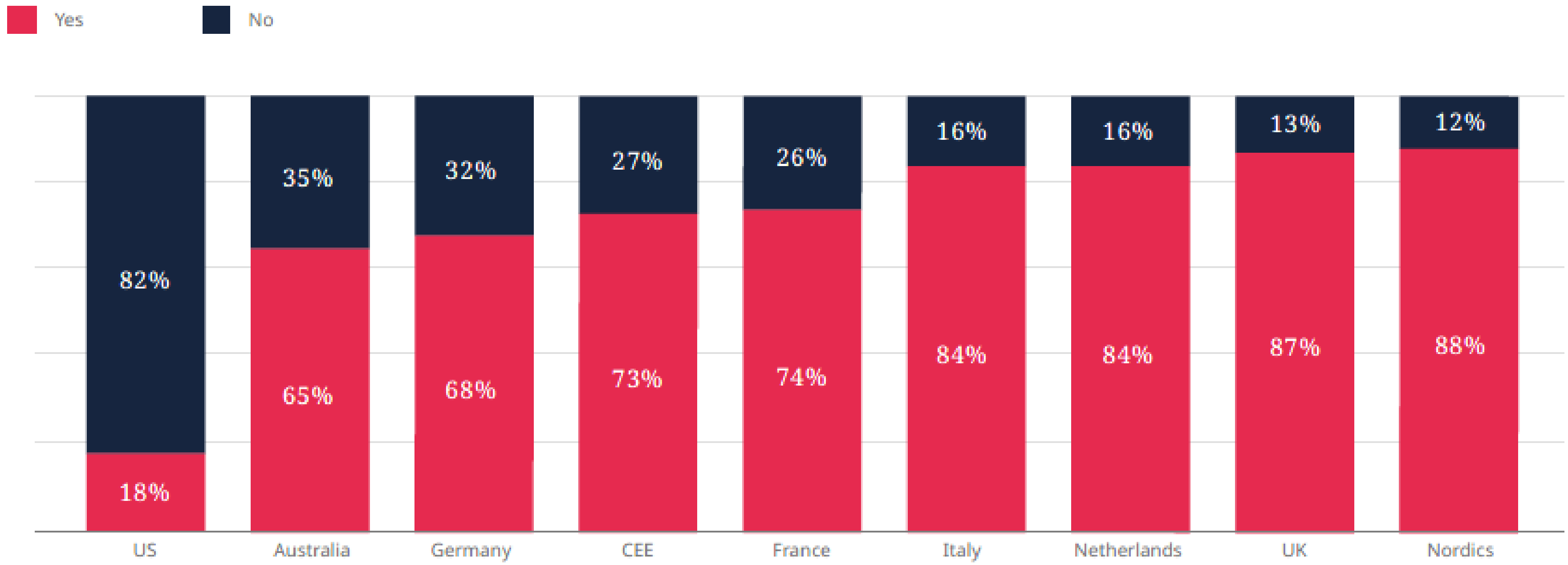
A small claims exclusion remains rare in the US market – only 18% of deals surveyed contained one.

Globally, small claims exclusions typically ranged from 0.05% to 0.4% of the price, the most common being >0.05%-0.1%. These tend to be set at an amount that is immaterial to the buyer – irrespective of deal size – resulting in the small claims exclusion being a lower percentage of the price as deal values rise.

Common small claims amount (% of price)



Small claims exclusion*



* 2018 to 2020

10. Claims threshold or 'basket' (excluding buy-side insured deals)

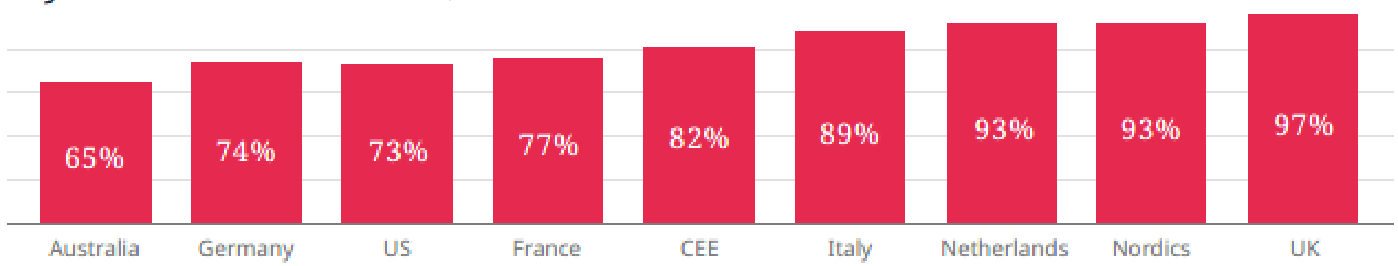
In non-insured deals containing commercial warranties, it is market practice in all regions surveyed to have a claims threshold or basket (ie an amount which claims must exceed before they can be brought against the sellers).

The claims threshold was set as a trigger or tipping basket in over 75% of the deals surveyed in Europe and Asia Pacific (ie when the threshold is reached, the whole amount is recoverable and not just the excess above the threshold). By contrast, in the US limits remained fairly evenly split between a trigger and an excess. Setting the threshold as an excess drove lower thresholds.

In all regions, the majority of claims thresholds continued to be 1% or less of the price paid. Auctions tended to result in lower claims thresholds, typically combined with a lower overall financial cap.

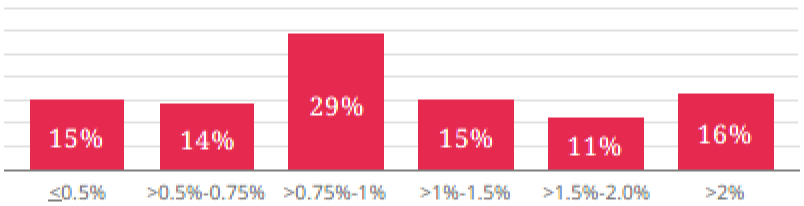
The trend seen in our COVID-19 report of a decrease in claims thresholds across the board has been replicated to some extent through 2020 as a whole (for example, in Europe 57% of deals have a threshold of 1% or less compared to 52% in 2019). This is indicative of a slightly more buyer-friendly market.

Deals with claims thresholds (excluding buy-side insured deals)*

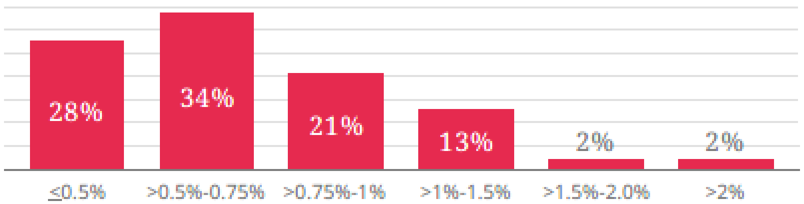


* 2018 to 2020

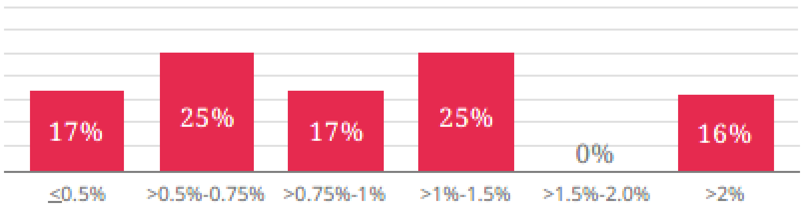
Europe



US



Asia Pacific

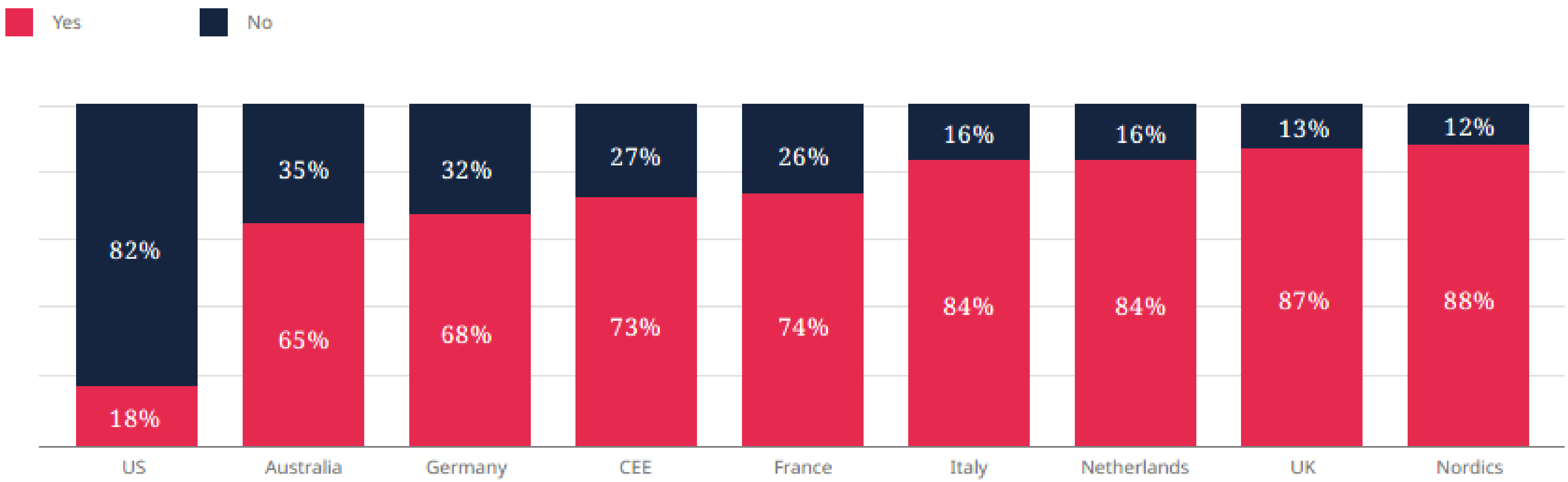


11. Approach to disclosure

While we saw a slight reduction across the board in 2020 of acceptance of general disclosure of data room contents against the warranties, it remains standard market practice in the Nordics, the UK, most of Continental Europe and Australasia (irrespective of deal process).

In Asia, specific disclosure was required in the majority of deals, and specific disclosure remains market practice in the US.

Data room disclosure*



* 2018 to 2020

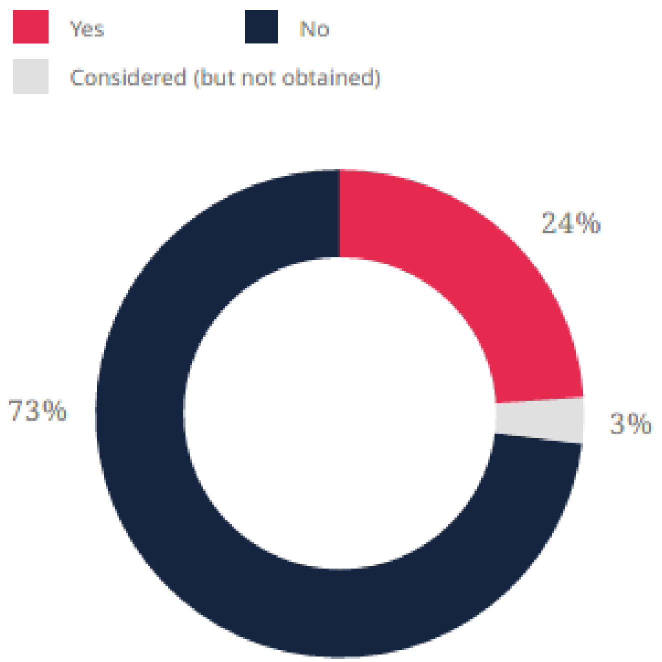
Insurance

12. Deal insurance

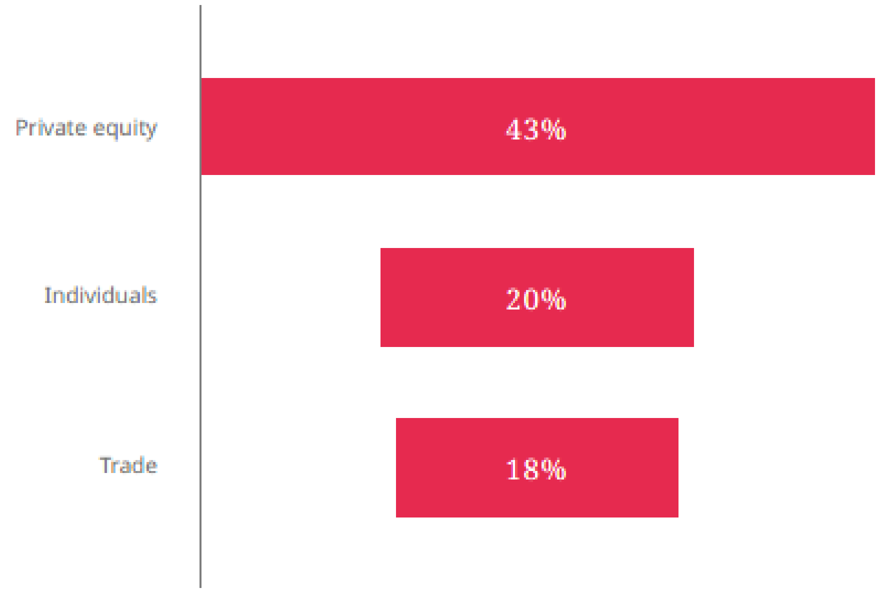
Use of M&A insurance remained an important facet of the private M&A market. In the deals surveyed, we saw the percentage of deals with buy-side insurance increase by nearly a quarter and a third more trade-to-trade deals used the product compared to 2019.

As expected given the nature of the liability profile on their transactions, private equity as a seller class continued to utilise buy-side insurance on its exits more often than other seller classes.

Deals with buy-side insurance



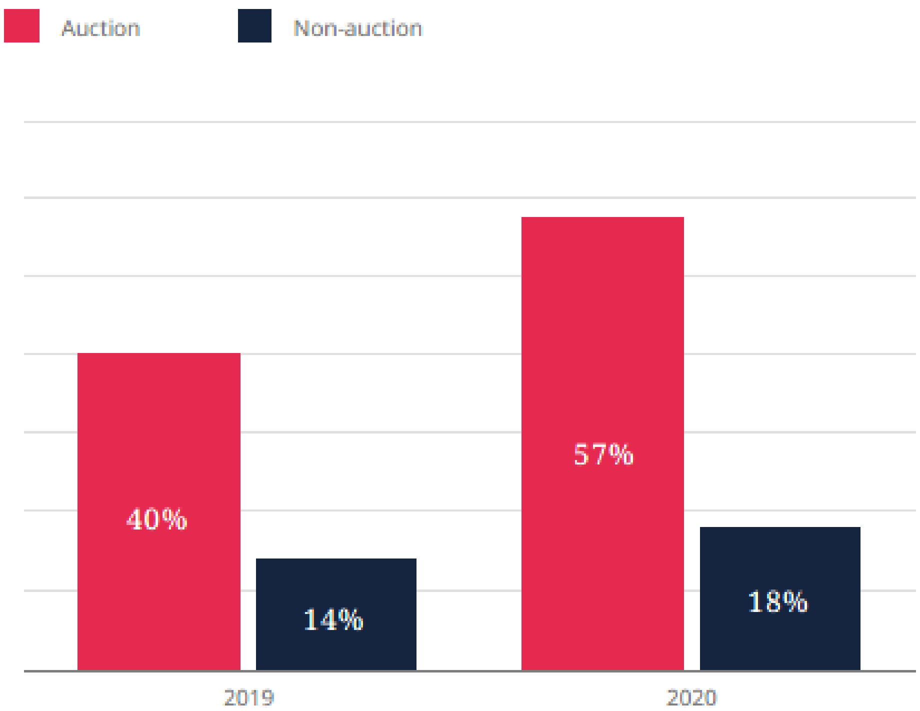
Use of buy-side insurance by seller



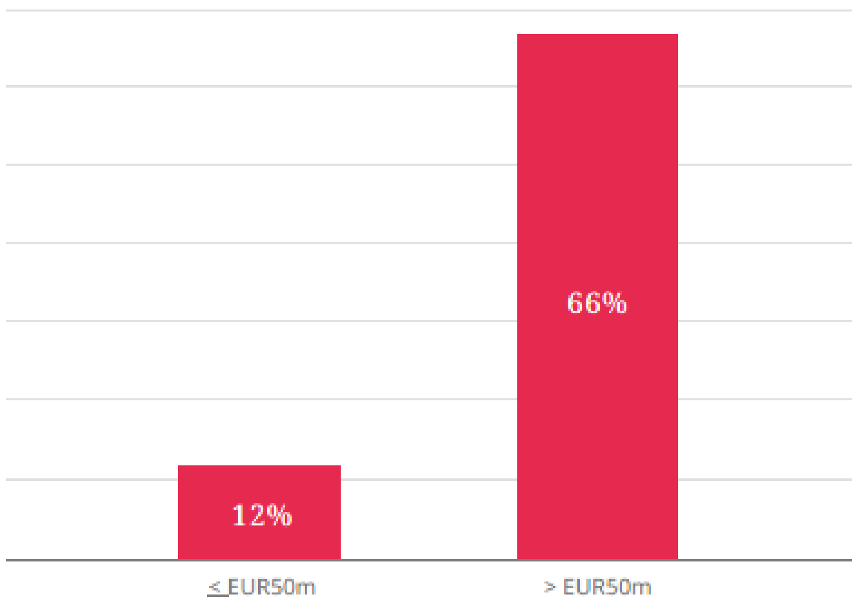
While originally typically used in auction processes, buy-side insurance is now used in more non-auction deals than auctions. However, buy-side insurance is still obtained on a much larger percentage of auctions than non-auction deals.

In 2019, we had seen the greatest growth in buy-side insured deals in sub-EUR50 million deals – this reversed in 2020, with limited use in smaller deals and increased use in deals over EUR50 million. This was, in part, driven by fewer auction processes for smaller deals and the comparative premium cost.

Buy-side insured deals by process



Buy-side insured deals by value



Emerging themes highlighted in our COVID-19 report became more stark as 2020 played out. The Lockton's Transactional Risks analysis of over 580 transactions in 2020 showed the following themes:

Underwriter appetite was more focused

H2 of 2020 saw a strong return of insured transactions with pricing remaining very competitive for the transactions that fitted within the market's appetite. TMT, healthcare, renewable energy, logistics and consumer goods deals were all being priced at a lower rate in Q4 2020 than Q4 2019. Conversely, COVID-19-affected sectors (such as hotel, retail and travel) saw the opposite. Underwriters continued to dig into the detail of due diligence, scrutinising financial forecasts, valuations, supply chains, customer contracts and employment matters in particular. More uncommon jurisdictions were also harder to place, as were large towers of insurance on GBP1 billion+ deals due to trends emerging from underwriters' claims data.

M&A insurance is coming under greater scrutiny from the wider insurance market

M&A insurance lines were protected from the wider hardening insurance market due to the number of competitive underwriters now in this market. Re-insurers and capacity providers are, however, increasingly concerned by loss ratios and putting pressure on markets to harden rates, particularly in sectors/geographies that have emerging claims trends.

Excesses and limits

Excesses continued to be a battle ground for underwriters, with a continued push by brokers for lower retentions. Whereas 1% of enterprise value was market standard only a few years ago, 0.25% of enterprise value is now often given for asset heavy businesses.

The market standard limit of 10-30% of enterprise value remains commonplace, but claims activity is starting to show that losses from warranty breaches can often go above 30%.

Premium and excess by region

REGION	PREMIUM (% OF LIMIT PURCHASED)		EXCESS (% OF ENTERPRISE VALUE)	
	2019	2020	2019	2020
Nordics	0.9-1.3	0.9-1.3	0.35-0.5	0.35-0.5
UK	0.8-1.2	0.7-1.2	0.25-0.75	0.25-0.75
Benelux	0.9-1.3	0.8-1.2	0.35-0.5	0.25-0.5
CEE	0.8-1.2	0.8-1.2	0.25-0.5	0.25-0.5
DACH	1.0-1.3	0.9-1.3	0.5-1.0	0.5-1.0
France	1.1-1.3	1.1-1.3	0.5-1.0	0.5-1.0
Southern Europe	1.0-1.3	1.0-1.3	0.75-1.0	0.75-1.0
MENA	1.25-3.0	1.25-3.0	1.0	1.0
Sub-Saharan Africa	0.9-1.2	0.9-1.2	0.5-1.0	0.5-1.0
US	2.5-3.5	2.5-3.5	1.0	1.0
Latin America	2.75-4.5	2.75-4.5	1.0-2.0	1.0-2.0
Asia	1.1-1.8	1.0-1.8	0.5-1.0	0.5-1.0
Australasia	0.9-1.2	0.8-1.2	0.5-1.0	0.5-1.0

Innovative products will continue to gather momentum

In order to gain market share and increase premium, markets are continuing to push at the boundaries of the possible. This is generally falling into two camps:

- expanding the existing insurance product, with policy additions such as non-disclosure of the data room or due diligence reports; and
- greater use of contingent risk and tax Insurance policies, with underwriters' appetite to take on known, identified risks expanding significantly.

Claims

Underwriters are not yet reporting any significant increase in claims activity but remain cautious. Warranties on accounts/financial statements, contracts, third-party claims and tax continue to be the most breached and, with tax authorities around the world under huge pressure to drive in tax receipts, tax claims could well increase.

20% of policies have notifications and in Lockton's experience valid claims are paid out in a timely fashion by underwriters who are keen to avoid litigation.

The market is now reaching a point of maturity with the 2015 book of business (widely accepted as the year W&I started to become a popular product) reaching the end of its policy term. Underwriters therefore are becoming ever more sophisticated at analysing which jurisdictions, sectors and warranties are riskier and are therefore adjusting their pricing accordingly. The biggest claims remain in the US where pricing is nearly three times that of European premiums.

Restrictive Covenants

13. Restrictive covenants

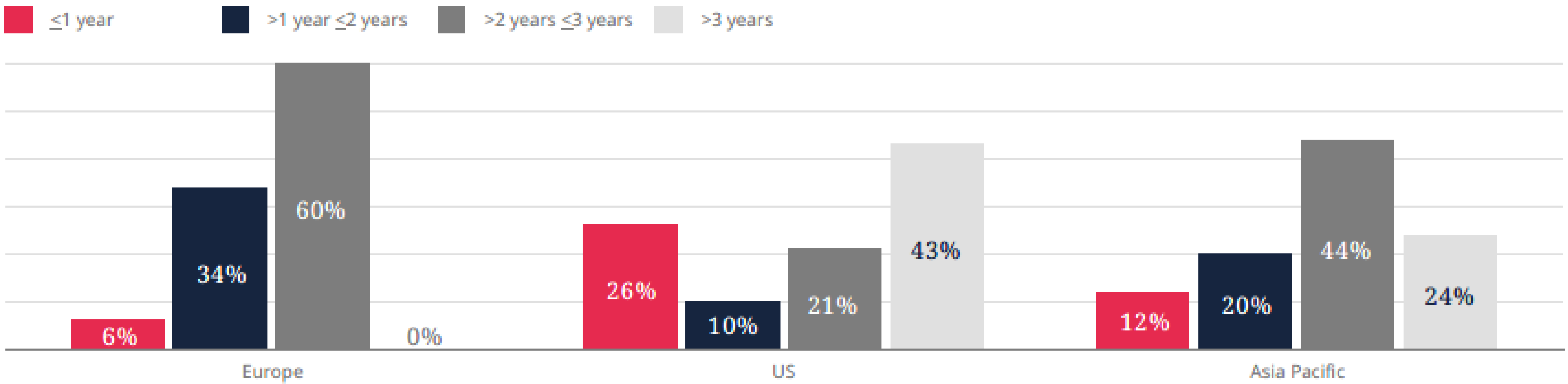
Globally, we saw restrictive covenants in approximately 75% of deals surveyed, with some regional variation. Trade sellers that hold retained businesses with similar activities to the target and private equity sellers typically resist giving restrictive covenants.

Restrictive covenants given were typically a general non-compete combined with a non-solicitation of people, customers and/or suppliers (depending on the nature of the target business).

Time periods remained the same, with regional variations principally driven by enforceability issues in the relevant jurisdictions. The most common restricted period was over three years in US deals, compared to greater than two years but three years or less elsewhere.

Generally, time periods were similar for both non-compete and non-solicitation covenants, with deal process having minimal impact. Interestingly, Denmark has introduced a six-month limit on non-solicitation of salaried employees.

Non-compete periods

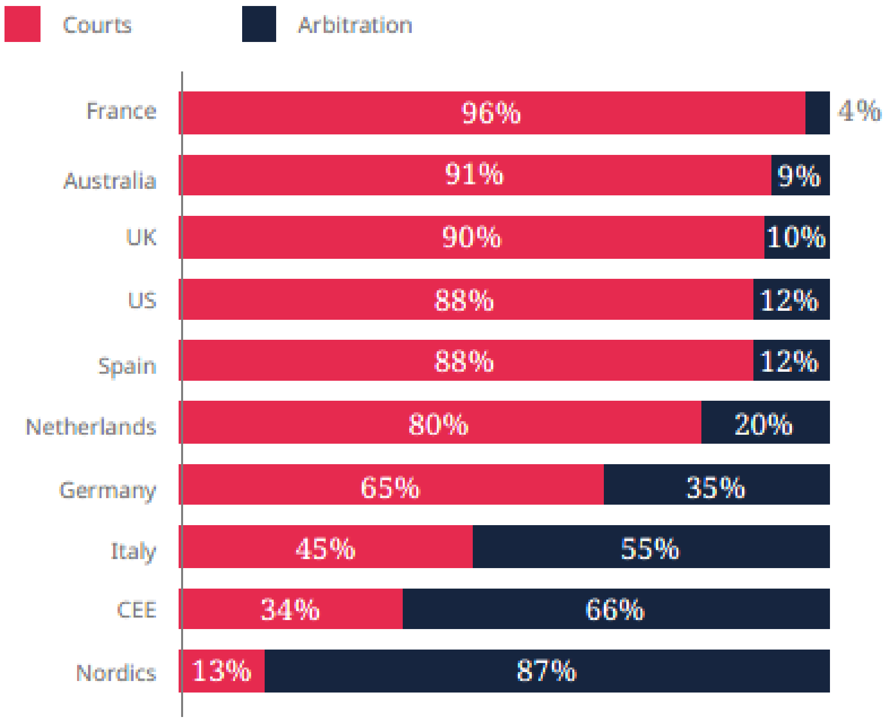


Disputes

14. Dispute resolution

The courts remained the prime forum for disputes in Australasia, the UK, the US and much of Continental Europe. The Nordics and Asia continued to favour arbitration. It also remains common in parts of Continental Europe (particularly in central and eastern Europe and Italy).

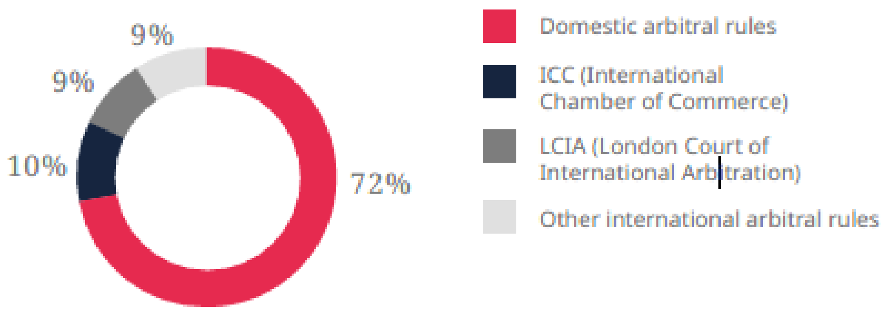
Dispute resolution*



Arbitration is used when it provides a quicker and more suitable method of dealing with complex M&A disputes than the local courts, for confidentiality reasons or, in non-domestic deals, when arbitral awards are easier to enforce in the relevant jurisdictions.

Domestic arbitral rules were used when arbitration was the preferred dispute resolution procedure in that jurisdiction, with international rules being used on deals with parties from multiple jurisdictions.

Arbitral rules*



Questions?