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Advisory

Pinsent Masons

PE M&A Report
2022

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Executive summary

Welcome to the 2022 edition of our annual review examining deal terms and trends in the M&A and private equity markets. For the fourth year running we are delighted to work alongside Howden M&A and Arrowpoint Advisory to pool our deal data, which we believe (as with previous years) provides the most comprehensive analysis of UK mid-market transactions available for review by buyers and sellers alike. We hope it continues to prove useful in assisting benchmarking on what constitutes 'market practice'.

In our 2021 report we commented on high levels of deal activity after an initial period of uncertainty as the world was gripped by the pandemic and lockdowns. Indeed as last year's report was being finalised the world had been subject to further lockdowns and how this would impact on M&A and PE activity for 2021 was unclear. As it was, the acceleration in deal activity seen towards the end of 2020 continued into 2021 and the global M&A markets had a record year! This was largely driven by abundant liquidity, a backlog of transactions from a pandemic disrupted 2020 and increased investor confidence driven by the global vaccine roll-out.

The UK M&A market reflected these broader global trends with private equity having a particularly strong year. Certain assets in sectors less impacted by the pandemic attracted some of the highest valuations and the most aggressive deal processes. Auctions were often very competitive and fast resulting in investors focussing their attention on competing aggressively on a far smaller number of assets where they had real internal sponsorship or a (so called) 'angle'.

Sectors seeing high levels of activity included technology, financial services, life sciences and healthcare and "digital" retail and consumer. Indeed sectors that were not reliant on physical presence were well placed to take advantage although some of the most successful businesses during the pandemic are now finding previous high demand for their products or services cooling off slightly and uncertainties exist around post-pandemic trends, how they will impact the sustainability of longer-term revenue and earnings growth. It will be interesting to see how these businesses fare.

While we noted in our 2021 report a subtle hardening of buyers' negotiating positions, driven by the caution and uncertainty around growth and level of investor returns, huge competition for the best investment opportunities saw a return to the sellers' market witnessed in pre-pandemic times – shown in a number of areas including a reduction in the use of MAC provisions and deferred consideration and an increase in pari passu ranking in all respects between investor and management loan notes. In other areas, trends seen over recent years continued.

The high levels of M&A activity saw developments in the W&I market over the course of the year driven by resource and capacity constraints prompting an increase in premiums, insurers taking an increasingly selective approach and a decrease in the ability of insurers to offer 'trees' for non-exclusive bidders on competitive processes. The report explores these developments in more detail.

In this year's report we have taken the opportunity to include commentary from the Pinsent Masons corporate teams in Germany, Spain, Ireland, France, and Netherlands for their perspective on deal trends in their jurisdictions, drawing out notable features to provide more of a European view beyond the UK perspective. We hope you find these comments enlightening.

As we reach the end of the first quarter of 2022, there are number of factors which may influence M&A activity and investor confidence over the course of the year. As we write fears of a war in Ukraine have become a reality with the risk of wider escalation, increasing fuel and energy prices feeding into wider inflationary / cost of living pressures and the spectre of higher taxes to pay for economic support measures during the pandemic are challenges that will no doubt be factored into buyers' thinking. However, given the various challenges the market has faced over recent years it is nothing if not agile and resilient and notwithstanding this backdrop, activity levels remain high and we are cautiously optimistic this will remain the case for the rest of 2022 and beyond.

Ed Stead
Head of Private Equity
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Daniel Stock
Head of UK W&I
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Head of Management Advisory
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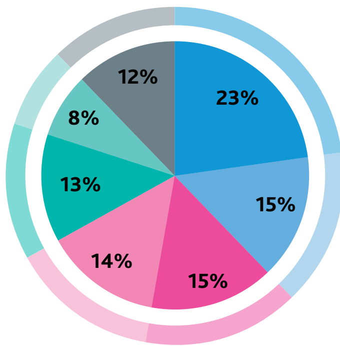
Survey methodology

This report presents the findings of our annual survey of the combined transaction data of Pinsent Masons, Howden M&A and Arrowpoint Advisory. We analysed data from 179 transactions completed in 2021 (compared to 183 in 2020) with a combined transaction value of £33bn (where disclosed) up by over 54% on 2020. The average transaction value across all deals was just under £198m, significantly up on the average seen in 2020.

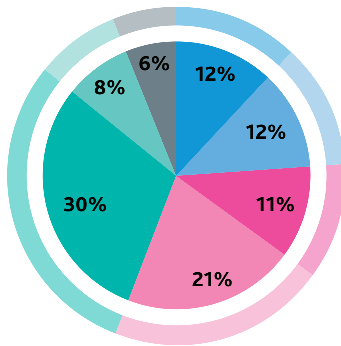
Our data was comprised of 80 private equity backed transactions at a combined value of £18.7bn and 99 trade transactions at a combined value of £14.1bn. At £235m, the average private equity transaction was significantly higher than the average trade transaction (£143m), which is consistent with previous years.

The Technology sector once again saw the largest number of transactions by volume, accounting for 23% of the total followed by Financial Services and Life Sciences & Healthcare each with 15%. Despite accounting for just 13% of transaction volume the Retail & Consumer sector accounted for 30% of total transaction value, followed by Diversified Industrials at 21%.

Transactions by sector



Transaction value by sector



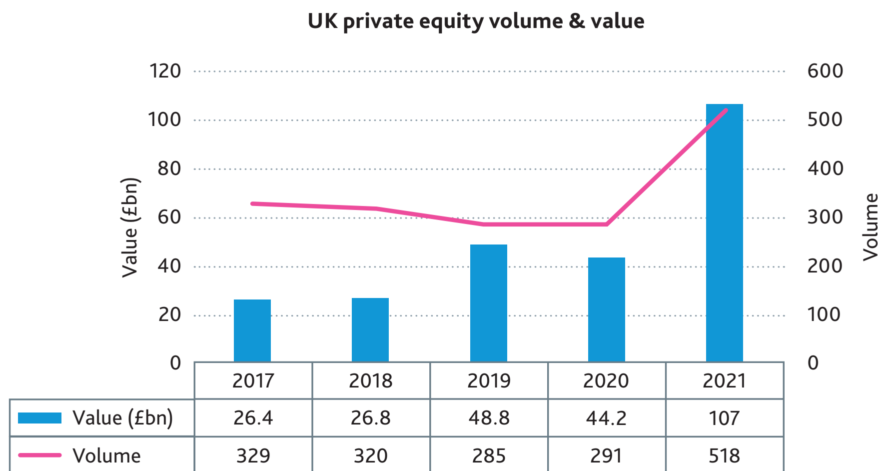
Key:
- Technology
- Financial Services
- Life Sciences & Healthcare
- Diversified Industrials
- Retail & Consumer
- Energy & Infrastructure
- Other

Market view

Global M&A markets had a record year in 2021 driven by abundant liquidity, a backlog of transactions from a pandemic disrupted 2020 and increased investor confidence arising from the vaccine roll-out. Data from Refinitiv suggests global transaction values hit $5.8 trillion, a 64% increase on 2020.

The UK M&A market reflected these broader global trends with MergerMarket recording over 2,000 transactions involving UK based businesses for a total value of £309bn, equating to over 700 more transactions than 2020 and £70bn of additional transaction value.

Private equity had a particularly strong year with over 500 UK transactions completed at a value (where disclosed) of over £100bn.



	2017	2018	2019	2020	2021
Value (£bn)	26.4	26.8	48.8	44.2	107
Volume	329	320	285	291	518

Source: MergerMarket

Despite the initial concerns for the global economy at the beginning of the pandemic in February 2020 it soon became clear that the virus wouldn't affect all sectors in the same way. In fact, quite the opposite. Across the consumer sector, for example, the pandemic has hit those businesses that rely on a physical presence (e.g., cinemas, nightclubs, pubs, restaurants etc) extremely hard, with many not surviving despite unprecedented levels of government intervention. However, the various periods of lockdown over the past two years have lit a torch under those businesses that supported remote working and living (e.g., general tech, video conferencing, takeout food delivery, prepared meals, grocery stores, fitness apparel to name but a few) and/or were ahead of the digital revolution and had business models that were set to thrive in a distanced world (e.g., online retailing, home workouts, music streaming etc). Those businesses that were either already well placed to take advantage of the rapid acceleration of transformational sectoral trends (or were able to pivot successfully) enjoyed strong sales, whilst others missed out and suffered, creating a hugely divergent landscape of Covid 'winners' and 'losers'.

The huge increase in digital, as opposed to physical, consumption together with the increase in the level of household savings as a result of fewer holidays, less spending on entertainment etc, has meant that some retailers have had direct access to consumers with more money in their pocket and with fewer options to spend it on. The best retailers and brands have used engaging content to draw people in and retain them as repeat customers, enabling them to not only aggressively capture market share and revenues in a fast-growing market, but also catapult forward some previously unknown digitally native brands. This has driven a range of exciting deals across the retail and consumer sector, as well as the tech and services sectors supporting it.

Global M&A markets had a record year in 2021 driven by abundant liquidity, a backlog of transactions from a pandemic disrupted 2020 and increased investor confidence arising from the vaccine roll-out.

The million-dollar question is whether the appetite and trend for digital-led consumer brands (and those supporting this ecosystem) will continue. Some of the most successful businesses during the pandemic are now finding demand for their products/services dwindle as consumers are being offered more choices to spend their earnings/savings. Uncertainties around post pandemic trends and how these will impact the sustainability of longer-term revenue and earnings growth, and concerns over macro-economic volatility, have led many investors and buyers to seek assets with strong levels of predictable and recurring revenues/earnings, as well as the potential for global scaleability, many of which are tech enabled. These assets have attracted some of the highest valuations and most aggressive deal processes in the past 12 months. In parallel, some investors are shifting their investment strategy from growth to value companies (i.e., seeking companies that are more mature and throw off regular income but have less of a growth story). That might lead to more traditional PE style acquisitions of businesses that can hold debt because of regular cashflows rather than the recent spate of growth capital deals in fast revenue growth but low profit businesses.

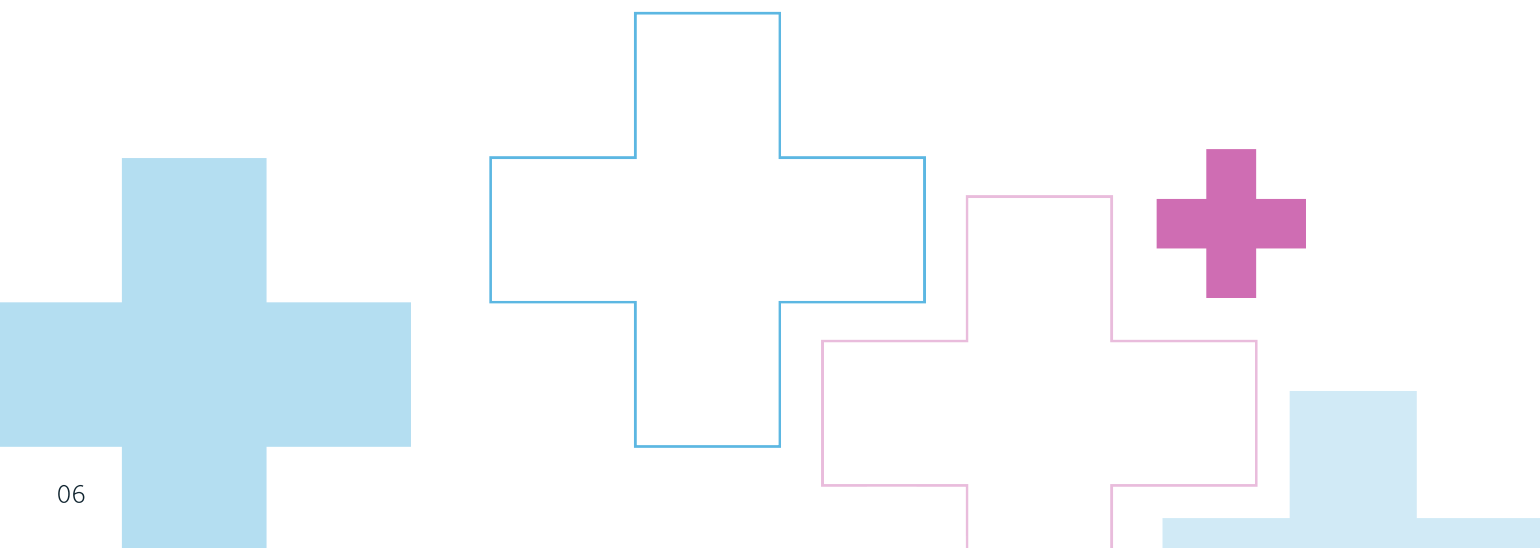
That might be the theory behind some of the recent public to private transactions (for example CD&R's takeover of Morrisons). Time will tell if the high growth deals will be replaced with more typical takeover activity involving more traditional, undervalued income generating companies. That certainly might be the case given the limited success of some of the recent SPAC deals involving high growth, tech enabled companies. We wonder if that bubble has burst.

When you pour onto an already hot M&A market the rocket fuel of quantitative easing, low interest rates, and the paucity of alternatives to make good returns, it is easy to understand why there has been huge competition for the very best investment opportunities. The increased demand and limited supply has led to investors either looking at earlier stage investments or when all the stars align being prepared to pay much higher valuations. That, in part, explains the increased deal volume and higher pricing in the mid-market. However, it would be wrong to believe that this backdrop of high deal volumes and increased pricing meant that sellers (and their advisers) had it all their own way in 2021. The current market conditions have put a lot of investors and buyers off buying assets across the board, preferring instead to focus their attention (and their cheque books) on competing aggressively on a far smaller number of assets where they have real internal conviction.

This has led to buyers and investors turning down a far larger proportion of deals at an early stage than in previous years, which in turn resulted in a need to expand processes to include significantly more parties than in the pre Covid period (even if the eventual number of seriously committed parties was similar).

From our own experience, as we write this report, the activity levels, particularly in private equity, do not seem to be abating, although investors remain picky. Leaving aside certain perceived riskier consumer sub-sectors, the volume of debt available has not reduced, even if the pricing seems to be tightening. Private equity funds still have capital to deploy and they need to execute transactions as a result. However, pricing of public company stocks has fallen, which has a knock-on effect on valuations in the private arena. We are also seeing more secondary buy-out processes impacted by the trend for some incumbent private equity houses to pass investments from an old to a new (or continuation) fund, most often where the price that third party buyers have been prepared to pay hasn't matched sellers' price expectations. As a result certain assets are being held for a far longer period, inevitably leading to lower activity.

We should also mention by way of a legal development, the National Security and Investment Act (NSI Act) which came into full force on 4 January 2022. This new regime introduces new requirements for foreign direct investment in certain business sectors with the potential to impact national security. The UK government considers that the NSI Act is going to result in far more regulatory scrutiny of transactions from a foreign direct investment standpoint and estimates 1,750 transactions each year will require notification under the new regime, and of these, up to 100 will require an 'in depth' review on national security grounds. The regime creates notification requirements for certain transactions in designated 'key sectors' either on a voluntary or mandatory basis. The inevitable impact of the regime is to increase the pressure to split exchange and completion – many parties will not want to 'break cover' and make a notification until a deal has been agreed and the parties legally bound to transact. That will give rise to a keener focus on control in the interim period between exchange and completion and the allocation of risk i.e., the scope of interim covenants, whether warranties will be repeated at completion, MAC clauses and termination rights in these circumstances.



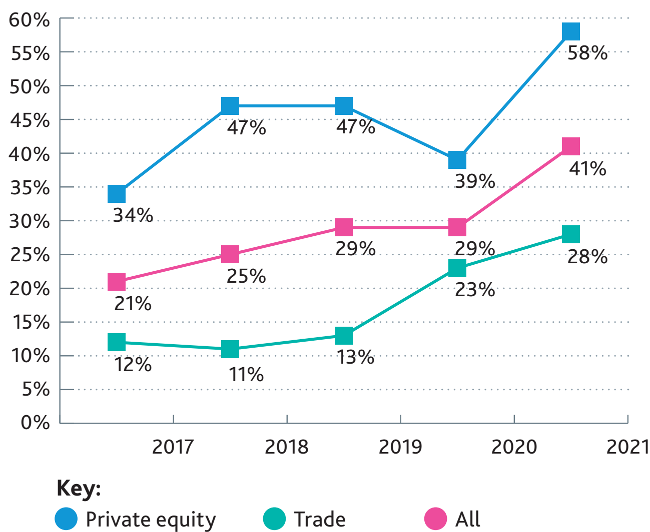
Deal process trends

Across all of the transactions under review 41% were conducted via an 'auction' process, but the figure for private equity was at its highest level in five years at 58% of transactions, which was a rebound from 2020 and more commensurate with previous years.

Interestingly, whilst auctions accounted for 57% of total deal value across all private equity and trade deals, across our private equity transactions auctions accounted for just over 70% of total transaction value with an average value of £289m.

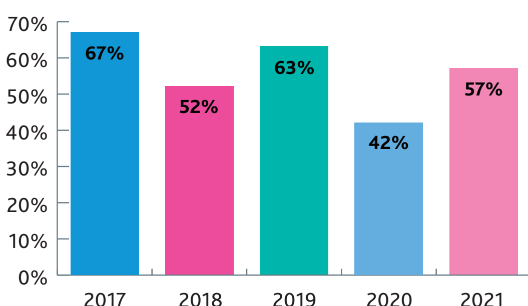
The increase in competitive auction processes reflects the increase in seller negotiating power from the less confident times of 2020. Auctions in 2021 were often very competitive and fast, particularly where the field comprised a number of 'conviction' investors chasing the 'perfect asset'. They give little time for relationship building (in fact, keeping the parties apart seems to be part of the aim these days). As private equity owners are typically focused on maximising price, auctions work well for the institutions. However, trade may have a broader set of goals (e.g., synergies, cultural fit etc) which require more interaction over a longer period of exclusivity. That opportunity is rarely available in a strictly refereed auction process.

Transactions via an auction process



Key:
Private equity Trade All

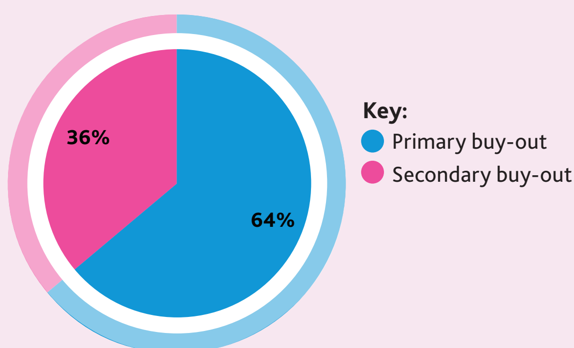
Share of total transaction value generated via an auction process



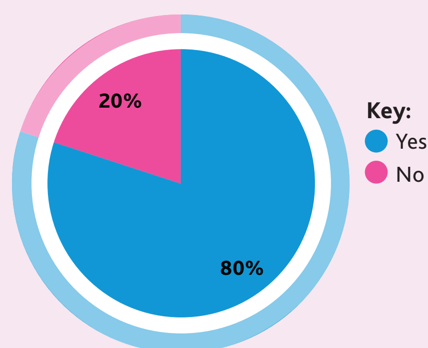
Last year we noted a big increase in the proportion of private equity deals that were secondary buyouts, with such transactions rising from 14% in 2019 to 38% in 2020, and this ratio has been maintained in our 2021 data with secondary buy-outs now accounting for 36% of private transactions.

Where a transaction was completed via an auction process a period of exclusivity was granted in 80% of transactions which is consistent with previous years.

Was the deal a primary or secondary buy-out?



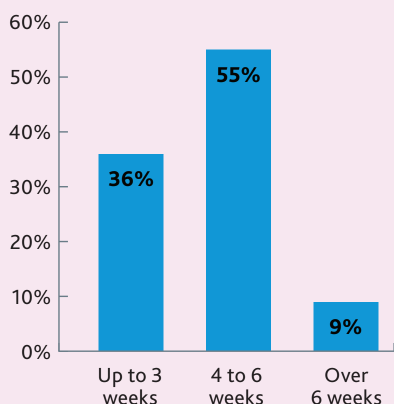
Was a period of exclusivity granted?



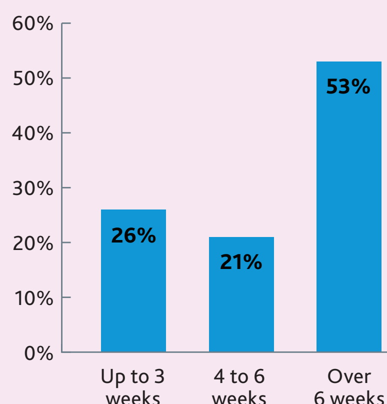
In over half of relevant transactions an initial exclusivity period of between 4-6 weeks was standard, with under 10% of sellers granting an exclusivity period of more than 6 weeks, which is consistent with prior years. However in 2020 we noted a distinct lengthening of the period between granting exclusivity and ultimate exchange and completion and indeed the length of time needed to complete deals in 2021 appears to have lengthened again with over half of the transactions taking more than 6 weeks to complete (up from 29% in 2020).

Whilst many investors or buyers who competed in some of the hottest, highly competitive auction processes in 2021 (where no exclusivity was granted and in many cases shortlisted parties fought to the end in contract races) might find this result a little surprising, this is perhaps more indicative of the larger number of competitive auction processes in the market last year. Even the most convinced buyers and investors having won the right to be chosen as the front runner still ultimately faced the need to deal with the complexities of projecting and diligencing growth in the middle of a pandemic. Some bidders arrived at the 'finishing line' with a high price, only to find it difficult to obtain sufficient clarity on future earnings to justify the valuation required to win the auction and get their internal Investment Committee or Board approval to complete. That has inevitably led to more time being taken to dig into the numbers and ensure that future growth prospects are justifiable.

What was the length of the initial exclusivity period granted?



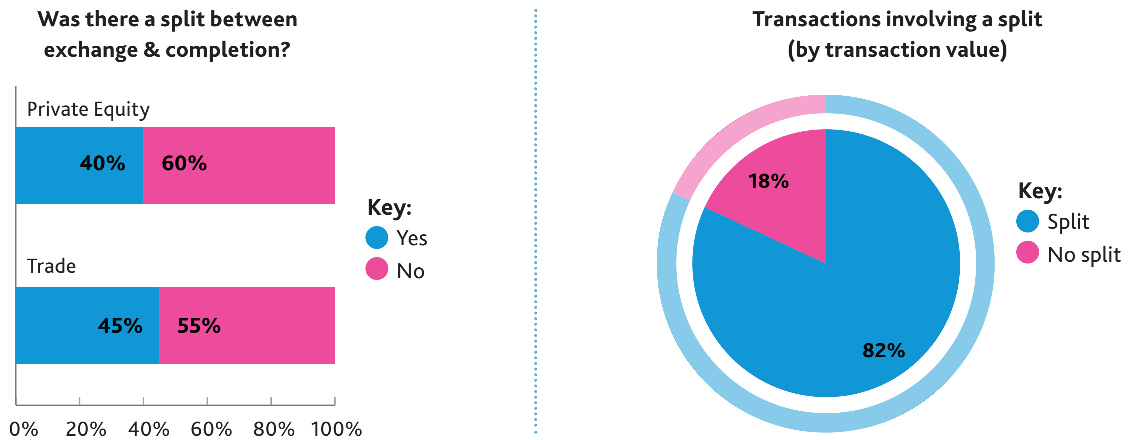
How many weeks were there between granting exclusivity and ultimate exchange & completion?



Split between exchange and completion

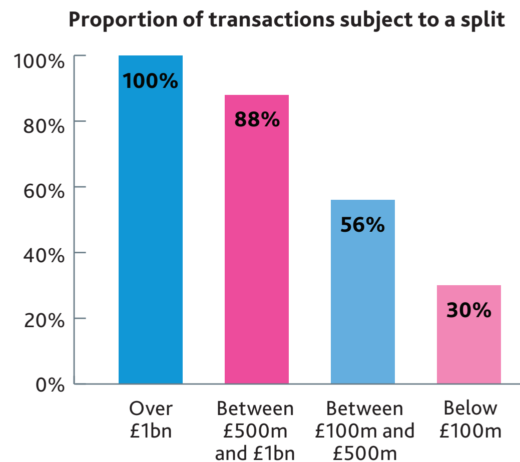
Slightly more private equity transactions were subject to a split between exchange and completion this year (40% compared to 34% in 2020), but there was little difference in the split for trade transactions. A split between exchange and completion in private equity deals enables financial sponsors to execute quicker than they otherwise would do: debt can be raised and long form equity documentation can be drafted and negotiated in between exchange and completion, leaving less to do before signing. In short, it's a tool that the savvy buyer can use to shorten the deal process thereby reducing execution risk for the seller and positioning themselves as a more attractive bidder as a consequence.

In terms of total transaction value 82% of total value was subject to a split which was up from the 67% in 2020 but more in line with historic norms.



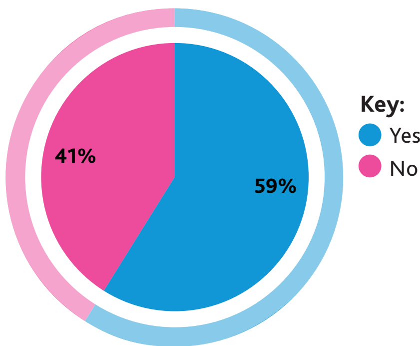
The rule of thumb is that the higher the value of the transaction the more likely there is to be a split between exchange and completion and this held true of 2021, though we also saw a higher volume of transactions in the £100m to £500m range being subject to a split.

The increased size of deals, the increase in regulation and the more global presence of the target, buyer and seller give rise to more anti-trust and other regulatory clearances. Where clearances are required parties are often keen to nail down the terms of the transaction by exchanging before going public with their filings. Completion often cannot occur before the regulatory consents are obtained, giving rise to more split exchange and completions.

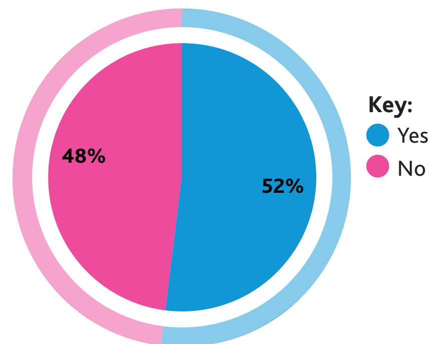


Warranties given by sellers at exchange were repeated at completion in 59% of transactions, the same as in 2020 and in line with historic data. Where warranties were repeated at completion a second round of disclosure was allowed in 52% of transactions down slightly from the 57% seen in 2020 but reflecting a long-term decline in the number of transactions where a second round of disclosure has been allowed.

Were the warranties repeated at completion?



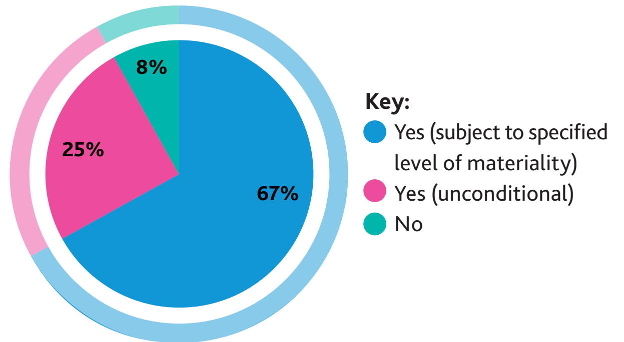
Was a second round of disclosure allowed?



The buyer was contractually permitted to walk away for a material breach of warranty or interim covenants during the gap between exchange and completion in 67% of transactions up from 53% in 2020. Far fewer transactions allowed the buyer to walk away regardless of the materiality of the breach (25% compared to 40% in 2020). It remains unusual for buyers to be prevented from walking away for a seller's breach during the interim period with less than 1 in 10 transactions having no buyer termination rights. On the face of it this data may be surprising because in competitive auction processes you wouldn't expect to see a buyer having a termination right (e.g., for breach of warranty). However, sellers are often happy to provide termination rights for actions within their control, for example tightly worded covenants relating to the operation of the business in the interim period.

We expect trends around split exchange and completion and positioning of parties to be subject to renewed negotiation in light of the NSI Act coming into force in January 2022 (see elsewhere in this report). This could increase the pressure to split exchange and completion as those deals in designated 'key sectors' are notified to the Secretary of State for review. It will be interesting to see what impact this new regime will have on the above trends and whether we see any (or all) of these trends shifting materially in the allocation of risk between buyers and sellers and indeed whether any whether any new trends emerge as a consequence.

Was buyer contractually permitted to terminate for a breach of warranty/interim covenants during the gap between exchange and completion?



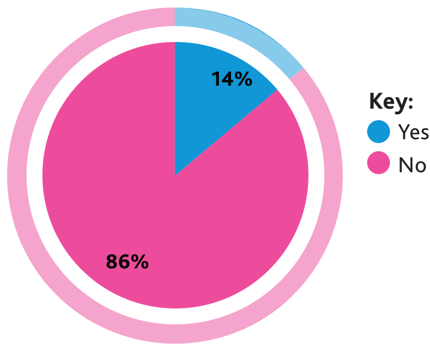
The buyer was contractually permitted to walk away for a material breach of warranty or interim covenants during the gap between exchange and completion in 67% of transactions up from 53% in 2020.

MAC clause

Use of more general MAC clauses continued to decline, reaching the lowest level in the five years that we have been tracking this data. Only 14% of transactions utilised a MAC clause in 2021 down from 27% last year and as high as 45% in 2018.

This is indicative of sellers' negotiating strength during the year - sellers have been able to push the risk of material unforeseen events on to the buyer and resist any requests for a MAC clause.

Was there a MAC clause?

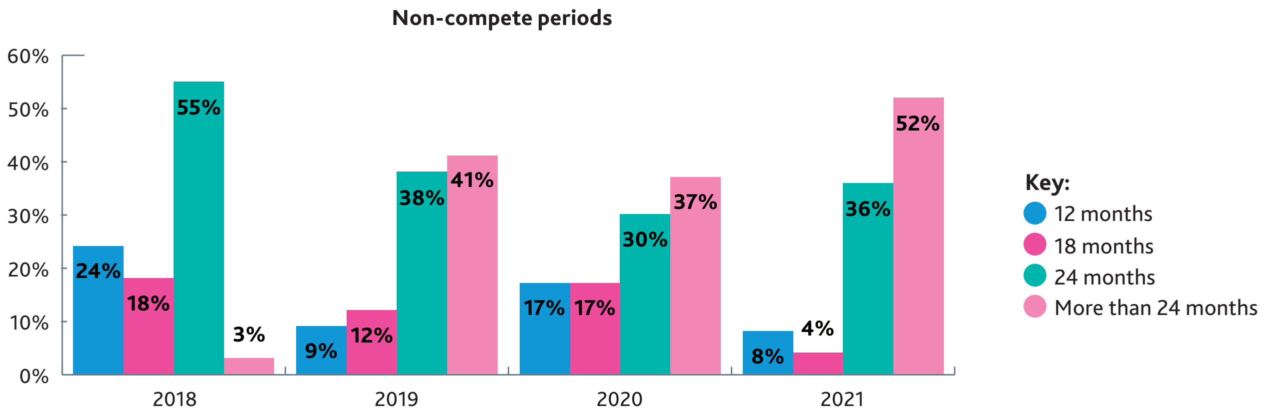


We may well see a reverse in the decline of MAC clauses in 2022 as more transactions are subject to split exchange and completion due to the introduction of the NSI regime, greater regulatory oversight and general market uncertainty.

Deal terms

Non-compete periods appeared to have shortened last year but have lengthened again this year, with over half of transactions requiring a non-compete period of more than 2 years – a remarkable rise from the 3% seen in 2018.

With the unbelievably quick growth of target businesses during the pandemic and the hot competition for quality, high potential businesses, companies are often being acquired at an earlier stage of development than in previous years. Founders and management teams are more important to earlier stage businesses than to their mature competitors. If you factor the buyers' need to retain talent and the full price buyers are paying, buyers are keen to use all levers available to encourage founders and management to stay to help deliver the further growth promised in the sales documentation. One such lever is the non-compete clause. Not surprising then that the length of the covenants has increased in 2021.

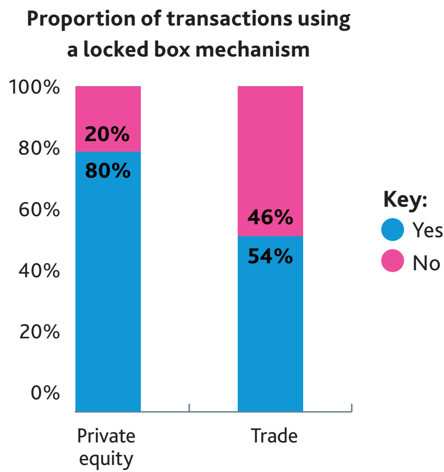


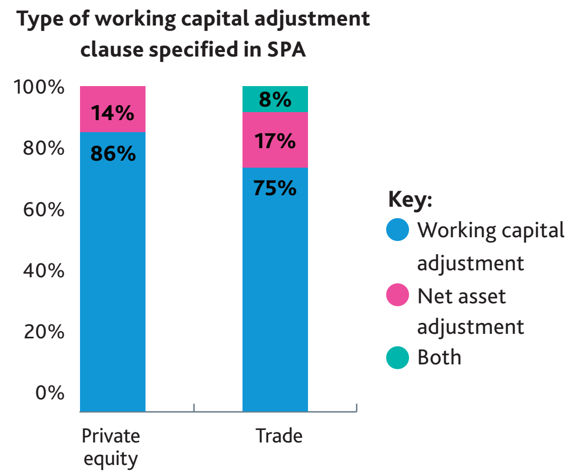
Non-compete periods appeared to have shortened last year but have lengthened again this year, with over half of transactions requiring a non-compete period of more than 2 years – a remarkable rise from the 3% seen in 2018.

Locked box, completion accounts and deferred consideration

There has been an ongoing increase in the use of the locked box mechanism in both private equity and trade transactions, with similar increases in both private equity and trade deals, with the use of locked box in private equity transaction up to 80% from 58% last year and from 29% to 54% for trade transactions. As locked box use is becoming market standard, trade is catching up with private equity. Whilst a locked box prevents lengthy negotiation of the working capital, cash and debt numbers post deal it is increasing the amount of upfront diligence undertaken on the target balance sheet. A well-advised seller will have in-depth financial vendor due diligence that will prepare the ground for a constructive discussion on the correct levels of working capital. Many buyers are now preferring the more detailed pre-exchange diligence and negotiation process over less pre-exchange information and the potential for a post-completion dispute.

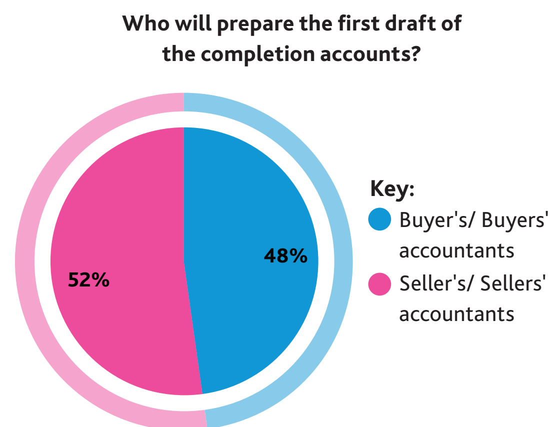
Where an adjustment clause was specified in the SPA it was typically a working capital adjustment which was prevalent in 86% of private equity and 75% of trade transactions.





Whether buyers or sellers prepare the first draft of the completion accounts is a common area of debate and the 2021 data indicates a shift towards sellers with the task falling to the sellers' accountants in 52% of transactions up from 34% in the previous year, though the ratio is more evenly split between buyers and sellers in this year's data. We note this data tends to be inconsistent year on year suggesting it remains very much up for debate on any given transaction as to who should prepare the first cut of any completion accounts.

Previously where completion accounts were used a small proportion (often just 5%) of transactions set a cap and collar to exclude immaterial price adjustments within agreed parameters, but this year none of the transactions under review set a cap and collar.



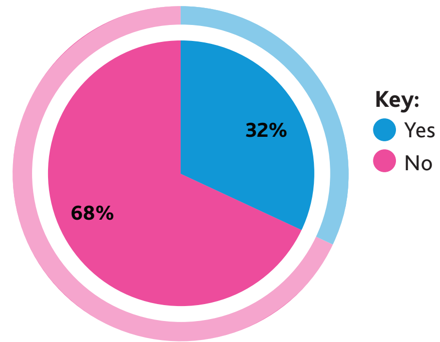
Many buyers are now preferring the more detailed pre-exchange diligence and negotiation process over less pre-exchange information and the potential for a post-completion dispute.

Deferred consideration

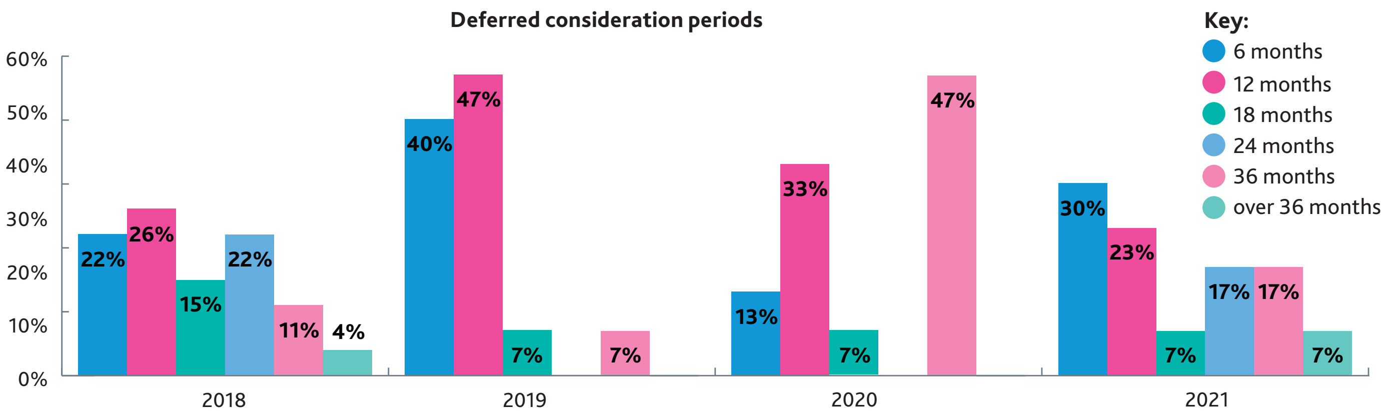
We have previously highlighted a growing use of deferred consideration as it provides a means of bridging valuation gaps caused by concerns around either the sustainability or recovery of earnings. In 2020 45% of transactions used an element of deferred consideration but this has fallen to 32% in the 2021 data. This reflects increasing confidence following the vaccine rollout and the resulting increase in predictability of future earnings. Buyers have more confidence to pay a fuller price on day one, feeling less need to wait and see the level of actual performance. It also indicates a hardening of sellers' resolve in a competitive market for quality assets.

The 2021 data shows a large reduction in 36 month deferred consideration periods from the levels shown in the 2020 data. Whilst a few of the deferred periods have increased, the majority have decreased. This is consistent with the improved transparency of future earnings leading to higher buyer confidence and reducing the need for deferred consideration periods.

Was payment of the considereation structured to include some or all by deferred payment?

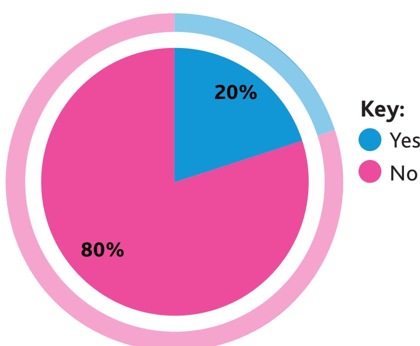


Deferred consideration periods

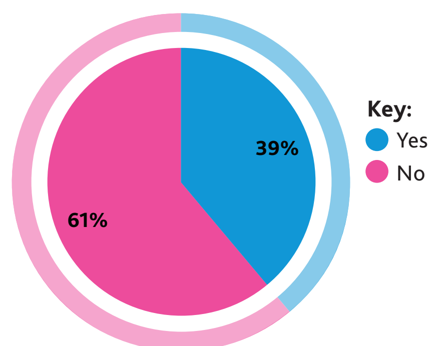


The decrease in use of deferred consideration was most visible in private equity transactions where its use fell from 37% to 20% which suggests a gradual decline in usage in recent years, perhaps reflective of competitive dynamics. The decline in trade transactions was also noticeable falling from just over half (51%) to 39% in 2021.

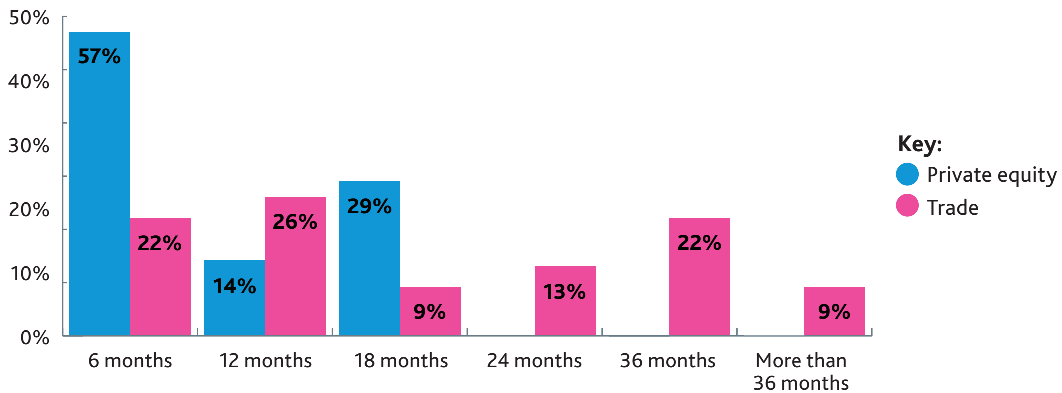
Did transaction include an element of deferred consideration? (private equity)



Did transaction include an element of deferred consideration? (trade)



None of the private equity transactions under review had a deferred consideration period of 24 months or longer (whereas in the 2020 data almost half set a 24-month timeline). This year almost 60% of private equity transactions set a deferred consideration period of 6 months. In most cases the deferred consideration was designed to help to bridge valuation expectations allowing sellers the chance to prove (and be paid for) the achievability of current financial year numbers. For trade deals the deferred consideration period was more evenly spread (with 44% using periods of 24 months or longer), with the most notable increase being in the use of a three-year deferred consideration period. Private equity buyers don't tend to want long deferred or earn-out periods (with none having periods longer than 18 months) as they have alternative incentivisation structures, such as sweet equity (and potentially ratchets), that deliver value to sellers and management in return for achieving growth targets, whereas trade buyers more typically see earn-outs as a way of not only bridging valuation gaps, but importantly locking in and incentivising key stakeholders to remain with the target.



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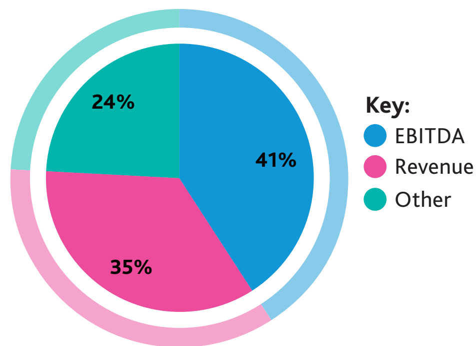
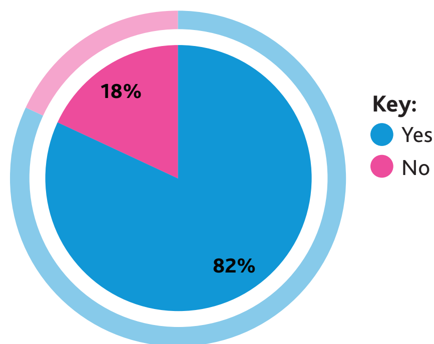
In this year's data EBITDA was the most used metric for basing deferred consideration payments (41%) compared to 35% for revenue, which held the top spot in 2020 (43%). The reduction in revenue-based targets may indicate a shift from a growth to value strategy and a more holistic approach to setting earn-out targets – one where sellers are not simply rewarded for growing market share, it has to be profitable revenue growth.

Protections in place for the earn-out period have increased from 2020 with 82% of transactions containing seller earn-out protections (71% in 2020). If more earn-outs are based on future profits, then sellers should be focusing on protections around cost controls rather than just the freedom to grow revenues.

Basis for payment of deferred consideration

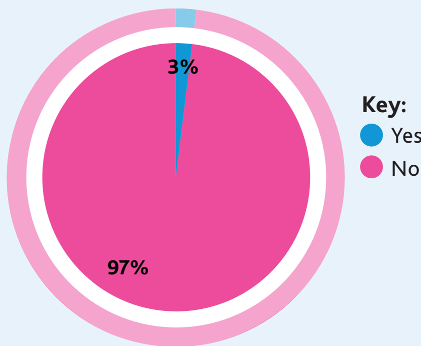


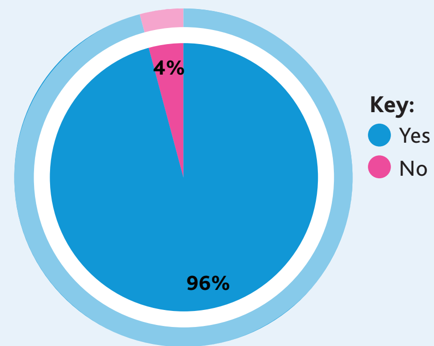
Were any protections in place for earn out period?



Warranties

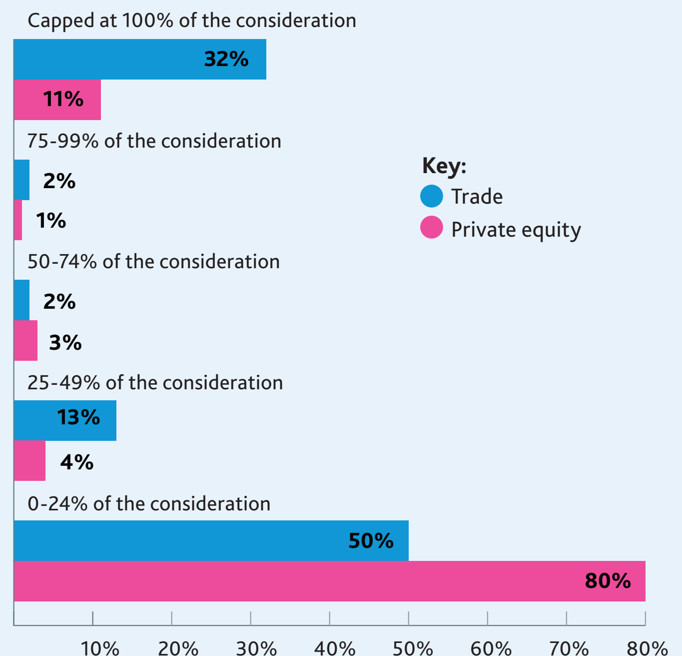
The accepted position remains that for M&A transactions it is highly unusual for buyers to be entitled to recover for breach of warranty on an indemnity basis, while a suite of caps on a sellers' liability under the warranties remains standard and the survey this year is consistent with prior years.





Our previous surveys had noted that in private equity transactions, the warranty cap continues to be set at a relatively low proportion of the overall consideration and in fact the position on private equity transactions has hardened this year with 80% of transactions set at up to 24% of the consideration, up from 58% in 2020, and those capped at 100% declining by a third to 11%. There has been far less movement in trade transactions where the caps remain similar to previous years.

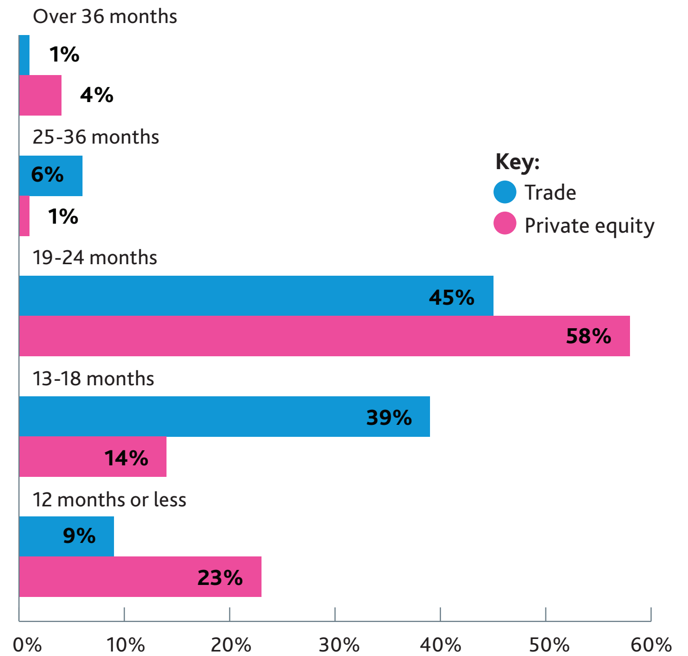
The reduction in liability caps for warrantors has reflected the strength of sellers' negotiating position and the increased use of warranty and indemnity insurance. Pricing of policies was historically low and insurers were happy to increase their risk profile in 2021 (including £1 caps on liability together with tipping baskets above the excess). This led to cost efficient alternatives to material seller warranty liability. As the market continued to heat up throughout the year capacity in the insurance market reduced and pricing hardened (see elsewhere in this report) and it will be interesting to see how the use of warranty and indemnity policies develops throughout 2022.



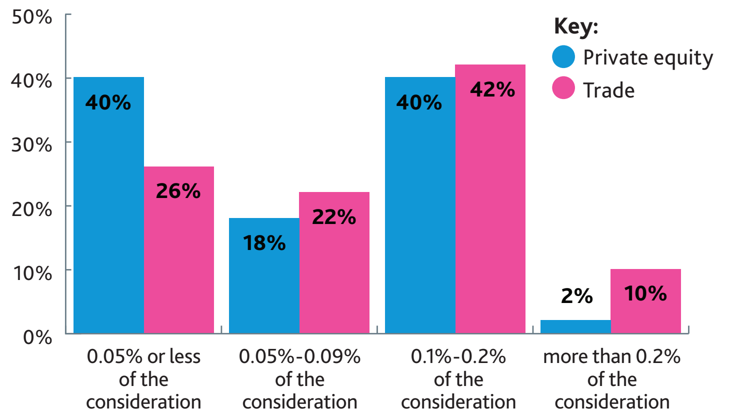
Pricing of policies was historically low and insurers were happy to increase their risk profile in 2021 (including £1 caps on liability together with tipping baskets above the excess).

Changes in limitation periods for commercial warranty claims are more muted though private equity transactions saw an increase from 7% to 23% of transactions using a period of 12 months or less with a consequent decline from 40% to 14% in the 13 to 18 month bracket. Data for trade transactions was little changed.

This reduction in time periods may be down to the increase in use of warranty and indemnity policies. The policy often has a completely different time period to the underlying warrantors' limitation period. If you are a buyer with a warranty and indemnity policy covering the vast majority of the potential liability for breach of warranty, you are focused on the time period in the insurance policy rather than the warranty deed. That gives rise to an "easy give" in the negotiation of the warranty deed and a reduced warranty period as a result.

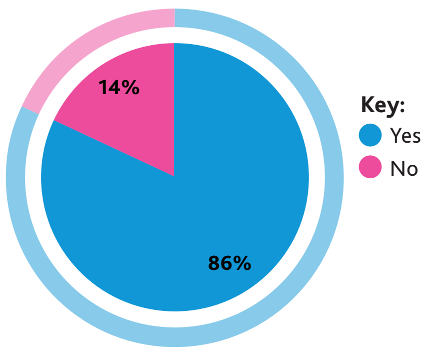


There was an increase in transactions setting a de minimis threshold for warranty claims at between 0.1% and 0.2% of the consideration (up from 30% to 40% for private equity and from 27% to 42% in trade transactions). Otherwise, similar patterns were seen in private equity transactions whereas there was an overall increase in the percentage of consideration required across trade transactions.

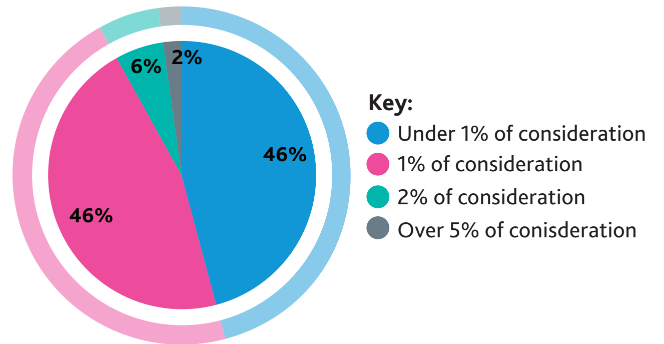


The proportion of transactions using a basket/threshold for claims increased from 69% to 86%, better reflecting perceived market practice and there has been little change in the threshold set with around 90% of relevant transactions set at 1% or less.

Did the transaction use a basket/ threshold for claims?



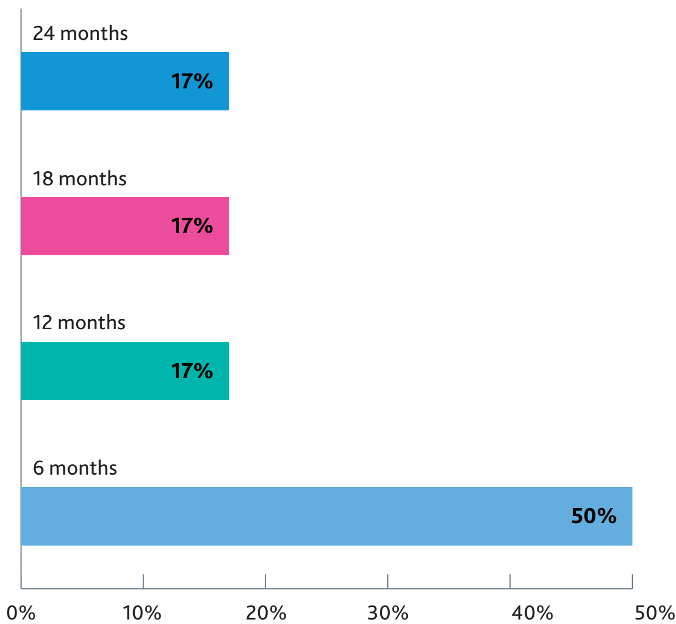
Transaction basket amount as a % of the consideration



Escrow retention accounts

In the 2020 data 18 months was the most common retention period, but 6 months was by far the most common in 2021.

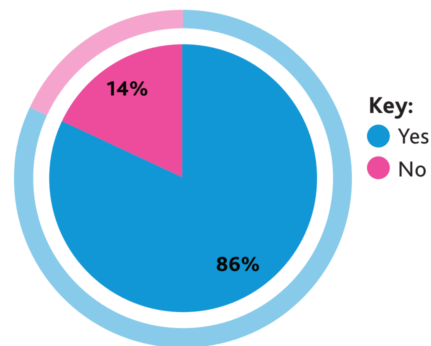
What is the time period for escrow/retention account?



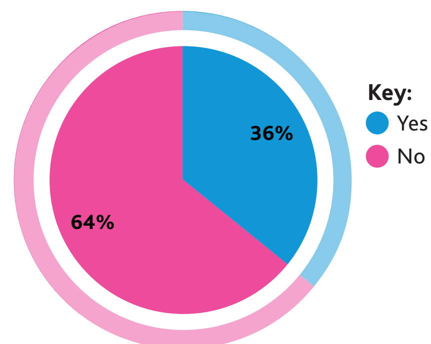
Disclosure

Trends are in line with prior years, though slightly more buyers gave a reverse warranty (36%) in 2021 compared with 29% in 2020.

Did the buyer agree to general disclosure of the data room?



Did the buyer give a reverse warranty?



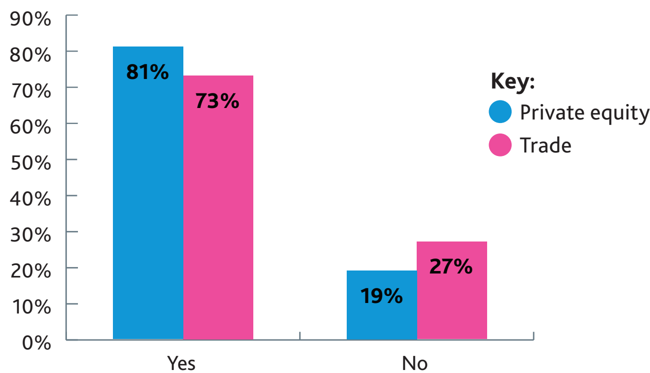
Tax

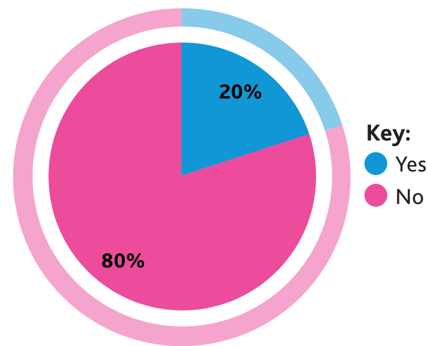
Over three quarters of transactions used a tax covenant, albeit a tax deed featured in 8 out of 10 private equity transactions. There was a slight fall in their use in trade transactions (81% to 73%).

There was a material increase in the use of a separate cap on liability under the tax covenant: up from 14% to 20%.

In some cases this was driven by buyers having a greater understanding of the exclusions on W&I backed deals for issues identified in due diligence. This has resulted in an increase in buyers seeking specific protection from sellers in relation to known issues which will be excluded from the W&I policy. Typically such specific coverage is subject to a tailored cap on liability linked to the estimate of the risk.

One trend to note is the use of tax deeds: where the seller does not provide a tax deed, the buyer normally negotiates a tax deed directly with the insurance underwriter instead. On the basis that W&I backed tax deeds have a £1 cap for a seller, the legal costs of negotiating the tax deed between buyer and seller (where the seller has no interest in the terms provided the £1 cap cannot be breached) often outweigh the increase in insurance premium.





The limitation period for tax warranty and tax covenant claims continues to be set at 6 years or more in the vast majority of transactions, though this year saw a slight increase in claim periods set at between 4-6 years. The relaxation of the period from a seller's perspective reflects the lower caps on liability achieved via W&I insurance (often £1) leading to less importance being placed on the length of the claim period.

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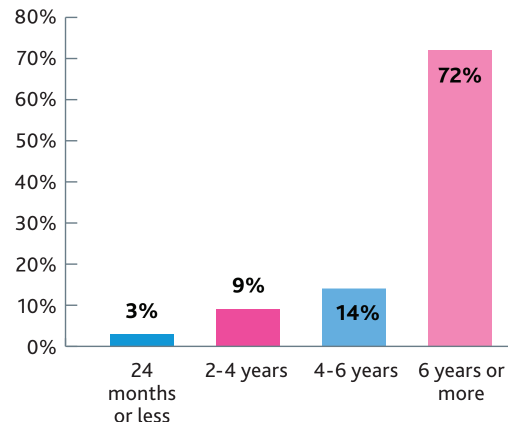
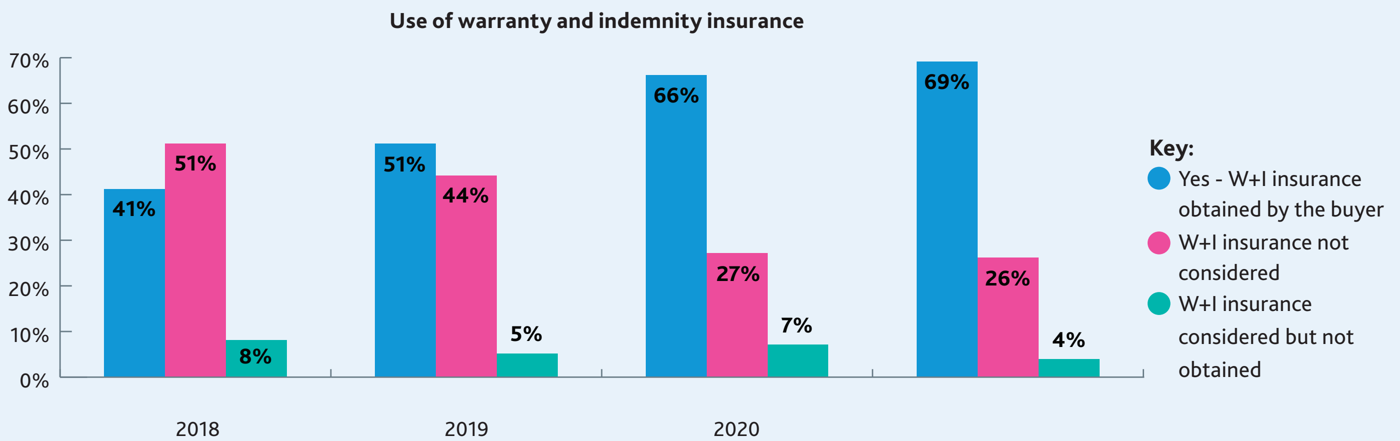


Warranty & Indemnity insurance trends

In line with last year's report, the Howden M&A team is once again writing this update following a record year for global M&A volumes. An increase in M&A volumes has, historically, translated into an uptick in the use of W&I insurance on transactions and we saw this trend continue last year, albeit with a smaller rise to 69% of transactions (from an already high 66% in 2020). Over the years we have been doing this survey we have seen a consistent increase in the number of transactions using W&I insurance and over two thirds of transactions have used W&I insurance in each of the last two years.



The unprecedented levels of M&A activity triggered some material developments in the W&I market over the course of 2021. Many of these developments were driven by the resource and capacity constraints that insurers started to experience towards the end of H1, with the effects of these constraints continuing to be felt until the end of the year. This lack of capacity amongst insurers led to a hardening of the W&I insurance market for the first time in a decade, prompting (i) premium increases across both real estate and operational sectors; (ii) insurers to take an increasingly selective approach when quoting deals and negotiating cover positions; and (iii) a decrease in the ability of insurers to offer 'trees' for non-exclusive bidders on competitive auction processes.

Pricing and retentions

As noted above, the hardening market prompted premium increases across both real estate and operational sectors. The premium increases seen last year can largely be attributed to both the temporary lack of insurer competition and increases in the number and severity of claims.

AVERAGE PREMIUM RATES (% OF THE POLICY LIMIT)			
Real Estate		Operational	
2020	2021	2020	2021
0.78%	0.85%	1.15%	1.48%

Retentions remained NIL for pure real estate deals throughout 2021. Operational deals have historically attracted retentions of 0.25%–0.5%, with tipping options offered for particularly attractive transactions. This historic 'norm' held true for much of 2021 – however, we started to see a change in behaviour towards the end of the year, with insurers sticking more rigidly to 0.5% retentions and tipping options rarely on offer.

TYPICAL RETENTIONS (% OF ENTERPRISE VALUE)			
Real Estate		Operational	
2020	2021	2020	2021
Nil	Nil	0.25%-0.5% fixed (with certain insurers beginning to offer tipping retentions on private equity backed transactions)	0.25%-0.5% (retentions frequently at the higher end of this range in H2 2021)

The premium increases seen last year can largely be attributed to both the temporary lack of insurer competition and increases in the number and severity of claims.

How has the hardening market impacted W&I processes more generally?

The constraints experienced throughout 2021 made it increasingly difficult to secure terms on deals that fell outside of insurers' 'sweet spot' (with the sweet spot typically being technology, infrastructure or manufacturing deals with EVs of between €200-700m and operations primarily in the UK and/or Western Europe). Insurer options were limited on deals outside of these sectors; where you might have had five to six insurers quote on a deal in the past, this was restricted to one to three insurers on many transactions. This was particularly evident across residential, retail and development assets, as well as the leisure, healthcare and financial services sectors.

Terms being offered by insurers on 'non-core' deals became considerably less competitive than would have been expected previously, with carve outs for matters such as product liability, cyber and professional indemnity becoming increasingly commonplace, particularly in the absence of robust insurance due diligence.

The length of time taken to receive terms and underwrite transactions also elongated as we moved through 2021. Normal time periods became five to seven days for an NBI report and at least two weeks to negotiate a final policy from receipt of progressed versions of the due diligence reports.

We also saw certain insurers declining to offer as many trees and, in some instances, insurers were entirely unable to offer trees. Where trees were offered, insurers increased the level of their legal and break fees for non-exclusive bidders – in some instances, the increase over previous market norms was significant. This led to an appreciable increase in the number of sellers opting to adopt a hard staple approach. By taking a hard staple approach, sellers sought to ensure that, notwithstanding the inability of insurers to underwrite for multiple bidders pre-exclusivity, the overall transaction timeline would not be detrimentally impacted. This approach was used to great effect, with the Howden M&A team being able to finalise policies for winning bidders within a matter of a few days following exclusivity being granted.

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Claims analysis and future impact on pricing

Given the phenomenal volume of European M&A activity since Q3 2020, which, in turn, led to an increasing number of W&I policies being underwritten, it is perhaps unsurprising that Howden M&A experienced a record number of claims notifications in 2021. However, the notification rate (number of notifications represented as a percentage of overall deals that Howden M&A advised on) dropped from 14% to 10% between 2019 and 2020/21. As W&I insurance becomes a mainstay in the deal making environment, many funds are now using it on all transactions undertaken as opposed to only those perceived to be 'riskier' in nature, which provides a likely explanation for the decrease in notification rates over time.

As has traditionally been the case, Material Contracts and Financial Statements remain the two most commonly notified warranty breaches. However, Howden M&A has seen a marked increase in notifications relating to Compliance with Laws warranties.

Perhaps most importantly for W&I insurance policyholders, Howden M&A's statistics show that W&I insurance works, with 74% of claims resolving positively: 57% resulting in a payment and, where the quantum did not exceed the policy retention, 17% eroding the retention. The remaining 26% is largely attributable to claims that were validly declined (for example being caught by a policy exclusion or the expiration of the policy period), likely driven by insureds' increasing willingness to notify insurers on a precautionary basis as they become more familiar with the product.

Despite the average notification rate decreasing overall, Howden M&A's statistics showed an increased rate for mega-deals (those above €1 billion EV). Large and complex deals are often considerably more challenging to diligence and issues are more easily missed, especially during fast-paced competitive auction processes. Insurers are continuing to feed this into their models, with mega-deals priced at an average rate of 1.95% in 2021 and lower value deals priced at an average rate of 1.08% in 2021. This is reflective of a wider trend towards M&A insurers placing increasing emphasis on assessing their claims history when making pricing decisions (as opposed to previous years, where aggressive competition amongst insurers has been one of the most significant drivers of rates). With insurers gathering ever more insightful W&I claims data, Howden M&A anticipates that W&I claims history will play an increasingly important role in driving future price rises. In particular, further pricing divergence is expected at a sector level, with those sectors with higher historical loss ratios being impacted disproportionally.

Outlook for 2022

As budgets and binders reset on 1 January 2022, Howden M&A has already seen an uptick in the level of competition amongst insurers versus the outlook in H2 2021. With this in mind, Howden M&A predicts that we will see decreases in pricing from the heights reached in Q4 2021. However, given the increase in the number and severity of claims notifications, coupled with insurers' increasing focus on deriving intelligence from their claims data, it is unlikely that pricing drops back to the low levels seen in 2020 / early 2021.

Furthermore, as pressure builds on insurers to demonstrate to their management teams or capacity providers that they are achieving attractive premiums on deals, insurers are starting to think more creatively about how they can deploy their capacity. As a result of this, Howden M&A anticipates an increase in appetite for insurance on distressed transactions and on transactions in sectors that historically insurers did not consider e.g. loan book sales. As these types of transactions are higher risk in nature, any insurance solution available will be priced accordingly.

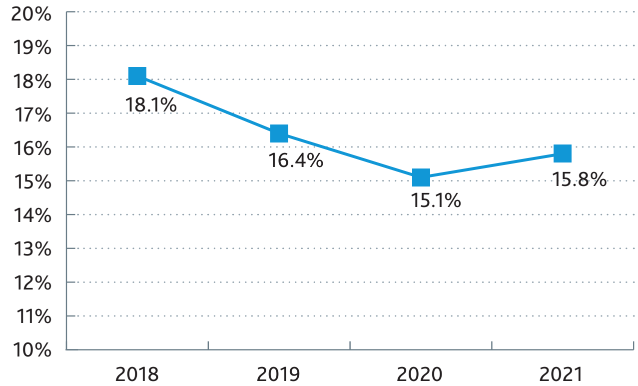
In addition, it is expected that the use of W&I insurance on secondaries deals will continue to build momentum. Having been successfully utilised on a number of single asset and concentrated portfolio transactions during 2021, we are now seeing the product considered on increasingly complex deal structures, for example fund of fund transactions.

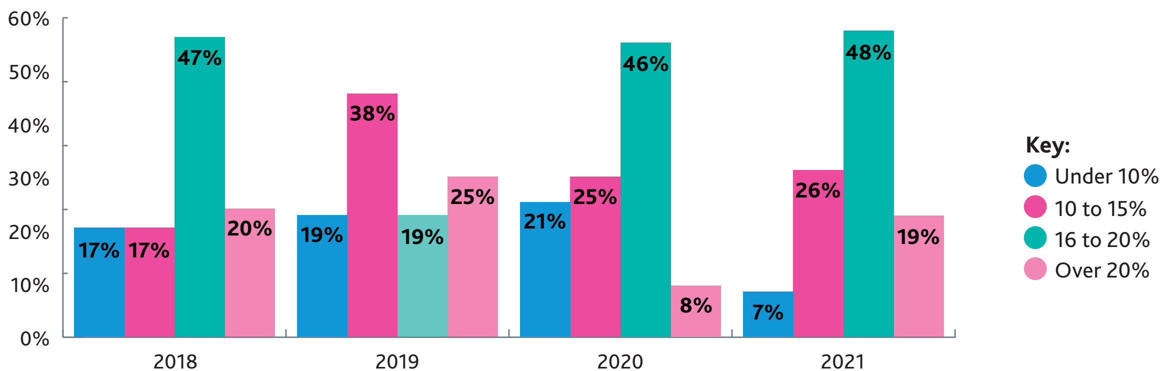
Private equity

Sweet equity allocation

In terms of management incentivisation we've seen the proportion of sweet equity earmarked for management coalesce between the 10% to 20% mark. In 2021 26% of transactions offered sweet equity 'pots' of between 10% and 15% and almost half of transactions offered between 16% and 20%. These figures are consistent with 2020. The proportion of sweet equity offered to management teams has averaged 16.4% over the last four years and we suspect this range will remain typical for the foreseeable future, as long as the market remains highly competitive for the more attractive assets and capable management teams.

These results, which track results over previous years, underlines that incentivisation by means of sweet equity has been and will continue to be the key tool for retaining management and for making sure they are committed to driving value growth for themselves and their private equity investors.





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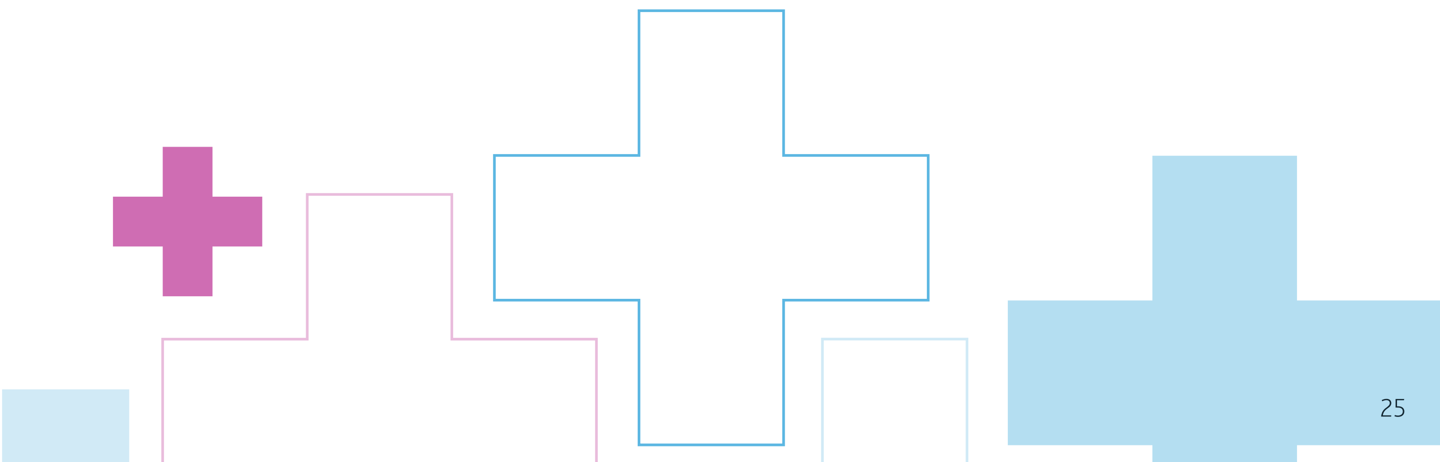
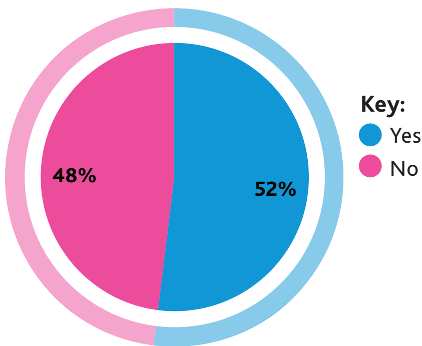


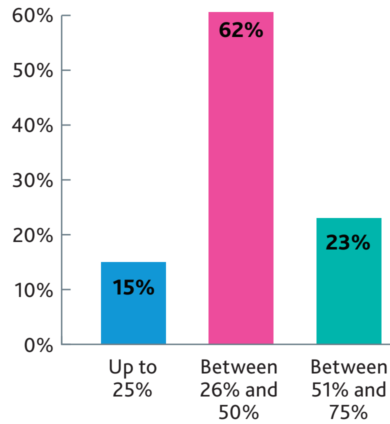
Rollover

Many investors have been looking to management teams to invest higher percentages of their value today as a sign of their belief in the future and we are starting to see an interesting correlation between higher sweet equity pots and higher rollover quantum from senior management participators.

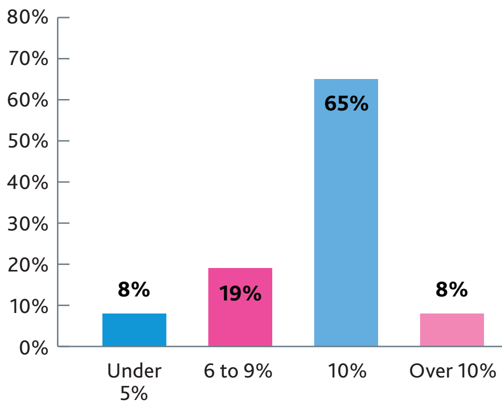
Did existing shareholders roll over?



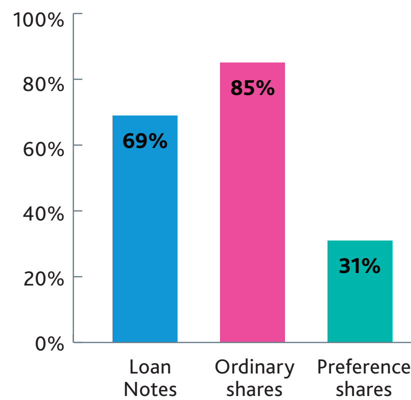
What was the quantum that management rolled?



What was the coupon on the preference shares/loan notes?



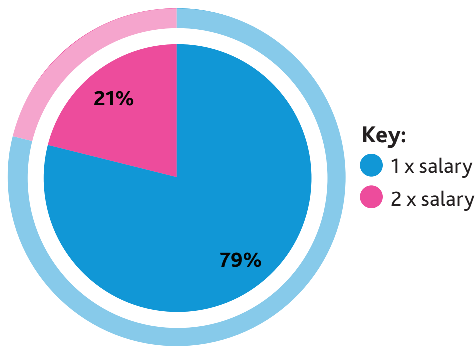
What instruments did the shareholders roll into?



Warranty caps

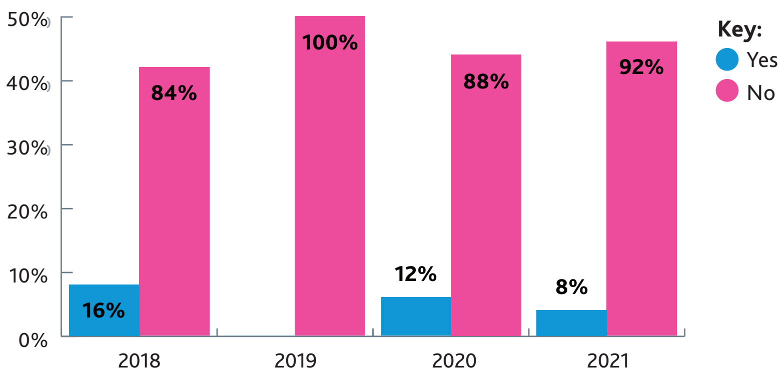
It would appear investors are becoming more comfortable with lower warranty liability caps for investment warranties. From the deals surveyed a settled trend is emerging for liability to be capped at a multiple of 1 times salary. In 2020, 59% of relevant deals had this multiple, rising to 79% in 2021 - a considerable shift. Our view (and consistent with other parts of our report) is that investors are increasingly confident with the level and quality of seller and other due diligence being made available together with their own top-up diligence. Also, there is a growing appreciation that investment warranty claims against management are extremely rare and only likely to occur where serious issues or failings are uncovered. More simply, with the continuing competitive deals market investors are keen to make their suite of management terms as attractive as possible. Whichever, investors seem to be taking the view that a multiple of 1 times salary represents sufficient 'skin in the game' for managers to ensure they consider the warranties and undertake a meaningful disclosure exercise.

What was the warranty liability cap for managers taking sweet equity?



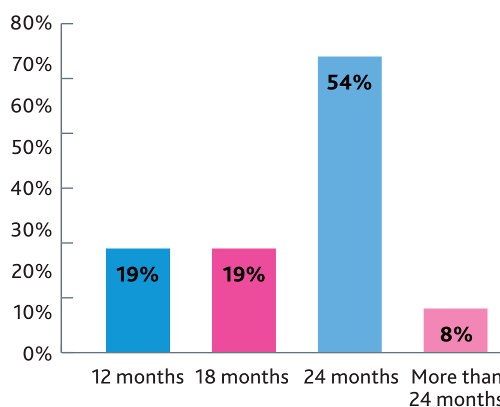
As in prior years, it is unusual for the liability cap to vary for rollover investors.

Did warranty liability cap vary for rollover investor?



Restrictive covenant periods

Last year we noted a shift towards a covenant period of 24 months where previously a period of more than 24 months was dominant. In 2021 there was a dramatic fall in this longer period, down from 37% of relevant deals surveyed to 8% in 2020. Again, we think this is reflective of a competitive market where investors are being pushed to propose a package of investment terms that will win over management teams. Periods of 12 months and 18 months were slightly higher than last year after we previously noted investor willingness to accommodate lower restriction periods for certain managers who are perhaps less important to the investment case, who have a relatively low level of equity holding or didn't receive significant proceeds from the sale transaction. Often this flexibility is helpful for senior management in selling investment deals to second tier managers. We are likely to see more instances of differentiation between categories of manager as the post-pandemic deals market takes shape.

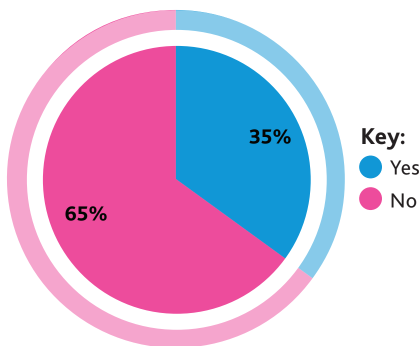


Fees

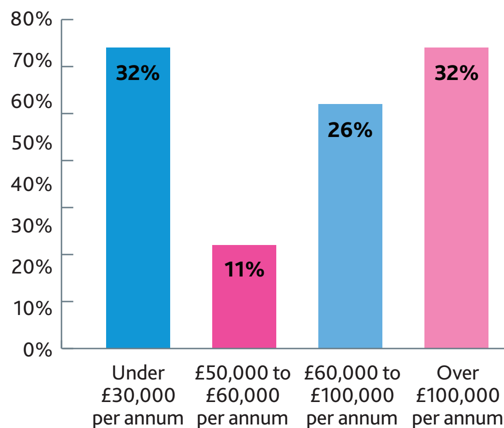
We have seen a clear increase in the charging of arrangement fees by investors. After appearing in a quarter of transactions in 2019 and 2020, they arose in a third of transactions in 2021. As ever higher values are being paid for certain kinds of assets (indicated elsewhere in the report), a higher incidence of arrangement fees may be evidence of investors seeking to clawback from the investee group value paid to sellers.

We saw a significant increase in investor director annual fees in 2021 most notable being the over £100,000 per annum category, occurring in 32% of the deals surveyed after showing in only 15% of deals in 2020. There was also a significant rise in fees in the £60,000 to £100,000 per annum range up from 8% in 2020 to 26% in 2021. In our experience, for larger or mid-market transactions, fees of over £100,000 are fairly standard.

Was there an arrangement fee?

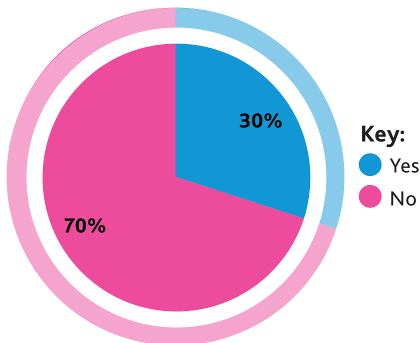


What is Investor director's annual fee?



The use of monitoring fees on top of director's fees has remained broadly consistent.

Is there a monitoring fee on top of director's fee?



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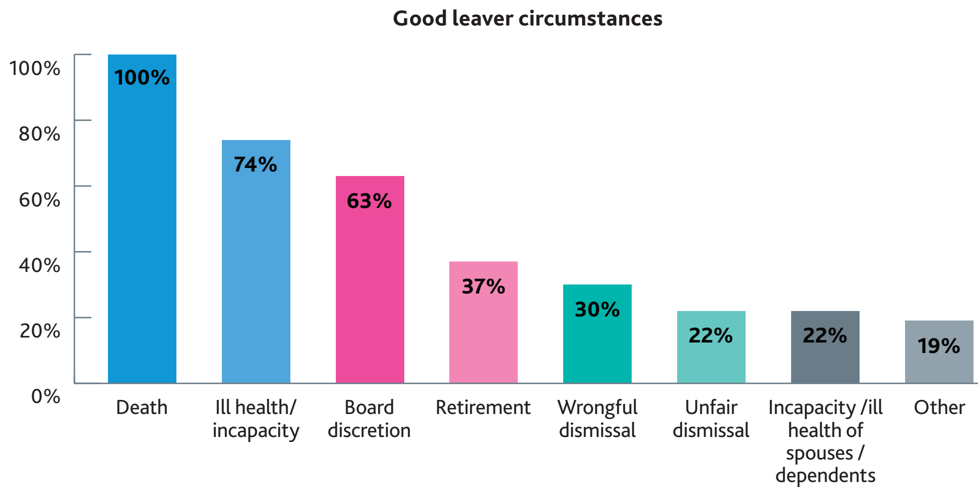
Leavers

There has been little change in those circumstances which tend to constitute 'good leaver' status over previous years which has included a decline in the use of unfair dismissal as a good leaver event. However, unfair dismissal appeared in 22% of relevant transactions after failing to appear in 2020. This was a surprise as the stated decline in the use of unfair dismissal tallies with our experience and is seemingly being replaced by the increased use of intermediate leaver.

This concept serves to usefully bridge the gap between those managers who are good leavers, where they are entitled to market or fair value, and bad leavers, where the lower of market or fair value and issue price (or £1 depending on the circumstances) is the accepted sale price. Intermediate leaver seems to provide a flexible (and we would suggest, more equitable) mechanism for investors and managers, striking the balance between a need to acquire shares from leavers to incentivise replacements at a lower price while rewarding departing managers for value created during their tenure.

Good leaver circumstances



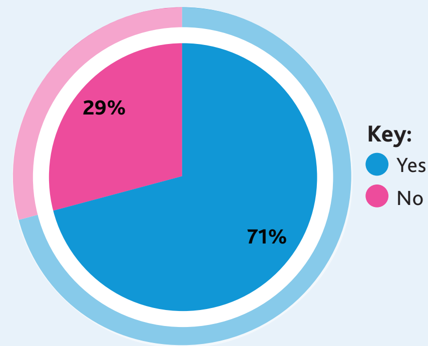
There has been little change in those circumstances which tend to constitute 'good leaver' status over previous years which has included a decline in the use of unfair dismissal as a good leaver event. However, unfair dismissal appeared in 22% of relevant transactions after failing to appear in 2020.

Intermediate leaver

Notwithstanding the above, we note however the use of intermediate leaver reduced to 71% in 2021 from a high of 89% in 2020. Though variations year to year are to be expected, we expect the use of intermediate leaver to remain high for the foreseeable future, and certainly while the deal market remains highly competitive.

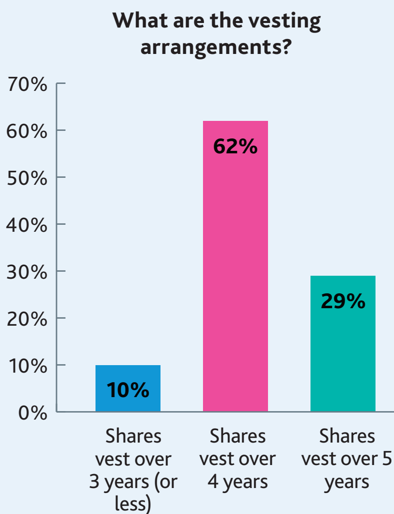
The typical vesting period for intermediate leavers is four years from completion, seen in 62% of the transactions, rising from 50% in 2020. In addition to this, and while not covered in the data, we are seeing investors agreeing to vesting schedules where all or a substantial majority (say, 80% or 90%) of management's shares vest at market or fair value at the end of the vesting period, particularly in auction sales. It is worth noting that voluntary resignation should generally be excluded from the intermediate leaver provisions to avoid managers being able to resign during the vesting period and being entitled to good leaver value for the relevant proportion of vested shares offered for sale. These provisions are not generally intended to reward managers who voluntarily decide to walk away.

Is intermediate leaver concept included?



The shift to a vesting period of 4 years was largely at the expense of the shorter time frame (shares vesting over 3 years declined from 17% to 10%).

What are the vesting arrangements?



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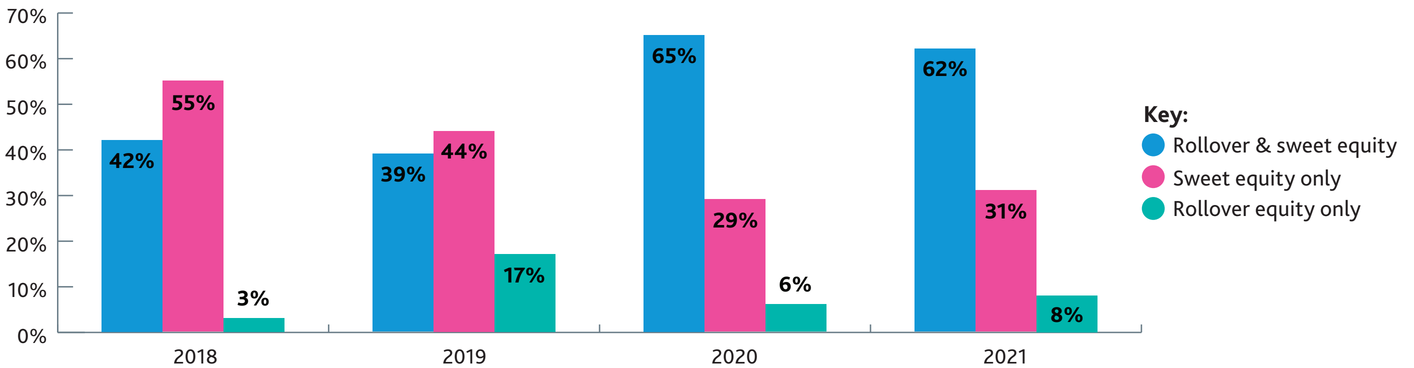
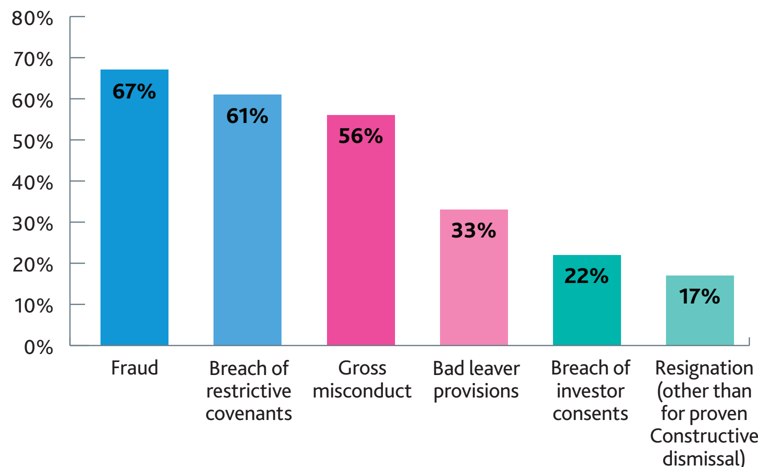
Rollover applying to leaver provisions

The percentage of deals where leaver provisions apply to rollover as well as sweet equity has remained consistent over the last couple of years (65% in the 2020 data and 62% last year) after a significant jump from 39% in 2019. Where previously private equity was comfortable in treating rolled value as historic value which was off limits, we have seen investor sentiment hardening with it increasingly being viewed as legitimate for rollover terms to apply in a small number of circumstances. These circumstances tend to be limited to particularly serious acts like fraud, summary dismissal or gross misconduct, breach of restrictive covenants and in some circumstances voluntary resignation. As these circumstances relate to the voluntary conduct of managers and given the potential for wider impact on the business in the event any of these circumstances occur, including damage to reputation and goodwill, the previous management friendly position on the treatment of rollover is becoming increasingly difficult for management teams to defend. We therefore expect this trend to continue.

Where rollover comes up for sale we are seeing the arguments in this area becoming more nuanced. For example, should rollover apply to all or a specified list of summary dismissal events? Should all or a proportion of rollover equity be offered for sale? What price should rollover equity be offered for sale: market / fair or nominal value? No clear trends have emerged as yet and much depends on the circumstances of the relevant transaction, including bargaining position of the parties, though it will be interesting to see how this area develops.

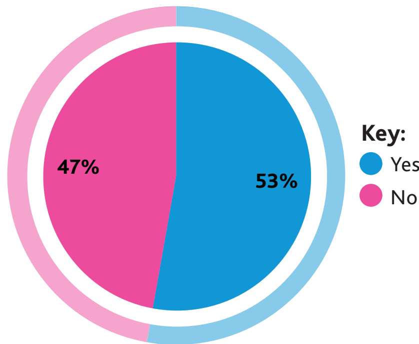




Preference shares

The position on use of preference shares in the transactions surveyed remains almost unchanged from last year (53% in 2020; 52% in 2021) with the typical coupon rate also unchanged at 10%.

Were preference shares issued?

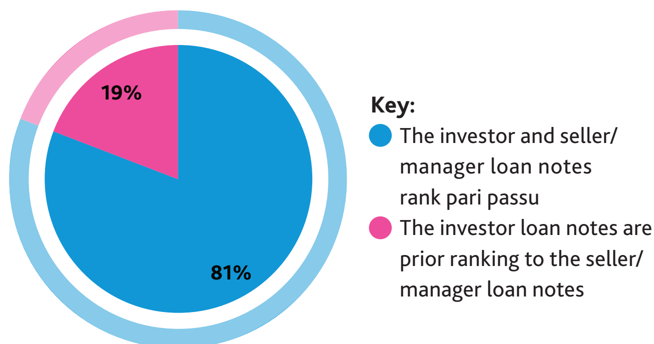


Key:
- Yes
- No

Ranking of loan notes

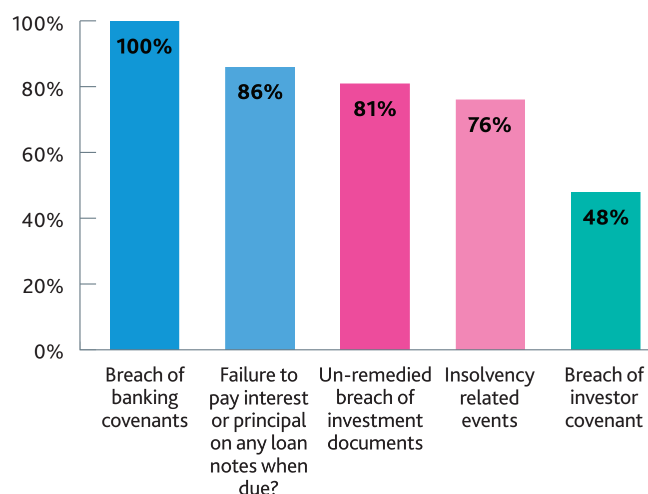
In competitive scenarios, the market (particularly in competitive auctions) seems to be moving towards parity between management and/or sellers and investors as pari passu ranking on loan notes increased from 71% in 2020 to 81% 2021. We see this as further evidence of a sellers' market as investors historically insisted on prior ranking in all circumstances or in a downside scenario (where prior ranking is most important). Investors' ability to control how loan notes are dealt in these circumstances is very important. These controls are essential for investors where an investment experiences difficulties and remedial action may be required, for example, to refinance or recapitalise the investee group, deliver an exit or re-cut management incentive plans where equity value is 'under water'. These controls tend to allow investors to deal in management or seller loan notes on an equivalent basis as their loan notes so that whatever action is taken, the same proportionate change or impact will apply to the investors' loan notes.

How do the investor and seller/manager loan notes sit for ranking purposes?



Swamping rights

We have seen a doubling down on swamping rights by investors although the inclusion of the various swamping events in the current data rose considerably against the deal data for 2020. A breach of banking covenants was referenced in all of the deals surveyed, up from 63% in 2020, and unremedied breach of investment documents doubled to 86% from 42% in the previous year. The greater increases were in the categories of failure to pay interest and principal on loan notes when due (86%, up from 26%) and insolvency related events (76%, up from 21%). Swamping rights are a mainstay of UK private equity and, as stated previously, are a generally accepted and legitimate way for investors to take evasive or remedial action to protect their investment. We sometimes see majority investors having weighted voting at board and shareholder level and the right to appoint multiple directors. However, this position is not common and UK private equity investors generally allow management to have day to day control until swamping is triggered where they will generally have the right to intervene.



European perspectives

Partners across Pinsent Masons' European network of offices have provided commentary on trends they are seeing in their local markets, primarily by way of comparison to the UK trends presented in this report.

Germany

In Germany we are seeing a significantly higher number of transactions where there is a split between exchange and completion than is reflected in the UK data. It is interesting to note that such splits are not primarily linked to higher deal size. One reason for this is likely to be the Foreign Investment Control (FIC) regime to which deals in Germany are subject. The regime is generally triggered when there is a non-EU purchaser. The regime is subject to other requirements (e.g. the technology being sold as part of the transaction), with no materiality threshold applied. There are two main aspects to note here:

- Though the FIC regime was implemented some years ago, it was not applied in practice until a few years ago. However, over recent years, the German authorities changed their approach to, and focus on, the FIC regime. This resulted in the appointment of new personnel and the setting up of working groups in the ministry which changed the rules of interpretation of the law which saw an increasing number of transactions being subject to scrutiny and formal review. There were also some recent changes to the law which has led to a more cautious approach by deal parties and their advisers. This has resulted in more notification procedures leading to an increase in deals being subject to a split exchange and completion.
- Due to Brexit, UK buyers are now regarded as non-EU and therefore a lot of transactions which did not previously fall under the FIC regime are now subject to review.

We have also seen a decrease in the number of MAC clauses on transactions though the number is likely to be even lower in Germany than the UK. One main reason for this is Covid, the pandemic and the lockdowns. The circumstances which would trigger a 'normal' MAC clause are becoming increasingly common in the current world. Whereas MAC clauses in the past were rarely triggered and were included as a means to protect buyers from extreme circumstances which were very unlikely ever to occur, due to the pandemic these same circumstances would likely have been triggered regularly over the past 2 years. Parties have therefore had to adapt to this new normal and accept that these circumstances are more likely than in pre-pandemic times. Parties are therefore placing less importance or reliance on MAC clauses.

On the flip side, we are seeing a lot more deferred payments than previously, which could be a consequence of parties seeking to mitigate covid-related uncertainty by means other than MAC clauses, particularly for sectors impacted more severely by lockdowns.

We are seeing similar trends with warranties in Germany as in the UK. However, what is different is that the percentage of deals showing disclosure of data rooms is lower in Germany. Conversely, a reverse warranty given by the buyer is very much standard in Germany.

Lastly, the percentage of W&I insured deals is, in our experience, much lower in Germany.

In Germany we are seeing a significantly higher number of transactions where there is a split between exchange and completion than is reflected in the UK data. It is interesting to note that such splits are not primarily linked to higher deal size.

Spain

The trends in the Spanish market are quite similar to those shown in the UK market, with no significant distinction between strategic and private equity transactions. In recent years, particularly before the pandemic, the use of W&I was not common practice; however, it is being used increasingly in the last couple of years. In the past insurers were not as flexible around the terms and conditions of the policies on offer and pricing, though now the market has evolved and it is not uncommon to see W&I policies used on transactions, often instigated by buyers to make their package of terms as attractive as possible in an increasingly competitive market.

One notable trend is the increasing number of transactions that have a split exchange and completion. The pandemic is largely behind this trend: as governments seek to protect critical industries without deterring foreign investment more generally, the natural consequence has been a tightening of the foreign investment regulations. This has had a significant impact on the number of cross border transactions where prior communication or official clearance has become a legal requirement.

As for the prospects of the M&A market in Spain, while the volume of M&A deals in 2021 were at historic high levels, including a significant increase in cross-border M&A transaction values, the pipeline for 2022 currently looks healthy, especially in sectors where there are no signs of slowdown: for example, renewable energy (including innovative and alternative energy sources), IT and, broadly speaking, technology related businesses, logistics, agribusiness and life sciences/healthcare. The outlook for the real estate market for the year looks positive also. We also expect 2022 to see significant growth in distressed transactions as insolvency moratoriums rise in Spain and across the globe. Areas of stress should provide opportunity for consolidation and value creation.

As in other parts of Europe, including in the UK, private equity investors are increasing their commitment to environmental, social and governance (ESG) matters, intensifying their attention on these aspects during the due diligence process, and we expect this area of diligence to become standard practice in the future.

Ireland

2021 was an extremely busy year for M&A activity in the Irish market. Similar to the UK market, we saw a significant number of deals that were paused in the first quarter of 2020, as the pandemic took hold, which were then resurrected either later in 2020 or in 2021. Given the availability of capital and positive investor sentiment, we would expect the market outlook to remain positive in 2022 with fierce competition for quality businesses. The sectors where we are seeing the most deals are in technology, energy, infrastructure and healthcare. Similar to Spain, it's interesting that many investors are increasingly focussed on ESG when deciding how and where to invest. We also expect to see further penetration into the Irish market by international private equity funds. In the last 24 months, BGF, Waterland, Synova and August Equity have been active in the Irish market and we anticipate other international funds will follow suit. International real estate funds, particularly from Asia, have shown a keen interest in Irish real estate, both commercial and industrial. Many M&A transactions continue to be funded by debt and while Ulster Bank is leaving the Irish market, the remaining traditional banks and non-bank lenders, both international and domestic, continue to be supportive of Irish M&A. Where deals have failed, the primary reason tends to have been buyers and sellers failing to agree on valuation, rather than an unexpected diligence issue or macro-economic factors.

Like the UK, given we are currently experiencing a seller's market, we are seeing a significant increase in the number of competitive auction processes, particularly in the case of secondary buy outs. W&I insurance has been over the last two years and continues to be very popular in the Irish market, and again particularly with secondary buyouts. Given that the cost and execution process has greatly improved and become more efficient than it was up to a few years ago, financial buyers and sellers are much more willing to use W&I on transactions. Trade sellers have not previously had the same level of appetite for W&I, although this is also increasing.

The trends present in the UK market are largely consistent with transactions in the Irish market. For higher value transactions, given the turnover-based thresholds which are applicable under the Irish merger control regime, it isn't surprising they have tended to more likely involve a split between exchange and completion. Similar to the position in the UK, where there is a split, buyers have tended to be contractually permitted to walk away only for sufficiently material breaches of warranty or interim covenants during the period between exchange and completion. Sellers have also often felt able to agree to this where the question of breach remains within their control. The Irish market has also seen a decline in the use of general MAC clauses.

Lastly, we have also experienced a marked increase in the popularity of locked box mechanisms, particularly in transactions involving private equity buyers or sellers. Greater certainty regarding price appears to be the main driver.

Netherlands

The same elements that made 2021 a very productive year for M&A in the Netherlands are expected to remain in place in 2022. Interest rates are expected to increase but perhaps not to the point where the cost of capital becomes prohibitive so that it should still deliver high returns for sponsors.

In general we have seen similar developments in the Netherlands as with wider European markets. Although sell-side activities are expected to remain stable as sponsors look for gains at attractive valuations and exit their investments in a strong capital market, there is stiff competition between buyers. The ensuing sellers' market has highlighted the following notable deal characteristics:

- Similar to the UK market, we are seeing some PE houses having a strong focus on value drivers, being more selective in their investment targets and only going for the targets they really want to secure. They are less inclined to get involved in pursuing a great number of deals and only focus on the ones that really matter to them.
- A continued simplification in documentation, locked-box mechanisms remain the standard, deals are W&I insured and a standard set of warranties is accepted.

We expect that the competition between buyers will remain strong, and that it will be a challenge for buyers to find the right investment opportunities at the right price.

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France

Consistent with the UK, transactions involving a split between exchange and completion have been increasing since 2020. This increase has been as a result in particular of the change in foreign investment control regulations which have applied in France since 1 April 2020. Based on the statistics published by the French Ministry of Economy, the number of foreign investments investigated by the Ministry increased by 22% between 2019 and 2020. This increase (which we expect to have continued once data for 2021 is published) has been as a result of government authorities implementing stricter regulations regarding foreign investments in France, notably by lowering the 'crossing condition' from 25% to 10% for non-EU/EEA foreign investors in listed companies, but also by amending the list of sectors subject to these regulations. This list was extended last year to include (notably) biotechnologies and artificial intelligence, and since 1 January 2022 technologies involved in the production of renewable energy. The main foreign investors in 2020 in France in sectors which are protected under these regulations were based in the United States and Canada and in Europe: Switzerland, UK and Germany.

In relation to M&A transactions, the French market has been affected by the Covid-19 pandemic. After 2020 saw a decrease of M&A transactions, 2021 has seen a growing recovery of the French M&A market to a level equivalent to pre-pandemic times. The private equity market in France was also particularly active and contributed to this increase. In our experience, the most resilient sectors during 2020 were technology and life sciences. This evolution resulted from several factors including the financial strength of several groups and the desire of strategic players to accelerate their transformation. We can expect a similar trend for 2022. However, the M&A market in France may be influenced by several factors such as a possible change in the economic climate, the geopolitical situation including the consequences of the war in Ukraine with the economic sanctions against Russia, the French presidential election in 2022 and/or the consequences of the pandemic across the world. The actual consequences of such factors are difficult to predict, however.

The Covid-19 pandemic gave rise in France in 2020 to a series of discussions regarding the implementation of MAC clauses on M&A transactions. Since 2021 we have seen the number of transactions which included MAC clause returning to pre-pandemic levels.

The Covid-19 pandemic gave rise to discussions related to changes in the pricing structures of M&A deals in France, highlighting the unattractiveness of locked box mechanisms within unstable economic environments. Transactions which were ongoing during the first lockdown in France often switched their pricing structure from a locked box mechanism to completion accounts. Even if the locked box mechanism remains attractive in particular to private equity investors, such price adjustment mechanisms have decreased in trade transaction since 2020. In the same way, deferred payments and earn-out structures were particularly attractive notably in 2020 but have tended to decrease since 2021 and we anticipate this trend to continue in 2022.

The use of W&I is less prevalent in France compared to the UK and focuses mainly on the real estate, renewable energy and pharma sectors. However, as the number of M&A transactions reaches record levels, we expect that we will see an increase in the use of W&I backed transactions more generally.

Consistent with the UK, transactions involving a split between exchange and completion have been increasing since 2020.

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