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CMS European M&A Study 2018

Tenth Edition

M&A 2018

Political and global security issues may have encouraged uncertainty in 2017 but the European M&A market seemed to view uncertainty as an opportunity.

Global activity was down on both value and deal count by 3% and 1% respectively, but European M&A surged by 14% to USD 929.3bn in over 7,000 deals with volume down just 1% against 2016.

This increase in European M&A activity was driven by the stability of the Eurozone as a bloc (especially France and Germany) on the back of solid GDP and employment figures. There was a new optimism in Europe with President Macron being elected in France and the worst fears of strong nationalist influences in the Netherlands, France and Germany proving unfounded. The UK also provided specific opportunities to investors. Although 2017 did little to clarify the direction of Brexit overall, it did allow foreign investors to continue to take advantage of the weaker GBP. There was also a significant rise in domestic consolidation as the UK prepares itself for its post-Brexit existence.

Private equity had a stellar year with plenty of available cash, a crowded mid-market and a steady increase in large buy-out deals. Industry and Consumer Products were the best performing sectors.

2018 has started in much the same vein as 2017 finished. US corporations and institutions have typically driven the M&A market and are now presented with the unique combination of President Trump's "America First" policy and dramatically lower domestic corporate taxes. They will be very busy in a booming domestic market, but we expect US corporates to continue to target European M&A alongside Asian and Eurozone dealmakers.

Our new CMS European M&A Study 2018 covers more than 3,650 deals. We focus on the 438 CMS deals in 2017 and the 2,488 CMS deals in the period 2010–2016 by way of comparison.

We are also proud to announce that this is the tenth edition of the CMS European M&A Study. This represents a significant body of work which is unique both for its longevity and large deal sample. In this edition, we take the opportunity to look back at how risk allocation in M&A deals has changed in the 2007–2017 period and the reasons for such change.

We trust that the CMS European M&A Study will assist you in your everyday M&A activities.

Stefan Brunnschweiler
Head of the CMS Corporate/M&A Group

CMS European M&A Study 2018

The CMS European M&A Study 2018 ('the Study') provides insight into the legal provisions of merger & acquisition (M&A) agreements, makes comparisons across Europe and with the US and identifies market trends. CMS analysed private M&A agreements relating to both non-listed public and private companies in Europe for the eleven-year period 2007–2017. Of the 3,651 CMS transactions we analysed, 438 relate to 2017 and 2,488 relate to the period 2010–2016.

In analysing the 2017 market, we report on current market standards on risk allocation in M&A deals, comparing 2017 against 2016 and the previous seven-year average in 2010–2016. The special features of this Study are as follows:

- CMS Trend Index – we provide a CMS Trend Index to illustrate a current fact or trend for the particular feature reported on, comparing the position in 2017 with that of 2016 and/or the seven-year period 2010–2016.
- CMS European/US risk allocation comparison – we provide a headline analysis of the differing risk allocation on standard issues in European and US M&A.
- CMS European regional differences – we highlight certain issues which are particular to one or more of the six covered European regions.
- CMS deal size analysis – we have analysed our data against three different deal values: firstly, deals up to EUR 25m; secondly, deals in a value range of EUR 25m to 100m; and thirdly, deals exceeding EUR 100m.
- Tenth Edition: Looking back to 2007 – we reflect on some significant changes in the way that risk is now allocated between sellers and buyers in M&A deals, and also on some significant similarities where the world does not seem to have changed at all.

Executive summary

There was a buoyant M&A market throughout 2017. Few predicted that it would last the whole year given the political uncertainty in Europe and further afield. Sellers exploited the buoyant market by reducing the residual risk on seller/buyer risk allocation to the same level as 2015 – and probably did even better than that. The 2017 results demonstrated a significant increase in all the seller-friendly aspects of M&A deals: more locked boxes; more use of W&I insurance; lower liability caps; and fewer MAC clauses. The headlines are as follows:

- Locked box was used in 25% of all deals across Europe and was particularly popular in larger deals;
- Earn-outs remained a popular feature, especially in Benelux, German-speaking countries and Southern Europe with longer earn-out periods and more turnover-based earn-outs than previously;
- Baskets and *de minimis* provisions were less frequent due to nominal liability caps in deals featuring W&I insurance making them redundant;
- W&I insurance usage is at an all-time high, especially in deals exceeding EUR 25m;
- Liability caps are getting lower, especially in the bigger European jurisdictions, mainly as a result of W&I insurance;
- Limitation periods are not getting any longer, with the majority operating in the one- to two-year range;
- Security for warranty claims is less frequent than it was a decade ago, with escrow accounts being very much the favoured alternative when there is security;
- MAC clauses have never been rarer in Europe;
- Arbitration regained some of its popularity with a notable trend emerging in favour of international rather than national rules where applicable.

As ever, there are regional differences. France still has the lowest seller liability caps. CEE uses arbitration as the dispute resolution mechanism more than any other region. The UK remains wedded to *de minimis* and basket provisions, although interestingly seller liability caps seem to be higher in the UK than in other regions. Deals in the German-speaking countries seem to occupy the middle ground on most issues as far as risk allocation in Europe is concerned. We continue to see similar trends in all or most of the European regions rather than on an individual basis.

We also see a different dynamic in larger deals or deals which have a US element. Both these aspects are explored in further detail below.

2017 results at a glance

CMS Trend Index

	2010 – 2016	2016	2017
DEALS WITH PURCHASE PRICE ADJUSTMENT	45%	47%	48%
DEALS WITH A LOCKED BOX (WHERE NO PURCHASE PRICE ADJUSTMENT)	44%	43%	49%
DEALS WITH NO BALANCE SHEET ADJUSTMENT	31%	30%	27%
EARN-OUTS	17%	22%	21%
— SHORT EARN-OUTS (12 MONTHS OR LESS)	28%	30%	13%
— LONG EARN-OUTS (36 MONTHS OR MORE)	22%	23%	21%
— EBIT / EBITDA-BASED EARN-OUTS	42%	42%	41%
— TURNOVER-BASED EARN-OUTS	29%	32%	37%
DE MINIMIS	68%	76%	72%
BASKET	66%	72%	68%
— LOWER BASKET (LESS THAN 1% OF PRICE)	54%*	55%	58%
— HIGHER BASKETS (MORE THAN 1.5% OF PRICE)	30%*	28%	24%
— FIRST DOLLAR RECOVERY	76%	82%	81%
LIABILITY CAPS			
— NO CAPS	16%	9%	10%
— LESS THAN 50% OF PRICE	52%	58%	60%
— LESS THAN 10% OF PRICE	10%	14%	21%
LIMITATION PERIODS			
— 12 – 18 MONTHS	33%	36%	34%
— 12 – 24 MONTHS	63%	66%	69%
— MORE THAN 24 MONTHS	22%	20%	19%
SECURITY FOR WARRANTY CLAIMS	33%	29%	30%
— RETENTION FROM PRICE	30%	22%	18%
— ESCROW ACCOUNT	58%	60%	63%
MAC CLAUSE	15%	15%	13%
ARBITRATION CLAUSE	34%	25%	29%
— APPLICABILITY OF INTERNATIONAL RULES RATHER THAN NATIONAL RULES	39%	37%	46%

* Data only available for 2011 – 2016

The key conclusions of the CMS European M&A Study 2018 are as follows:

Purchase price adjustments – the proportion of deals with purchase price adjustments in 2017 was 48%. This is almost identical to 2015 and 2016 but still more than the seven-year average.

Locked box – locked box was used more in 2017 than in 2016. There were over 25% of European deals using a locked box mechanism compared with 23% in 2016, including a marked increase in locked box usage in large deals, being used in 88% of EUR 100m plus deals and especially in some regions, notably the UK, Southern Europe and German-speaking countries, although there was a decrease in other regions, notably Benelux.

Earn-outs – earn-outs remained popular, with 21% of deals including an earn-out component although this was slightly less than in 2016. They were most popular in Benelux, Southern Europe and German-speaking countries with 30%, 33% and 28% respectively, roughly twice as popular as in CEE, France and the UK.

Earn-out period – although the proportion of longer earn-outs (i.e. more than three years) remained similar in 2017 to that in 2016, there was a notable increase in the number of earn-outs in the 24 – 36 month range, increasing from 18% in 2016 to 29% in 2017. Short earn-out periods of 12 months or less declined dramatically from 30% to 13%.

Earn-out basis – turnover-based earn-outs gained in popularity as against EBIT / EBITDA earn-outs, with turnover being the earn-out criterion in 37% of earn-out deals compared to 32% in 2016 and 29% in the 2010 – 2016 period. It appears that buyers increasingly value revenue over the more easily manipulated earnings criteria for the purposes of striking the eventual purchase price.

***De minimis* –** we saw the number of deals including *de minimis* provisions drop from 76% in 2016 to 72% in 2017. The frequency of its use has decreased in most jurisdictions except the UK and France. The most likely explanation for this is the increased use of W&I insurance. The most popular threshold remained less than 0.1% of the purchase price (31% in 2017, slightly down from 33% in 2016).

Baskets – we saw a very similar trend as for *de minimis,* most probably for the same reasons. There were fewer deals with baskets in 2017, falling from 72% to 68%, although still higher than the seven-year average of 66%. The basket threshold was on average slightly lower, with 31% of deals having a basket of 0.5% or less of the purchase price compared to 28% in 2016. 'First dollar' recovery remained overwhelmingly the most popular form of damage recovery on a warranty claim except in France and Southern Europe (41% and 51% respectively). There remained a significant difference in approach compared with the US, which favours 'excess only' recovery (70% of deals).

Liability caps – liability caps have been getting lower, especially in the 'less than 10% of the purchase price' category, with 21% of deals in 2017 compared with 14% in 2016 and 10% during 2010–2016. This most likely was a result of the higher number of deals featuring buyer W&I insurance. Lower liability caps were a particular feature of EUR 100m plus deals, with 52% having a cap of less than 10% of the purchase price. For deals where the liability is 50% or more of the purchase price, there were different trends within European regions.

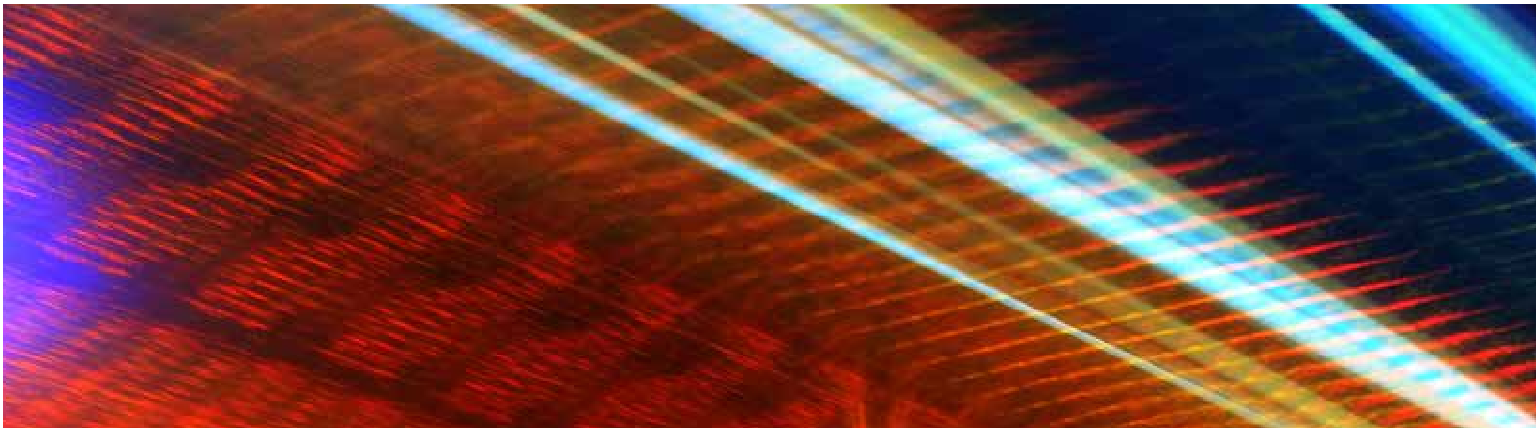
Warranty & Indemnity insurance – it was a boom year for W&I insurance, with 14% of deals across Europe involving W&I insurance. Larger deals were more likely to have a W&I insurance component, with 35% of deals where the purchase price exceeded EUR 100m featuring W&I cover. One particular development was that deals including a W&I component were more likely to feature a basket provision operating on an 'excess only' basis (23% compared with 9% in 2016).

Limitation periods – there was a similar number of 'long tail' deals in both 2017 and 2016 (i.e. those with a limitation exceeding 24 months), but there was some change in two other time bands, with 69% of deals having a general warranty limitation period of 12–24 month range (as against 66% in 2016) and 35% in the 18–24 month range (as against 30% in 2016).

Security for warranty claims – the number of deals which had some kind of security against warranty claims did not differ much between 2016 and 2017 at approximately 30%. Escrow accounts were, however, very much the favoured form of security. Retention of part of the purchase price by the buyer remained hard to achieve and occurred less frequently in 2017 (18% of relevant deals, as against 22% in 2016).

MAC clauses – 2017 was a record year for low take-up of MAC clauses, featuring in just 13% of European deals. This once again demonstrates the total disparity with US deals, where the bulk of transactions (93%) have MAC clauses.

Arbitration – the number of M&A deals with an arbitration clause rose to 29% in 2017 from the low of 25% in 2016. The most notable feature of those deals where arbitration was the chosen dispute resolution mechanism was the fact that a higher proportion favoured international rules in 2017 rather than national rules (46% as against 37% in 2016). Arbitration provisions remain popular in CEE (66%) and Southern Europe (53%), but there was little take-up in UK (8%) or France (4%).



CMS European / US risk allocation comparison

Transactional lawyers are increasingly aware of market practice differences between Europe and the US when acting on deals. As in previous years, the Study continues to highlight such of those differences as can be established via the data under review.

- As in prior years, purchase price adjustments feature in the vast majority of US deals (86%) compared to 48% in European transactions. These figures have remained essentially static.
- It continues to be the case that working capital adjustments are the most frequently used component of a purchase price adjustment. In the US, working capital adjustments feature in 89% of the deals involving a purchase price adjustment whilst the figure remains at 40% in Europe. Separate debt and cash adjustments are the next most commonly used metrics.
- The frequency of earn-outs has also remained largely the same over the past year. They feature marginally more often in the US (28%) than in Europe (21%).
- In European earn-out deals, EBIT/EBITDA is the most commonly adopted metric used to calculate any earn-out payment (40%) whereas in the US it is more evenly split between turnover/revenue (32%) and EBIT/EBITDA (29%).
- A *de minimis* financial limitation is seen in almost three quarters of deals in Europe (72%, down from 76% last year), but still remains less common in the US (35%, down from 37%).
- The existence of a basket financial limitation occurs in almost all deals in the US (98%) compared to 68% on European deals. Coupled with this disparity is the basis of recovery. In the US, 70% of baskets operate as 'excess only' baskets or a deductible (where recovery is only permitted above the relevant threshold), but such a feature occurs just 19% of the time in European deals involving a basket in 2017. In contrast, in Europe we more consistently experience 'first dollar' baskets (once the threshold is met, the buyer can recover from the first dollar of damage) – 81% of the time against 26% in the US.
- Lawyers are often asked what is a usual figure for a basket and the 1% value is often stated. It is therefore worth noting that in the US the basket tends to be much lower, 1% or less in 95% of deals whilst in Europe we see much less consistency – 32% up to 0.5%, 27% between 0.5 and 1% and 41% of deals over 1%.
- Whilst most deals in US and Europe will feature a liability cap for the seller, as previously reported in the Study, lower liability caps are more popular in the US, with 95% of US deals having liability caps of 25% of the purchase price or less compared with only 47% of European deals.
- A MAC clause is habitually included in a US deal (93%) but far less common in European deals (only 13%) where they are not needed on deals where signing and closing is simultaneous.

As a quick reference, the table below sets out the differences noted:

Europe / US differences

	EUROPE	US
PURCHASE PRICE ADJUSTMENT	48%	86%
WORKING CAPITAL ADJUSTMENT	40%	89%
EARN-OUT DEALS	21%	28%
DE MINIMIS	72%	35%
BASKET	68%	98%
BASKET THRESHOLD (1% OR LESS)	59%	95%
'EXCESS ONLY' RECOVERY	19%	70%
'FIRST DOLLAR' RECOVERY	81%	26%
SUB-25% LIABILITY CAPS	47%	95%
MAC CLAUSES	13%	93%

There are of course other features of market practice in the US and Europe which are worth noting.

The lower liability caps in the US noted above are almost always typically backed up by a cash escrow or retention of between 10% and 15% of the purchase price, which amount is often also the seller's liability cap on the deal. In Europe, the use of cash escrow/retention mechanisms is less customary, rarely equivalent to the cap and tends to be adopted as a specific security for identified issues or in relation to purchase price adjustments.

European deals (especially those involving W&I insurance) involve negotiation of the extent of general disclosure against warranties that is permitted and, connected to that, whether the buyer will agree that the contents of a data room can be generally disclosed. General disclosure concepts are rare on US deals with specific disclosure schedules connected to the purchase agreement remaining the conventional way to qualify warranties given by the seller.

US transactions also do not favour permitting the use of 'buyer's knowledge' limitation provisions or reverse warranties where a buyer is prevented from bringing warranty claims where it has knowledge of the relevant matter. In the US this type of provision is known as an anti-sandbagging clause and US buyers would often strongly resist the inclusion of one of these and instead insist on the reverse, a 'sandbagging' provision which essentially affirms the position that only the disclosure schedules qualify the warranties.

A final feature of US M&A market practice as regards risk allocation is the 'materiality scrape'. This is a provision where, for the purposes of establishing whether the *de minimis* or basket financial threshold has been met, the buyer is entitled to disregard materiality qualifications in the warranties. Such provisions are extremely rare in European deals.

The results of the 2017 Study therefore highlight substantially the same distinctions between US and European market practice as observed last year. This seems to be a clear recognition that on the topics referred to above the positions reached in the US and Europe are well established and whilst, on a deal by deal basis, will be subject to negotiation, the features themselves will likely not change significantly over time absent some major legislative or regulatory change.

CMS deal size analysis

The Study analyses data from deals:

- with values of up to EUR 25m
- with values of between EUR 25m and EUR 100m; and
- with values over EUR 100m.

We have found that depending on the size of the deal, certain of the risk allocation metrics differ and the parties' attitude towards risk is clearly impacted by the consideration involved in the transaction.

The bullet points below identify (i) some changes since last year and (ii) the main differences, in each case, when comparing the larger EUR 100m plus deals with the sub-EUR 100m deals:

- Purchase price adjustments (PPAs) appear, unlike in 2016, to be broadly as common on smaller deals as on larger deals;
- Where there is no PPA, the use of locked box mechanisms is even more frequent on the large deals;
- As in prior years, earn-outs are rare on larger deals but notably longer – two thirds being longer than three years and 0% being 12 months or less;
- EBIT/EBITDA is more popular as the criteria on which earn-outs are based on the smaller deals, with turnover/revenue being common on the larger deals;
- Liability caps are proportionately lower on larger deals;
- W&I insurance is more likely to be purchased on larger deals;
- Time periods within which to bring warranty claims are shorter on larger deals; and
- Whilst the instances of security being provided for warranty claims are broadly equivalent regardless of deal size, escrow/retention accounts are more popular on the larger transactions.

More frequent use of locked box for large deals

Low liability caps and more W&I insurance for larger transactions

For ease of reference, we set out the differences in the table below:

Deal size comparison

	< EUR 25M	EUR 25M – 100M	> EUR 100M
PURCHASE PRICE ADJUSTMENT (PPA)	48%	48%	50%
LOCKED BOX (NO PPA)	39%	60%	88%
EARN-OUTS	25%	16%	10%
SHORT EARN-OUTS (12 MONTHS OR LESS)	17%	7%	0%
LONG EARN-OUTS (MORE THAN 36 MONTHS)	18%	21%	67%
EBIT/EBITDA-BASED EARN-OUTS	39%	56%	20%
TURNOVER-BASED EARN-OUTS	41%	19%	40%
LIABILITY CAP (LESS THAN 10% OF PRICE)	13%	29%	52%
LIABILITY CAP (LESS THAN 25% OF PRICE)	32%	52%	75%
W&I INSURANCE USAGE	4%	27%	35%
LIMITATION PERIOD (OF MORE THAN 24 MONTHS)	22%	18%	6%
SECURITY FOR WARRANTY CLAIMS	29%	31%	33%
ESCROW ACCOUNT (IF SECURITY FOR WARRANTY CLAIMS IS AGREED)	53%	78%	82%
MAC CLAUSE	12%	15%	15%
ARBITRATION	26%	32%	38%
TAX INDEMNITY CLAUSE	55%	59%	77%

So what conclusions can we draw from this data?

- On large deals, the parties will often want certainty as to the purchase price. This lends itself to (i) use of locked box discipline and (ii) lack of earn-outs. Using a locked box helps to fix the price but gives a buyer recourse to the extent of unpermitted leakage from a diligenced balance sheet. Given the high deal values, sellers typically would be satisfied with the large upfront consideration offered.
- In terms of risk allocation, whilst the data may suggest lower liability caps (and perhaps other more seller-friendly limitation provisions), in real money terms the financial caps are expected to be significant (although lower in value percentage terms). The seller may also be able to offload warranty exposure more easily by pre-packaging a buyer's W&I policy.
- On the large deals, the buyer will focus on big ticket money items; issues that go to the heart of the value of the deal. So we suspect buyers may be focussed instead on MAC clauses and meaningful security for claims (e.g. in the form of an escrow) or an insurance policy to protect against significant items which materially erode value.

CMS European regional differences

The Study demonstrates the following major differences in market practice within the European region as follows:

In Benelux:

- Transactions in Benelux with an escrow account increased significantly from 24% in 2016 to 37% in 2017 and Benelux is the region with by far the highest number of such transactions compared to other jurisdictions (e.g. France 8% and UK 15%).
- There has been a significant decline in the application of MAC clauses in the Benelux region, falling from 26% of transactions in 2016 to 13% in 2017 although this seems to reflect a move back to the 2010–2016 average of 15%.

In CEE:

- Arbitration clauses were applied in 66% of transactions for 2017 in the CEE region (itself an increase from 56% in 2016) which is far ahead of the application of local courts for dispute resolution in respect of, for example, UK and French transactions at 8% and 4% respectively.
- There was a significant increase in the use of an earn-out mechanism for CEE transactions from 10% in 2016 (and the average for 2010–2016) to 15% in 2017, reflecting a move towards the overall European average of 21%.

In German-speaking countries

- Earn-outs continue to increase in popularity in respect of German transactions with 29% in 2017 (compared with an already significant 25% in 2016), which is substantially above the European average of 21%.
- Only 12% of 2017 transactions in German-speaking countries included MAC clauses, which broadly matches the UK experience at 8% but is some way behind transactions in CEE and France, where the figures are 22% and 25% respectively.

In France:

- The large majority of transactions in France included a basket with an 'excess only' recovery basis (59% in 2017), which compares with a European average in 2017 of just 19% and accordingly is nearer to US practice where basket 'excess only' arrangements applied in 70% of transactions.
- In 2017 there was an increase in transactions with a lower liability cap of up to 25% of the purchase price from 70% to 76%, which is some way ahead of the European average of 42% of all transactions.

In Southern Europe:

- Once again deals in Southern Europe had the highest proportion (62%) of transactions with a limitation period for warranty claims of more than 24 months. This is a significant deviation from the European average of 19% of such transactions.
- A significant proportion (33%) of Southern European deals included an earn-out mechanism, which clearly exceeds the European average of just 21% of all transactions in 2017.

In the UK:

- Very few deals in the UK included a basket 'excess only' basis of recovery for warranty claims, at just 9% of transactions; the vast majority (at 91%) were calculated on a 'first dollar' basis, which means that the proportion of "excess only" deals is lower here than anywhere else in Europe.
- The UK had the lowest number of transactions with a limitation period for warranty claims over 24 months, at 6%. This compares with a range for such longer limitation periods from 37% (CEE) to 62% (Southern Europe) of transactions.

Tenth Edition – looking back to 2007

CMS published its first CMS European M&A Study in 2009; covering nearly 500 deals in the previous two years. Now there is a data bank of some 3,650 deals and we are taking the opportunity to look back at the changes in the 2007–2017 period. This period spanned the global financial crisis; the meteoric rise of China; the more recent Eurozone uncertainties; growing national and populist dissatisfaction with the EU project; the UK's Brexit vote; greater protectionism; digitisation; new war zones and a ramping up of global insecurity.

The M&A market struggled in the aftermath of the global financial crisis. 2008–2011, in particular, were depressed years, but the later years, especially 2014–2017, saw a buoyant M&A market.

What has happened to risk allocation on M&A deals during that period?

Locked box

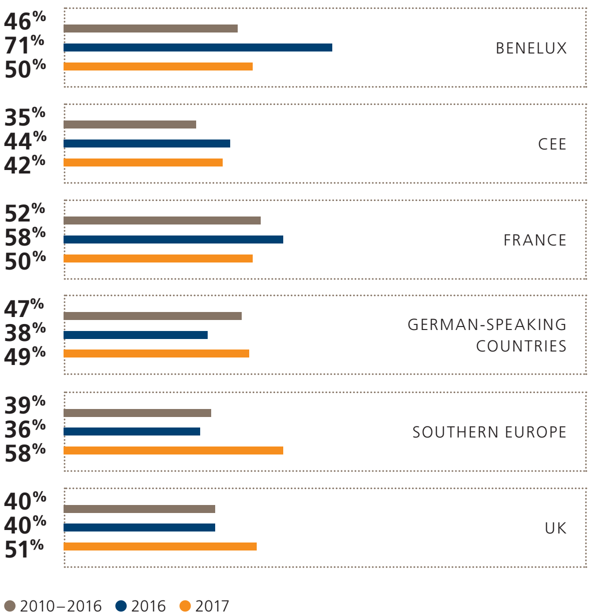
The years (2007–2017) covered by our ten editions of the CMS European M&A Study are definitely the "locked box years". Prior to 2007, a locked box was not universally used. It was just emerging as a technique favoured by private equity sellers to avoid protracted wrangling about completion accounts. The traditional approach had three disadvantages: it gave rise to price uncertainty; it was time consuming and an unproductive distraction; and, in some cases, it delayed the return of funds to investors. Using the locked box mechanism avoided all this.

The idea of striking the price being based on heavily vetted and warranted pre-closing accounts with strong safeguards against cash extraction gained popularity. Like many techniques which started in the private equity world, major corporate sellers could also see the attraction of the locked box mechanism and gradually adopted it, especially in auction processes.

CMS first analysed locked boxes in 2009 and found that approximately 6% of deals across Europe used a locked box. By 2011, it was 20% and in 2017, 25%.

Locked box started as an Anglo-Saxon invention. It soon became widely used in German-speaking countries and increasingly throughout Europe. Its even spread of usage across Europe in 2017 is evident from the fact that its popularity spans 42% in CEE to 58% in Southern Europe for use of locked boxes in deals where there is no purchase price adjustment. Every other jurisdiction or region has locked box usage around the 50% mark. Yet in 2010 only two European regions were above 25%, and in 2009 the UK and German-speaking countries were using it in less than 15% of deals where there was no purchase price adjustment.

Locked box 2010–2017



100% = transactions with no purchase price adjustment mechanism (deals with purchase price adjustment and locked box are not included)

Warranty and Indemnity (W&I) insurance

W&I insurance has changed the M&A landscape during 2007 – 2017 and has never been more widely used in M&A deals than in 2017.

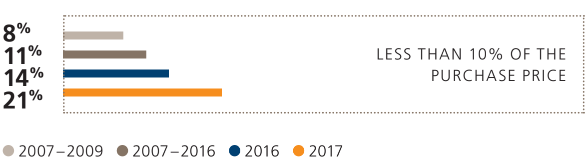
For years, the 'warranty gap', i.e. where there was either (i) no obvious warrantor to stand behind the warranties (e.g. private equity sellers), or (ii) insufficient warranty cover due to concerns about the creditworthiness of the warrantors, was often a very difficult, sometimes intractable, deal issue. W&I insurance has filled that gap and, over time, adapted to particular deal issues and developed its own market practice, e.g. to cover the repetition of warranties on closing; the sale of single asset special purpose vehicles such as real estate wrappers; and the coverage of known risks.

CMS acts either for the insurer or insured on over 150 deals a year. Although we do not specifically review the many deals where we act for the insurer, the change in market practice on risk allocation as between sellers and buyers is palpable and one of the most obvious is the seller liability caps which are highlighted elsewhere in the Study. After initial scepticism about whether insurers would respond positively when claims were made, the market now has confidence in the product. There is extensive know-how, execution skills and experience in the W&I insurance market which means that tight M&A deadlines can be achieved with most sellers and buyers understanding the market norms both in terms of coverage and premium. Many auctions (whether run by private equity or strategic sellers) now feature a W&I insurance option for the buyer. In turn, buyers often feel more comfortable about the prospect of claims against an insurer rather than the seller.

Lower liability caps

One of the most notable differences during the 2007 – 2017 period has been the fall in liability caps for sellers in M&A deals.

Liability caps 2007 – 2017



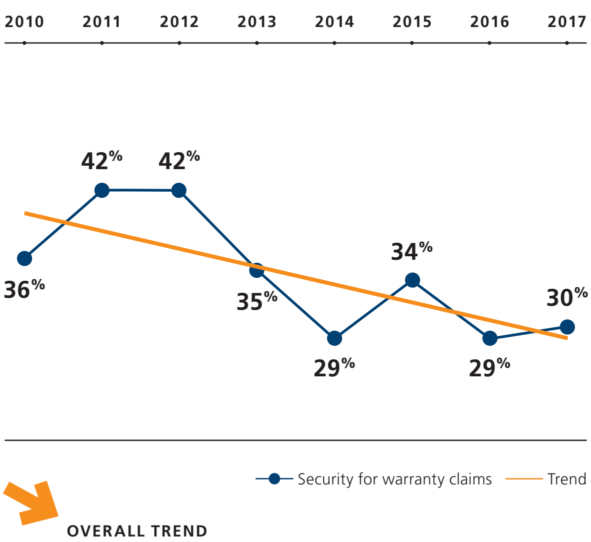
100% = all evaluated transactions

In the period 2007 – 2009, just 8% of deals had a liability cap for the seller of less than 10%. In 2017, 21% of deals had a liability cap of less than 10%. The availability of W&I insurance is the most obvious explanation for this change. Indeed many deals now have only nominal seller liability caps for warranty breaches. Strategic buyers have found themselves confronted with very low seller liability caps and relying on W&I insurance. In turn, when those buyers become sellers, they have adopted a similar approach. There have been two other drivers for the apparent change in attitude to seller liability caps. Firstly, deals covered in each of our ten editions of the Study have got larger, and therefore the amount represented by up to 10% constitutes a higher actual figure. Secondly, low liability cap deals have been the market norm in North American transactions for many years and although European risk allocation norms have been and remain different from those in North America, some of this attitude may have filtered through.

Security for warranty claims

The number of deals in which buyers demanded security for warranty claims declined during the 2007 – 2017 period. Even in 2011 and 2012 it was as high as 42% of transactions requiring some kind of security, whether that be a retention from the purchase price, escrow account, bank guarantee or other mechanism. In three of the last four years, i.e. 2014 – 2017, the equivalent percentage has been 30% or less. This is presumably not related to buyers becoming more comfortable with the sellers' covenant, but more to do again with the influence of W&I insurance which has presented an acceptable form of potential redress for buyers.

CMS Trend Index Security for warranty claims



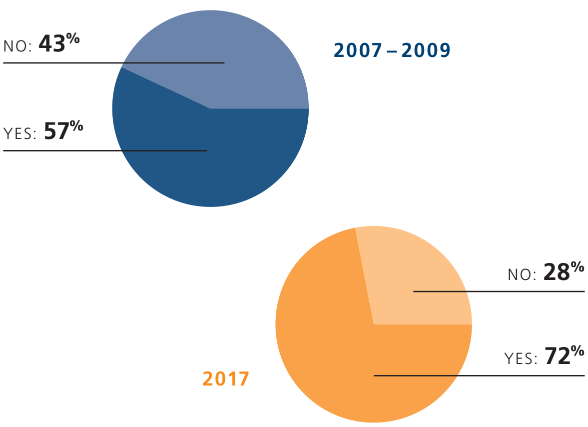
Earn-outs

Earn-outs have become more popular, with 21% of deals in 2017 having an earn-out component compared to 16% in 2007–2009. Turnover-based earn-outs ranged from 21% to 30% in 2007–2009. In recent years they have become more popular as buyers appreciate revenue rather than earnings (which are more easily manipulated). The target's turnover was the relevant criteria in 37% of 2017 earn-out deals.

European convergence

Many of the differing practices in the separate jurisdictions or geographies in the early part of the 2000s have converged. It is equally true (see CMS European regional differences on page 12) that some territories retain their national characteristics (e.g. France's lower liability caps and preference for 'excess only' recovery on warranties; or the UK's traditional high number of deals with *de minimis,* basket and liability caps), but generally speaking the breadth of the bands between the various jurisdictions and geographies has narrowed. There are fewer examples of extreme differences in market practice between the various European territories and regions. For instance, the proportion of deals with *de minimis,* baskets and liability caps in Southern Europe and CEE is much closer now to, say, the UK, than it was in the 2007–2009 period. Indeed, the existence of *de minimis* provisions in deals across Europe rose from 57% in 2007–2009 to 72% in 2017. Similarly, baskets became widespread in European deals, rising from 49% in 2009 to 68% in 2017.

De minimis 2007–2017



100% = all evaluated transactions

US and Europe – no such convergence

North America and Europe are clearly separated by more than the Atlantic Ocean when it comes to deal norms in M&A deals. This is clearly demonstrated in our CMS European/US risk allocation comparison on page 8 where there is a difference of at least 40 to 50 percentage points on certain deal fundamentals, such as frequency of working capital adjustments, MAC clauses and low liability caps. The remarkable fact here is that despite the shrinking of the world through greater connectivity and the presence of US corporations throughout Europe (and therefore many US buyers) – and to a lesser extent vice versa – the difference remains as great as ever and has hardly shifted in any of our European/US risk comparisons through all our ten editions of the Study.

Plus ça change plus c'est la même chose

There have been shifts in our matrix when measuring risk allocation trends in our ten editions of the CMS European M&A Study. Some have reflected business confidence at the time – for instance, the start of the recovery in 2010 and 2011 when the Study showed that sellers were getting better deal terms with lower liability caps and shorter warranty limitation periods as the market rebalanced after the global financial crisis. Others have resulted from the influence of private equity and the emergence of a new industry. Locked boxes and W&I insurance are obvious examples.

Many important features, however, have hardly changed at all:

- the proportion of deals with purchase price adjustments was 47% in 2009 and is 48% in 2017 (with not much variation in between);
- the proportion of deals with MAC clauses was 17% in 2007–2009 and 13% in 2017.

Some deal points have fallen away. For instance, in our first edition of the Study we covered the frequency of warranties on equity capital and net assets (which were covered in 15% of deals) and tracked the regularity of a specific warranty relating to target debts (27% of deals). Both of those areas have become more the basis of price adjustment or forensic due diligence investigation and have been subsumed into broader accounts warranties nowadays. They are no longer particularly relevant features in M&A deals.

Key messages

- 2017 was a buoyant year for European M&A with value worth almost USD 1trn and little change in volume.
- CMS reported data for 438 deals in 2017, virtually the same as 2016.
- None of the political events such as national elections in France, Germany and the Netherlands, the election of President Trump and the Brexit uncertainties have adversely affected the M&A deal market.
- Sellers were able to enjoy their most favourable risk allocation result for at least a decade and 2017 is certainly the best on record since CMS first started reporting on seller/buyer risk allocation in 2007/2008.
- Radical US tax reforms, the power of private equity and the promise of some Brexit certainty may sustain the European M&A market for most of 2018.

What will be the big changes by 2028?

Risk allocation in private M&A deals will not change radically. The influence of private equity which led to locked boxes and kick-started the W&I insurance industry represented bigger changes in the last ten years than any in the previous twenty years. Changes may be brought about by extensive use of artificial intelligence, electronic document execution and even the standardisation of sale and purchase agreements. W&I insurance may not continue to be the attractive proposition it is today because of an avalanche of claims pushing up premia and adversely affecting policy coverage. In addition, both the US and UK, the source of most deal-making techniques, may develop new risk allocation methodology as each jurisdiction concentrates more on its domestic market over the next few years.

We can be sure that speed of execution, price certainty and an effective right of recourse for the buyer will continue to be the priorities. It will be fascinating to see how CMS' 20th edition of the CMS European M&A Study in 2028 looks back on the next ten years.

The data used in the Study is not publicly available and is based on privately negotiated transactions in which CMS acted as an advisor to either the buyer or the seller. CMS is one of the few legal service providers with the capability to provide a European study of this kind due to its presence and market penetration in a wide range of jurisdictions across Europe.

Purchase price adjustment (PPA) / Locked box

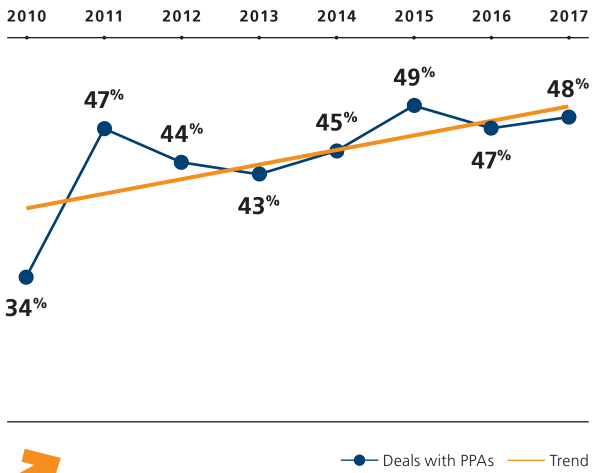
M&A agreements which include provisions to adjust the purchase price (PPA) generally do so either to reflect correctly the debt-free/cash-free position at completion or as regards the wider balance sheet position of the target business at completion (whether by reference to net asset value or working capital). The purchase price is often adjusted upwards or downwards depending on whether assumed or estimated levels of cash/debt, net assets or working capital are achieved.

As PPA provisions mean there is uncertainty as to the final purchase price until the completion accounts are finalised (which can take many months after closing), many sellers have sought to include locked box provisions in M&A agreements so there is no post-completion price adjustment. In such cases the M&A agreement will include a warranty in respect of a fixed pre-closing balance sheet and provisions protecting the buyer to some extent for movements in it by covenants as to non-leakage (e.g. dividends or management charges) from the target to the seller.

General Overview

SECTION 1.1

Purchase Price Adjustments (PPAs)

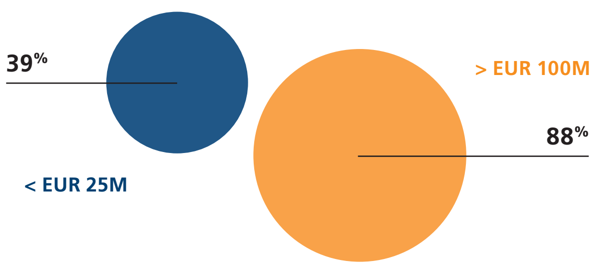


OVERALL TREND

More deals with PPAs

SECTION 1.2

CMS Deal Size Analysis Locked box where no PPA



100% = all evaluated transactions

PPA RATIO

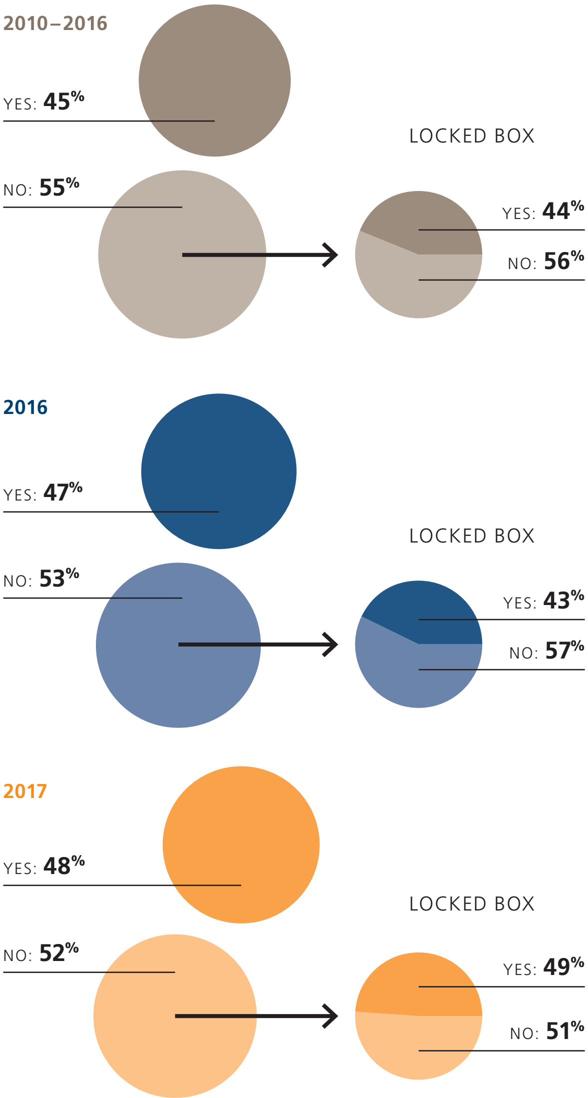
48%

The bigger the deal, the more likely a locked box (where no PPA)

In 2017 we saw a marginal increase over 2016 in the number of transactions with PPA provisions (from 47% to 48%) and the continuing trend over the 2010–2016 period of more locked box arrangements for non-PPA transactions (from 44% to 49%) 1.1. There was a very significant increase from 2016 to 2017 in locked box arrangements for transactions with a purchase price of more than EUR 100m (from 58% to 88%) and a marked increase for UK and German locked box deals from 40% to 51% (UK) and 38% to 49% (German-speaking countries). We believe this reflects the higher number of private equity sellers and auction transactions in 2017, which typically include locked box structures, and where sellers have relative bargaining strength 1.2 1.3.

SECTION 1.3

Purchase Price Adjustment 2010–2017



100% = all evaluated transactions
100% = transactions with no purchase price adjustment mechanism (deals containing purchase price adjustment and locked box at the same time are not included)

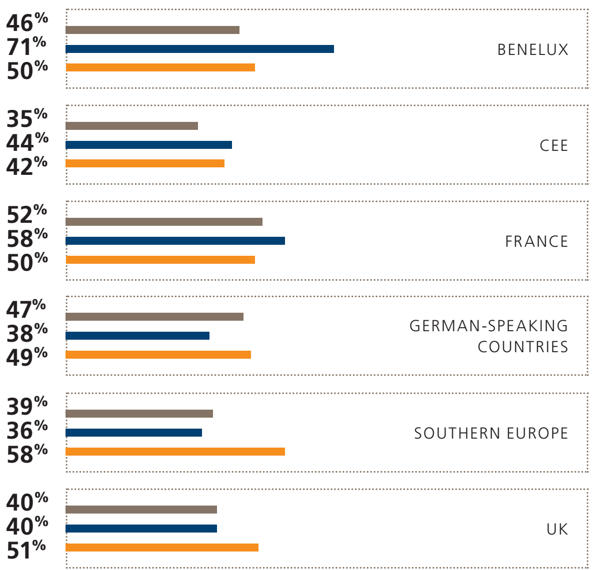
DEALS WITH WORKING CAPITAL ADJUSTMENT

40%

During 2017 there were marked differences in the use of a locked box in non-PPA deals across European regions. Whereas there have been significant increases compared with 2016 in relation to the UK (from 40% to 51%), Southern Europe (from 36% to 58%) and German-speaking countries (from 38% to 49%), there have been reductions in respect of Benelux (from 71% to 50%), CEE (from 44% to 42%) and France (from 58% to 50%). However, as indicated above, the overall year-on-year European trend is an increased usage of locked boxes, featuring in 25% of 2017 deals compared with 23% of 2016 deals 1.4.

SECTION 1.4

Locked Box 2010–2017



● 2010–2016 ● 2016 ● 2017
100% = transactions with no purchase price adjustment mechanism (deals with purchase price adjustment and locked box are not included)

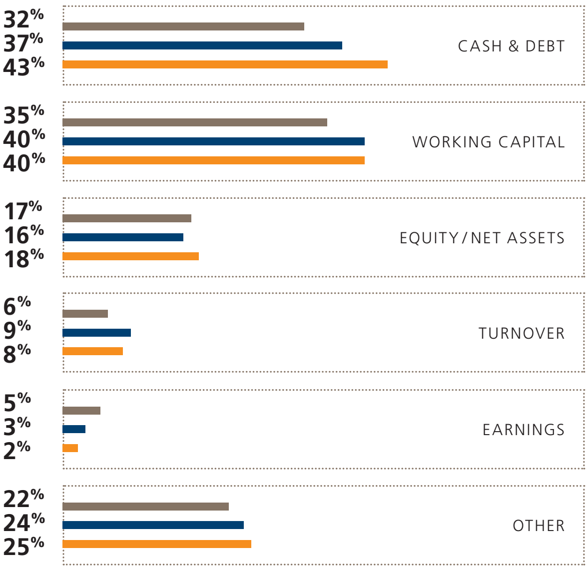
Specific Issues

Overall the elements which comprise the adjustment factors for a PPA transaction have remained consistent, with most such transactions in 2017 reflecting adjustments for cash/debt (43%) and working capital (40%) with fewer reflecting adjustments for net assets or historic turnover or earnings. Of interest is that the 2017 cash/debt (43%) and working capital adjustments (40%) have increased significantly over the 2010–2016 period (32% and 35% respectively) 1.5. However, this increase does not compare with the much larger proportion of transactions in the US which have a working capital adjustment (89% vs. 40%) 1.6.

SECTION 1.5

Purchase Price Adjustment

Chosen criteria 2010–2017



● 2010–2016 ● 2016 ● 2017

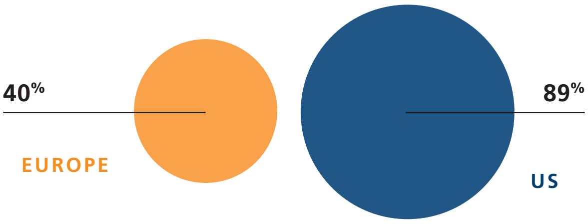
Cash & Debt does not include "cash only" and "debt only"

100% = all transactions including a purchase price adjustment – multiple criteria may apply

SECTION 1.6

Purchase Price Adjustment Europe/US

Working capital as adjustment criterion



100% = all transactions including a purchase price adjustment

WORKING CAPITAL ADJUSTMENT

EUROPE 40%

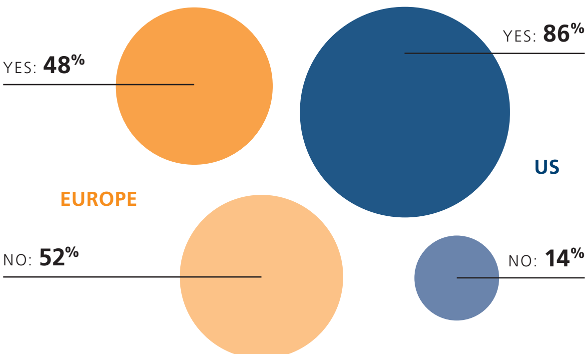
89% US

The proportion of transactions in Europe with PPA provisions (48% in 2017) continues to be significantly less than equivalent transactions in the US (86% in 2017) 1.7.

The increase over 2016 in the number of European transactions with PPA provisions (from 47% to 48%) was reflected in the UK (from 53% to 54%) and CEE (from 42% to 46%) but offset by a decrease in respect of transactions from German-speaking countries (from 43% to 39%) 1.8.

SECTION 1.7

Purchase Price Adjustment Europe/US

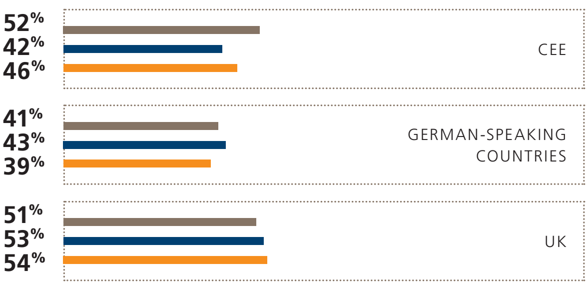


100% = all evaluated transactions

SECTION 1.8

Purchase Price Adjustment 2010–2017

Time trend Europe



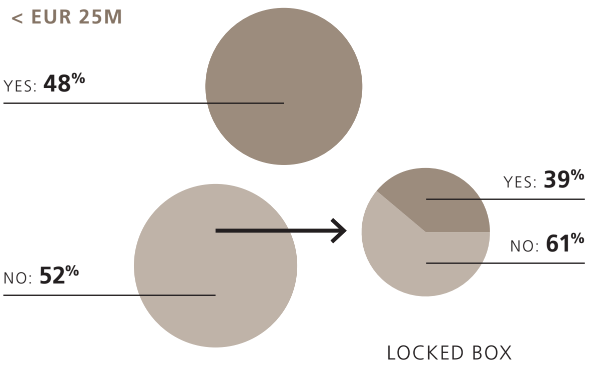
● 2010–2016 ● 2016 ● 2017

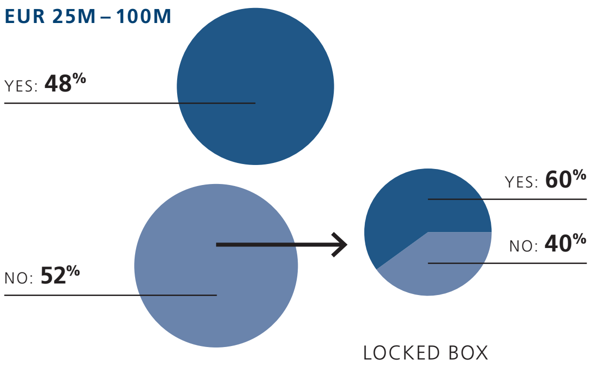
100% = all evaluated transactions

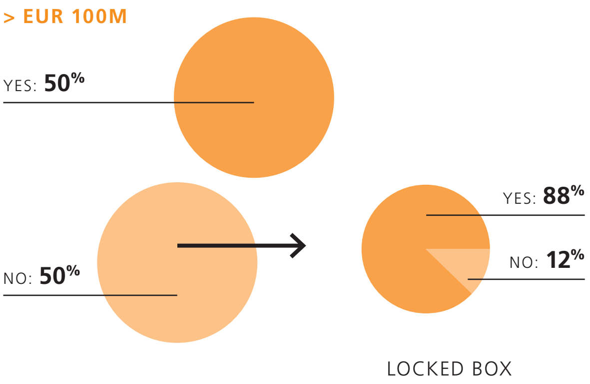
Analysis by Deal Size

SECTION 1.9

Purchase Price Adjustment 2017







88% of EUR 100m plus PPA transactions with locked box

100% = all evaluated transactions
100% = transactions with no purchase price adjustment mechanism
(deals containing purchase price adjustment and locked box at the same time are not included)

We found that in 2017 deal size did not significantly affect whether PPA provisions are included in M&A agreements. The proportion of deals with such provisions for deals of less than EUR 25m and more than EUR 100m were 48% and 50% respectively. However, there is a marked difference in the number of locked box arrangements for those deals which do not have PPA provisions. For those deals of less than EUR 25m, only 39% were locked box, and for deals of more than EUR 100m, 88% were locked box. This confirms the recent trend that the larger the transaction which is not a PPA transaction, the more likely it is to include a locked box arrangement 1.9.

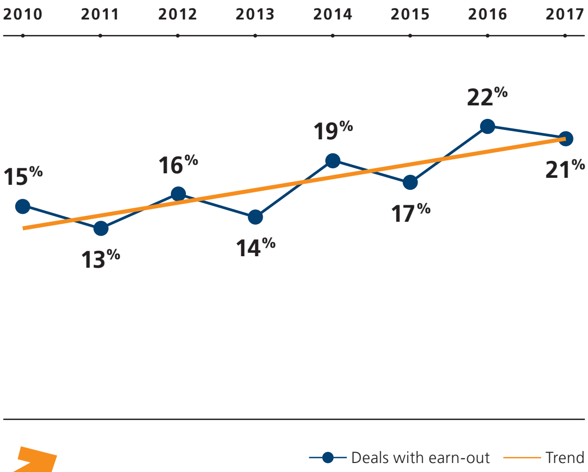
Earn-out

Earn-out provisions are included in M&A agreements to adjust the purchase price by reference to the post-completion performance of the target business, most commonly its future earnings, and often as an incentive to management sellers who are remaining with the business. Such provisions mean the benefits and risks of the target business post-acquisition are shared by the seller and the buyer. The seller has the opportunity to increase the purchase price. The buyer benefits by linking the final purchase price to the actual performance of the target under its ownership.

General Overview

SECTION 2.1

CMS Trend Index Earn-out



OVERALL TREND

Earn-out deals increasing

SECTION 2.2

CMS Sector Analysis Earn-out

SECTOR	2017
BANKING & FINANCE	14%
HOTELS & LEISURE	22%
ENERGY	21%
CONSUMER PRODUCTS	26%
TECHNOLOGY, MEDIA & COMMUNICATIONS	26%
INFRASTRUCTURE & PROJECTS	0%
LIFESCIENCES	24%
REAL ESTATE & CONSTRUCTION	13%
INDUSTRY	24%
BUSINESS (OTHER SERVICES)	22%
CMS AVERAGE	21%

100% = all evaluated transactions of the respective branch

Most earn-outs in TMC, Consumer Products and Lifesciences deals

The trend for more transactions to include earn-out provisions continued in 2017. Over the 2010–2017 period, the proportion of such earn-out transactions has varied from under 15% to more than 20% of all transactions in recent years. This is partially a function of the desire of buyers to pass on risk for future performance to the seller and is also linked to the increasing norm for such structures in particular sectors (e.g. in the Technology, Media & Communications, Lifesciences and Consumer Products sectors) 2.1.

Given that earn-outs are favoured in more innovative sectors, it is no surprise that, as was the case in 2016, the highest proportion of earn-out deals across all the sectors in 2017 are Technology, Media & Communications (26%), Consumer Products (26%), Lifesciences (24%) and Industry (24%). Asset-based sectors such as Real Estate & Construction and Infrastructure & Projects hardly see any earn-outs, although Hotels & Leisure saw more in 2017 (22%) than in 2016 (3%) 2.2.

Earn-outs are also much more popular when individuals or founders are the sellers (32% of deals) as opposed to trade sellers (12% of deals).

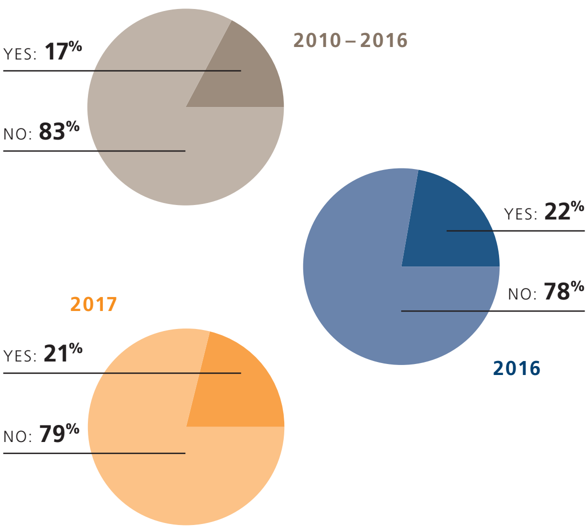
The use of EBIT/EBITDA/earnings as a criterion for determining the basis for earn-out adjustments has decreased in recent years. In particular, the use of an EBIT/EBITDA criterion has decreased from 50% of earn-out deals in 2015 to 41% in 2017 and the application of 'other' criteria has also reduced significantly from 31% to 20% (in the period 2010–2016). By contrast, a turnover based criteria increased during that same period from 29% to 37% in 2017 which may reflect a dynamic in favour of sellers as the test is usually more objective and certain than that derived from an EBIT or earnings based adjustment 2.3 2.4.

TURNOVER-BASED EARN-OUTS INCREASE TO

37%

SECTION 2.3

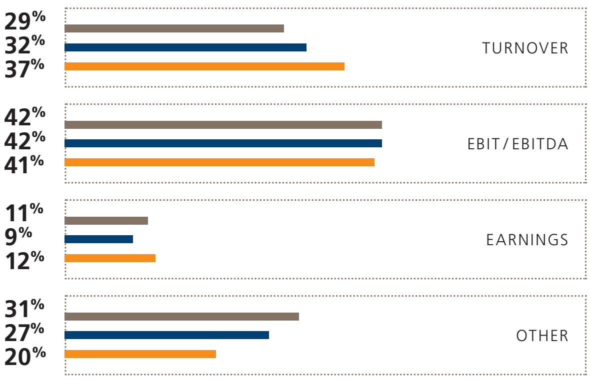
Earn-out 2010–2017



100% = all evaluated transactions

SECTION 2.4

Comparison of Criteria Used for earn-out 2010–2017



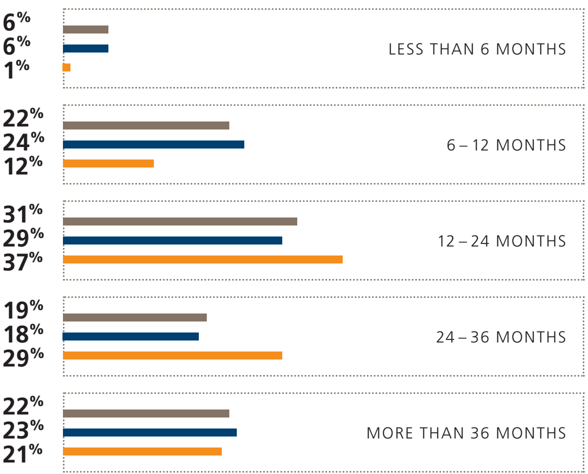
● 2010–2016 ● 2016 ● 2017

100% = all transactions including an earn-out clause – multiple criteria may apply

Turnover-based earn-outs becoming more popular.

SECTION 2.5

Earn-out 2010–2017 Duration of time periods relevant for the assessment of the earn-out



● 2010–2016 ● 2016 ● 2017

100% = all transactions including an earn-out clause

Although most earn-out periods continue to be for 12 to 24 months (37% of earn-out transactions in 2017), there continues to be a decrease in short earn-out periods of less than 12 months (only 13% in 2017) and a corresponding increase in earn-out periods of more than 24 months. The increase in the usage of earn-out periods of 24 to 36 months from 18% in 2016 to 29% in 2017 was particularly notable. This is likely to reflect continuing market uncertainty and concern about future performance post-acquisition 2.5.

EARN-OUT PERIODS OF 24–36 MONTHS INCREASE TO

29%

Specific Issues

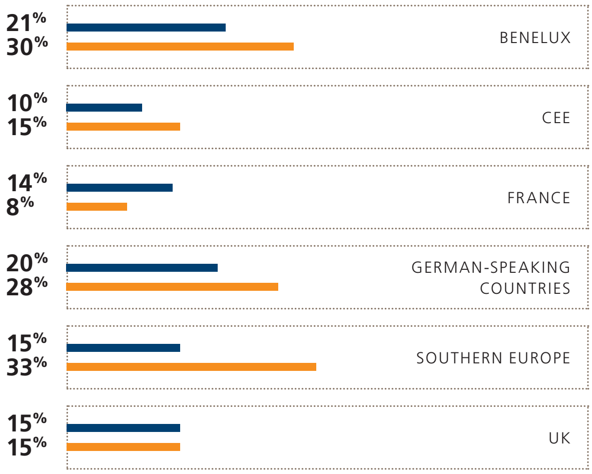
The overall percentage of 21% of transactions comprising an earn-out element applies across Europe but there continue to be interesting regional variations. For example in Benelux, Southern Europe and German-speaking countries, this average is exceeded significantly with percentages of 30%, 33% and 28% respectively whilst the percentages are much less in respect of CEE (15%), France (8%) and the UK (15%) 2.6.

EARN-OUT APPLIED IN
21%
OF TRANSACTIONS

SECTION 2.6

Earn-out 2010–2017

Time trend Europe



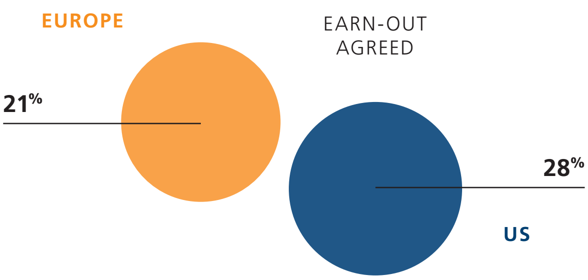
● 2010–2016 ● 2017

100% = all evaluated transactions

SECTION 2.7

Europe / US Comparison

Earn-outs

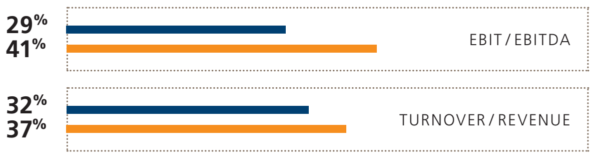


100% = all evaluated transactions

SECTION 2.8

Earn-out Europe / US

Earn-out criteria



● US ● Europe

100% = all evaluated transactions with an earn-out mechanism

EARN-OUT COMPARISON
EUROPE 21%
28% US

The recent convergence between practice in Europe and the US in relation to earn-out provisions appears to have stopped in that 28% of US deals had an earn-out element in 2017 compared to 21% for European deals. In 2016, these percentages were closer, at 26% and 22% respectively (i.e. a swing of 4% to 7% difference between 2016 and 2017). There is also a difference between Europe and the US in criteria applied to determine the earn-out adjustment, with only 29% of US earn-out transactions applying an EBIT/ EBITDA criteria (compared with 41% for Europe). The revenue-based criteria are closer at 32% (for the US) and 37% (for Europe) 2.7 2.8.

Analysis by Deal Size

We found that earn-out provisions continue to be most prevalent in deals with lower values. This may reflect the fact that such deal sizes more often apply in the case of founder shareholder exits and other management disposals. In 2017 the proportion of earn-out deals for transactions under EUR 25m was 25%, which is a slight increase over the 23% reported for 2016. For transactions of more than EUR 100m, the proportion of earn-out deals is slightly higher, at 10% compared with 8% in 2016 2.9.

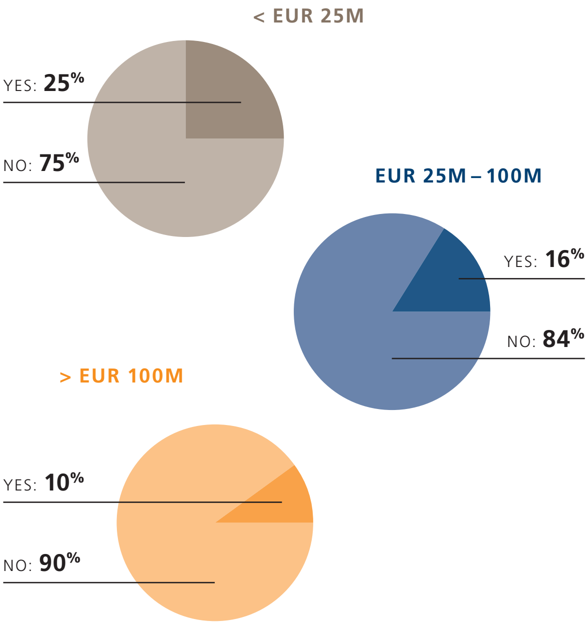
For the smaller deals there is a greater prevalence of EBIT/EBITDA-based adjustments (56% compared to 20% for larger deals) which may reflect the relative bargaining strength of buyers in such transactions 2.10.

Earn-outs tend to be more attractive in smaller mid-cap deals.

SECTION 2.9

CMS Deal Size Analysis

Earn-out 2017

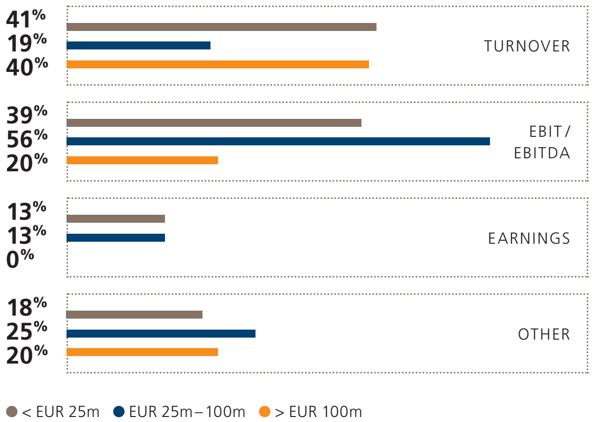


100% = all evaluated transactions

SECTION 2.10

CMS Deal Size Analysis

Comparison of criteria used for earn-out 2017



100% = all transactions including an earn-out clause – multiple criteria may apply

EARN-OUT CRITERIA FOR EUR 100M PLUS TRANSACTIONS:

TURNOVER 40%

20% EBIT / EBITDA

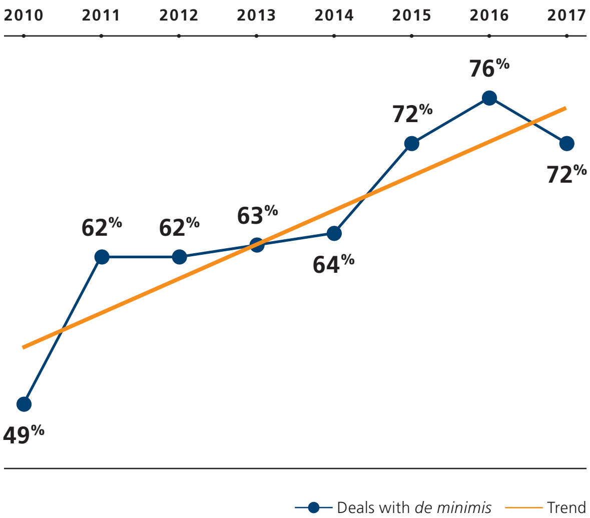
De minimis

De minimis provisions apply to exclude individual warranty claims below an agreed amount. If a claim is less than this minimum amount then it will be ignored. It is a helpful protection for a seller as it protects against potentially frivolous claims and its application is determined purely by reference to an objective monetary amount.

General Overview

SECTION 3.1

CMS Trend Index *De minimis*



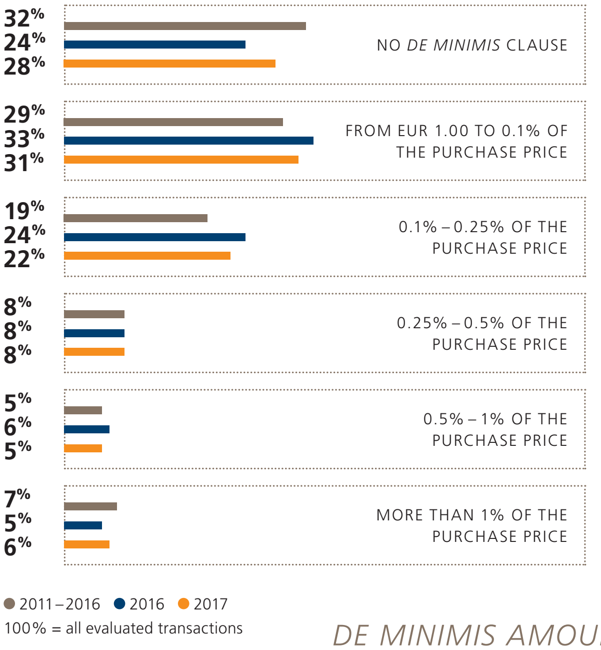
RECENT TREND

OVERALL TREND

Decrease in deals containing *de minimis* provisions.

SECTION 3.2

***De Minimis* 2011–2017** (new bands)



100% = all evaluated transactions

DE MINIMIS AMOUNT

The vast majority of European deals include a *de minimis* exception and they are therefore an increasingly standard seller protection in European transactions. This is demonstrated by the 72% of transactions which included such a provision in 2017. Although this is a decrease on the position in 2016 (76%), it is reflective of the overall trend in recent years. The principle of a *de minimis* clause is usually accepted by buyers at the outset of a transaction but leads to a debate with sellers relating to the actual amount 3.1.

The agreed position in respect of *de minimis* provisions continues to be in the range of up to 0.25% of the purchase price, with most set at less than 0.1% of the purchase price (31%). In many cases the determinant factor for the amount is not linked to the price but to the absolute value of individual claims that should not be counted irrespective of price. This is reflected in the proportion of deals with *de minimis* provisions of more than 0.25% of the price continuing to be relatively low (less than 20% in 2017) 3.2.

DE MINIMIS RATIO 2017

72%

Specific Issues

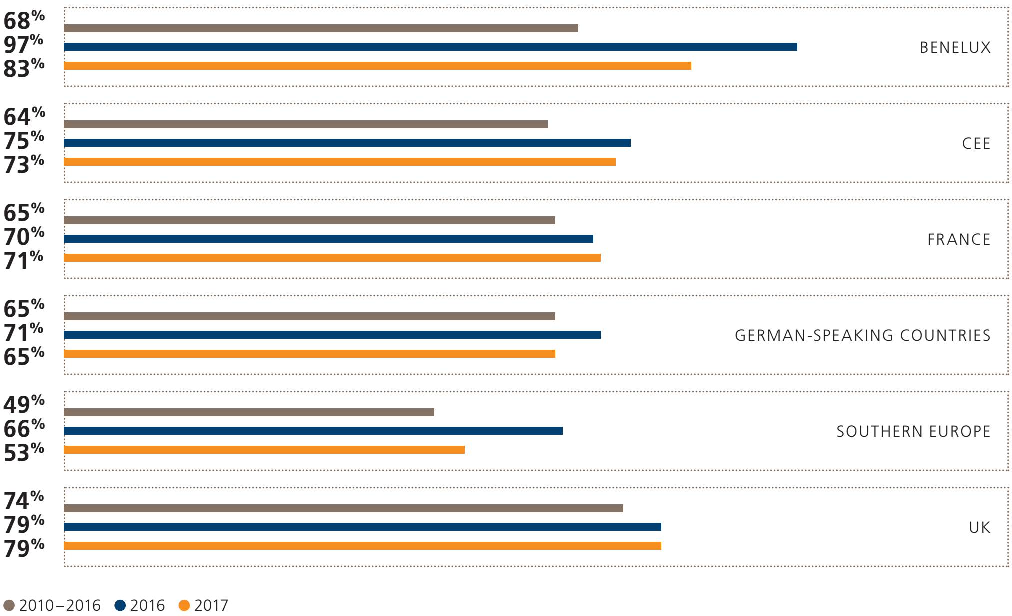
There are continuing regional differences as regards the application of *de minimis* clauses in M&A agreements across European jurisdictions although the clear trend remains that they are applied in the vast majority of transactions. Of interest is that in the UK, the percentage remained the same as in 2016 (79%), varying little since 2010. In other jurisdictions there has been a decline in application since 2016. In Benelux the decline is from 97% to 83%, in CEE from 75% to 73%, in German-speaking countries from 71% to 65% and in Southern Europe from 66% to 53%, with France the exception, increasing from 70% to 71%. It is likely that the greater number of transactions covered by W&I insurance and with a nominal liability cap for the seller has resulted in the *de minimis* provision becoming redundant in such deals 3.3.

De minimis amounts declining as a result of increased W&I insurance.

SECTION 3.3

***De Minimis* Clause 2010–2017**

Time trend Europe: Transactions containing a *de minimis* clause



100% = all evaluated transactions

De minimis provisions less popular in CEE, German-speaking countries and Southern Europe

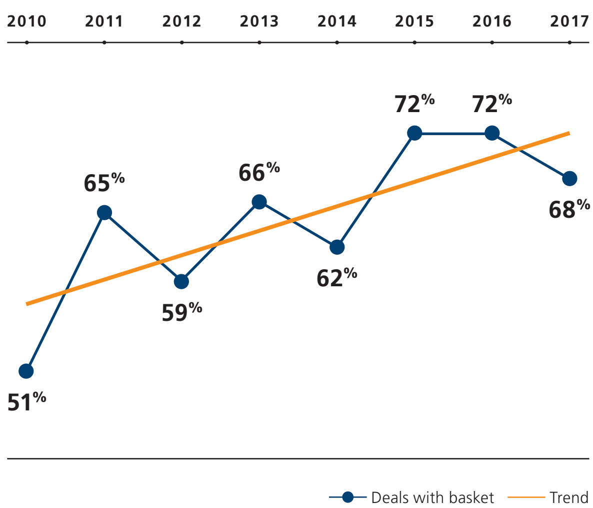
Basket

The basket provision in M&A agreements protect sellers from warranty claims to the extent the total amount claimed is less than an agreed amount often determined by reference to a percentage of the purchase price. This is an additional protection to the separate *de minimis* exception for individual claims. The basket will protect against the entire claim up to the basket (i.e. 'first dollar') or just the excess of the claim over the basket amount (i.e. 'excess only'). The type of basket selected usually impacts on the monetary level of the basket itself.

General Overview

SECTION 4.1

CMS Trend Index Basket

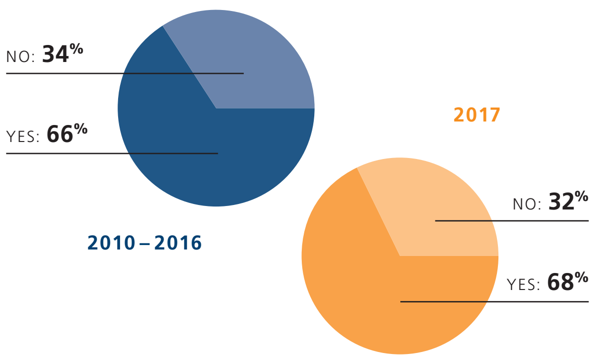


RECENT TREND

OVERALL TREND

SECTION 4.2

Time Trend 2010–2017 Baskets



100% = all evaluated transactions

BASKET RATIO 2017

68%

Fewer deals containing baskets

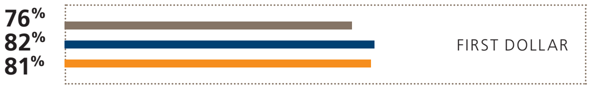
The use of baskets in European transactions has declined significantly from 2016 to 2017 i.e. from 72% to 68%. This level is closer to the yearly average of 66% for the period from 2010–2016 and may therefore reflect a reversion to the norm and, similar to the case with *de minimis* limitations, is likely to be due to the higher number of nominal liability caps due to the use of W&I insurance, although such a decline is still a surprise as baskets have become such a common feature of most transactions 4.1 4.2.

Decline in basket due to increase in W&I insurance.

The proportion of transactions with 'first dollar' and 'excess only' baskets has remained broadly constant at 81% and 19% respectively (as compared to 82% and 18% for 2016), although the year-on-year trend is continuing to increase so that buyer-friendly 'first dollar' baskets are more prevalent in 2017 (81%) when compared with the seven-year average for the period 2010–2016 which is 76% 4.3.

SECTION 4.3

Baskets 2010–2017



● 2010–2016 ● 2016 ● 2017

100% = all evaluated transactions

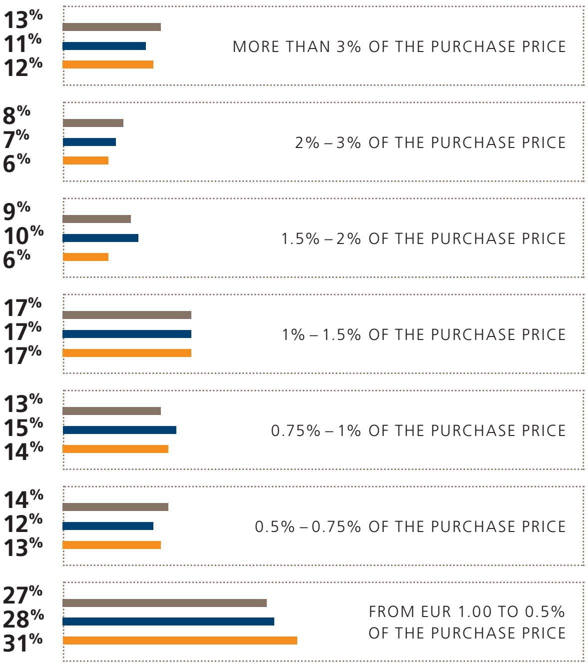
Most baskets are 'first dollar' at 81%.

Specific Issues

There has been an increase in the use of lower levels of baskets from 2016 to 2017 and over the average preceding six-year period. Baskets at the level of up to 0.5% of the purchase price are most common but have increased to apply in 31% of transactions as compared with 28% (for 2016) and 27% (six-year average). This may reflect a greater degree of caution from buyers in a time of market uncertainty. The range of application in respect of other bands has remained broadly consistent except for a significant decline in the range of 1.5 to 2% of the purchase price, which has declined to 6% from the prior year 10%. The second most common range is 1 to 1.5% of the purchase price, seen in 17% of transactions 4.4.

SECTION 4.4

Time Trend 2016–2017

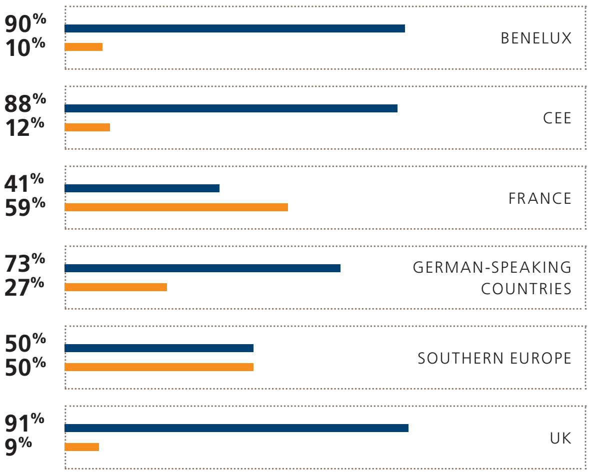


● 2011–2016 ● 2016 ● 2017

100% = all transactions with a basket clause

SECTION 4.5

Baskets / First Dollar 2017



● First Dollar ● Excess Only

100% = all transactions with a basket clause

Decrease in level of baskets with 31% of transactions at 0.5% of purchase price.

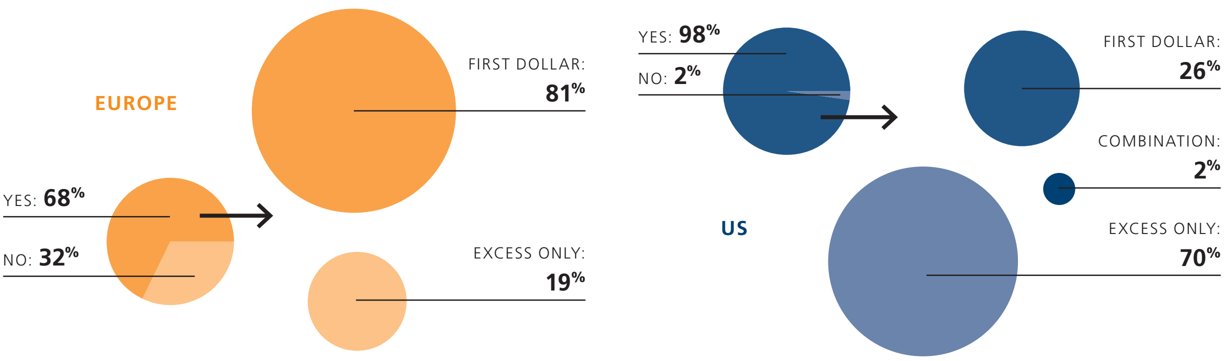
There continues to be a wide range of application of 'first dollar' and 'excess only' basket provisions across the relevant European jurisdictions. The use of 'first dollar' baskets ranges from the high of 91% in the UK, 90% in Benelux and 88% in CEE to 73% in German-speaking countries. In France and Southern Europe there is a marked difference with usage at the relatively low levels of 41% and 50% reflecting different market norms 4.5.

The range of application of basket provisions as between Europe and the US continues to be stark in that 98% of all US transactions incorporate a basket provision and is therefore of almost universal application as compared with the lower level of 68% for European transactions. Of further interest is that in respect of a significant majority of US transactions, an 'excess only' basket applies (70% compared with 19% in Europe) 4.6.

SECTION 4.6

Europe / US Comparison

Type of recovery once basket threshold is exceeded



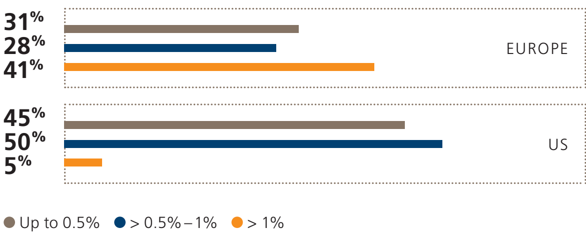
100% = all transactions with a basket clause

The size of baskets as between Europe and the US continues to vary significantly. Only 5% of US transactions contain a basket for more than 1% of the purchase price (compared with 41% in Europe). This may correspond to the wider application in the US of the 'excess only' recovery principle highlighted above, since buyers may be more willing to accept 'excess only' in the event of a lower basket 4.7.

Basket sizes much larger in Europe than in the US with 41% in Europe at more than 1% of purchase price compared to 5% in the US

SECTION 4.7

Europe / US Comparison Size of baskets



100% = all transactions with a basket clause

Liability caps

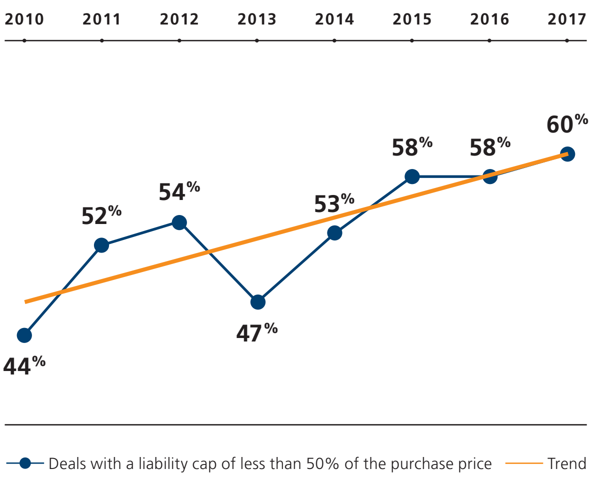
Most M&A agreements provide that the seller's aggregate liability for warranty claims is capped at an agreed level by reference to the consideration received. A seller would generally expect that it should not suffer through warranty claims any more than it has been paid for the target business. As demonstrated by the statistics in this report, 90% of M&A agreements signed in 2017 include an overall financial cap so the point for negotiation between a seller and a buyer is as to the amount of such a cap. The starting point for a buyer will generally be the purchase price itself and the seller may be seeking in lower percentage, particularly where the consideration is significant in itself.

General Overview

SECTION 5.1

CMS Trend Index

Liability caps (less than 50% of purchase price)



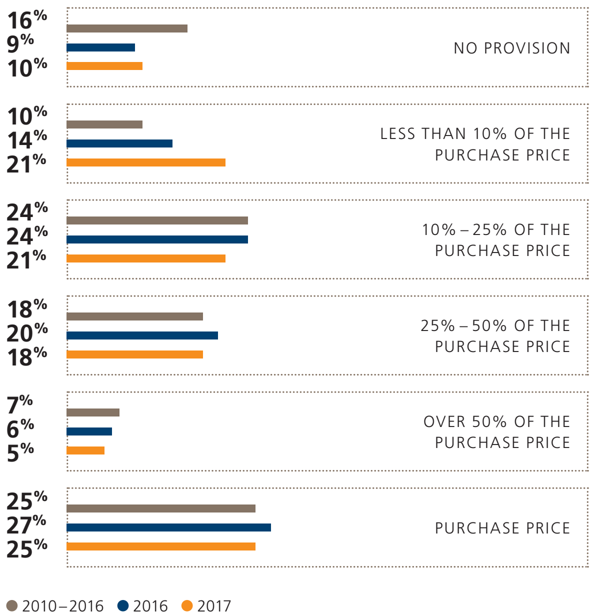
OVERALL TREND

Liability caps are getting lower.

SECTION 5.2

Liability Caps

2010–2017



100% = all evaluated transactions

In 2017 there was a marked increase in the use of a liability cap of less than 10% of the purchase price (21% of transactions as compared with 14% in 2016 and 10% for the seven-year average). This compares with an aggregate liability equal to the purchase price applying in 25% of transactions which remains broadly unchanged from 2016 (27%) and the seven-year average (25%). Except for the 10% of transactions where there is no cap on liability, most other transactions feature a cap of 10–25% of the purchase price (21% in 2017 vs. 24% in 2016) and 25–50% of the purchase price (18% in 2017 vs. 20% in 2016) 5.1 5.2.

52% of large transactions with cap of less than 10% of the purchase price

The increase in the use of small liability caps of less than 10% of the purchase price applied in an extraordinary 52% of transactions with a purchase price of more than EUR 100m, which seems to reflect continuing market practice that the cap on liability for sellers in large transactions is decreasing. Indeed a purchase price cap applied in respect of just 6% of EUR 100m plus transactions in 2017. This compares with the cap on liability for smaller transactions (i.e. less than EUR 25m) ranging from 31% involving the purchase price to 13% being for less than 10% of the purchase price. This all demonstrates the highly negotiable nature of the level of liability caps between sellers and buyers 5.6.

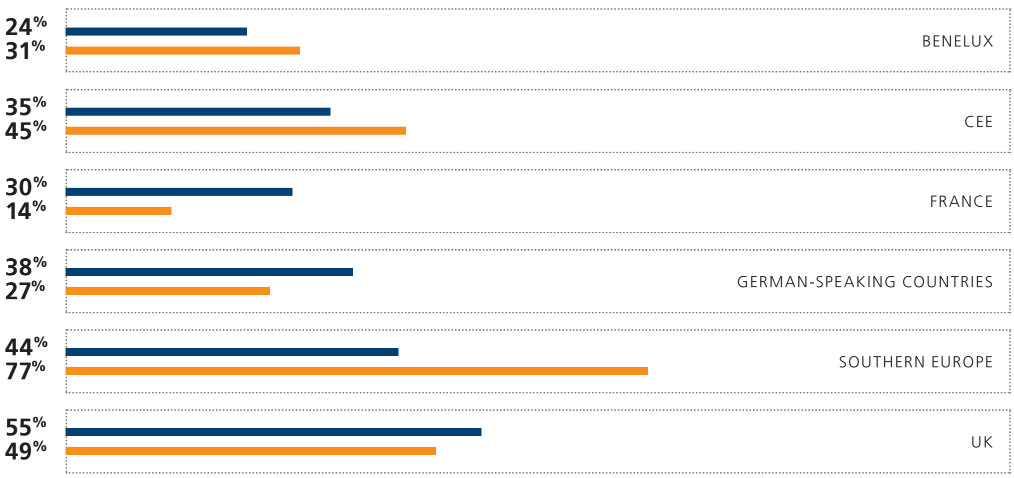
Specific Issues

25% of transactions with a cap equal to 100% of the purchase price.

SECTION 5.3

Liability Caps (more than 50% of purchase price)

Time trend Europe



● 2016 ● 2017

100% = all evaluated transactions

Across the European jurisdictions there remains a divergence in the application of liability caps of more than 50% of the purchase price. Compared with 2016, there was an increase in their application in Benelux (from 24% to 31%), in CEE (from 35% to 45%) and Southern Europe (from 44% to 77%) whereas there was a significant decrease in respect of France (from 30% to 14%), German-speaking countries (from 38% to 27%) and the UK (from 55% to 49%). This is likely a reflection of market norms in each jurisdiction (e.g. French transactions generally have low liability caps) together with uncertainty in particular markets (e.g. in the UK with Brexit and economic factors continuing to play out) 5.3.

In 2017 we found a greater degree of consistency across the sectors as to the frequency of application of liability caps of up to 25% of the purchase price although there remains a lower proportion in relation to the Infrastructure & Projects (25%), Energy (30%) and Banking & Finance (31%) sectors. The sectors retaining higher liability caps continue to be Real Estate & Construction (51%) and Industry (55%) 5.4.

DEALS WITHOUT LIABILITY CAPS

10%

SECTION 5.4

Frequency of Liability Caps up to 25%

SECTOR	2017
BANKING & FINANCE	31%
HOTELS & LEISURE	40%
ENERGY	30%
CONSUMER PRODUCTS	34%
TECHNOLOGY, MEDIA & COMMUNICATIONS	40%
INFRASTRUCTURE & PROJECTS	25%
LIFESCIENCES	46%
REAL ESTATE & CONSTRUCTION	51%
INDUSTRY	55%
BUSINESS (OTHER SERVICES)	43%
CMS AVERAGE	42%

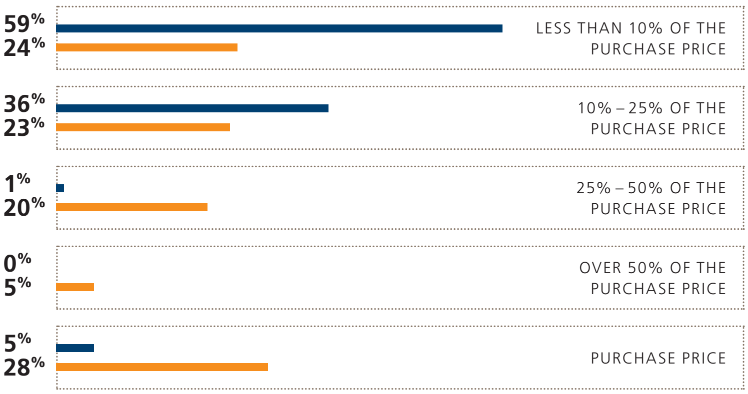
100% = all evaluated transactions of the respective branch

Liability caps remain higher in respect of European transactions as compared to US transactions. Where applicable, only 5% of US transactions reflected a cap on liability equal to the purchase price (compared to 28% in Europe) in deals where there is a liability cap, and a very significant 59% of US transactions incorporated a liability cap of less than 10% of the purchase price (as compared with 24% in Europe for such deals) 5.5.

Continental European caps are higher than those in the UK with 28% of continental European transactions capped at 100% compared with 5% in the UK.

SECTION 5.5

Liability Caps Europe / US



● US ● Europe

100% = all transactions with a general liability cap

US data refers to 'transaction value'

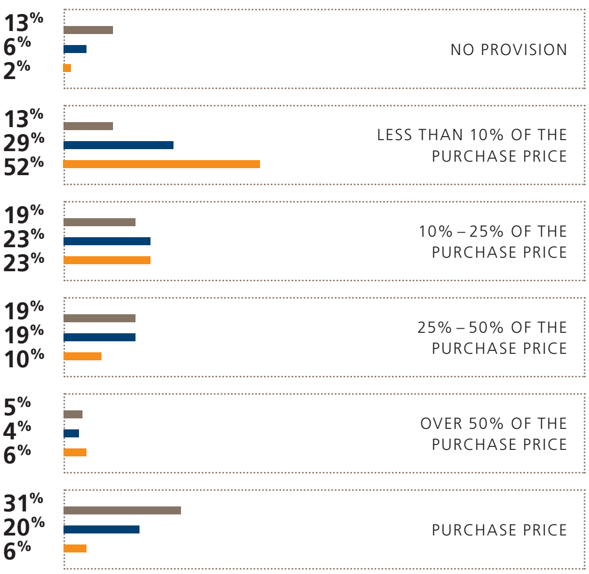
Analysis by Deal Size

As indicated below the analysis by deal size shows that the liability cap and purchase price do directly relate to each other. There are generally proportionately lower liability caps for transactions with a high purchase price. We saw that 52% of EUR 100m plus transactions included a liability cap of less than 10% of the purchase price. This was a significant increase on the 43% reflected in the 2016 statistics 5.6 5.7.

SECTION 5.6

CMS Deal Size Analysis

Liability caps 2017



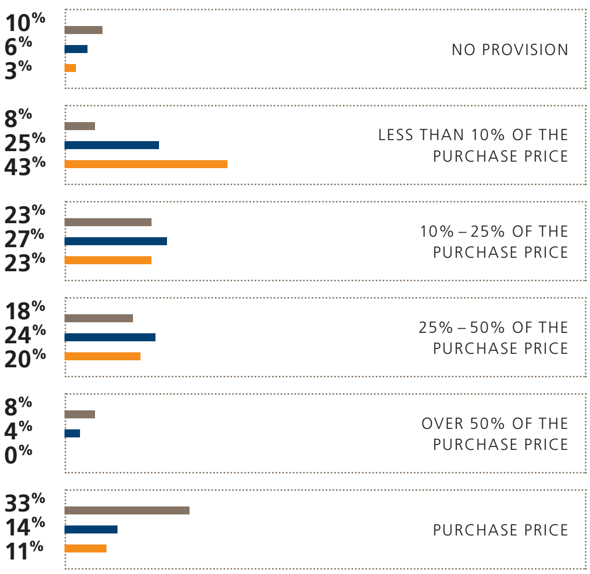
● < EUR 25m ● EUR 25m – 100m ● > EUR 100m

100% = all evaluated transactions

SECTION 5.7

CMS Deal Size Analysis

Liability caps 2016



● < EUR 25m ● EUR 25m – 100m ● > EUR 100m

100% = all evaluated transactions

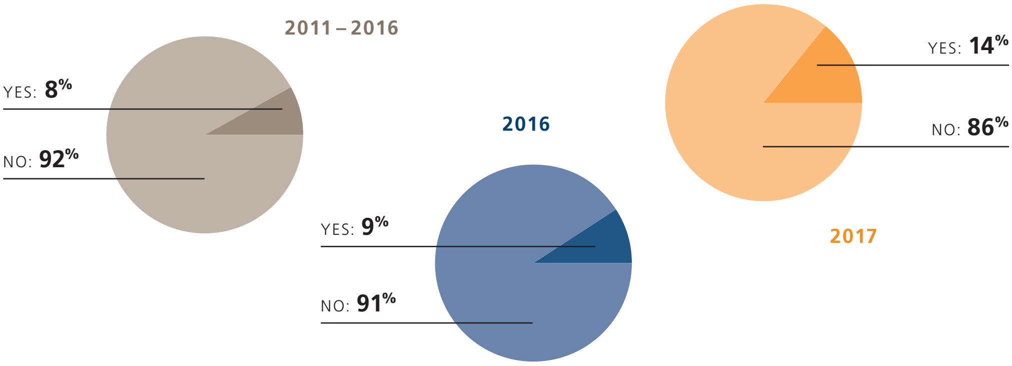
Warranty & Indemnity insurance

It seems as if Warranty & Indemnity insurance (W&I insurance), sometimes called M&A insurance or, in the US, Representations and Warranties insurance, is the new normal, given how popular the product now is in the market. It can provide an elegant solution where sellers are not prepared or are unable either to give or stand behind warranties. The Study indicates that the frequency of deals with W&I insurance continues to rise, with 14% of all deals across Europe including W&I cover, usually for the buyer. This is up 5% since 2016 and 6% higher compared to the six-year average in 2011 – 2016 6.1.

SECTION 6.1

W&I insurance 2011 – 2017

W&I insurance was actually used by the buyer or seller



100% = all evaluated transactions

FREQUENCY OF W&I DEALS CONTINUES TO RISE

14%

General Overview

Brian Hendry, Head of Mergers & Acquisitions at insurance broker Paragon International, commented: "We have experienced an increase in demand for W&I insurance, so much so that the market has rapidly expanded with the number of insurers more than doubling in the last 24 months. This increased competition has benefitted those seeking insurance as we have seen a general price reduction of circa 25% and for some industry sectors over 40%. On the policies themselves, we are also seeing developments in favour of the insured, for instance reductions to the level of the policy excess, which was commonly set at 1% of the transaction value for many years. Insurers are now regularly agreeing to lower levels and in certain industry sectors a nil excess is available. As with any insurance policy we understand that there is a scepticism over the insurer's interest in paying claims, but based on direct experience and numerous market conversations (recognising that there will be a claim process to work through), there are many positives arising from W&I policies, including the ability to negotiate with the dedicated claims teams at the insurers who can make fast, unemotional decisions."

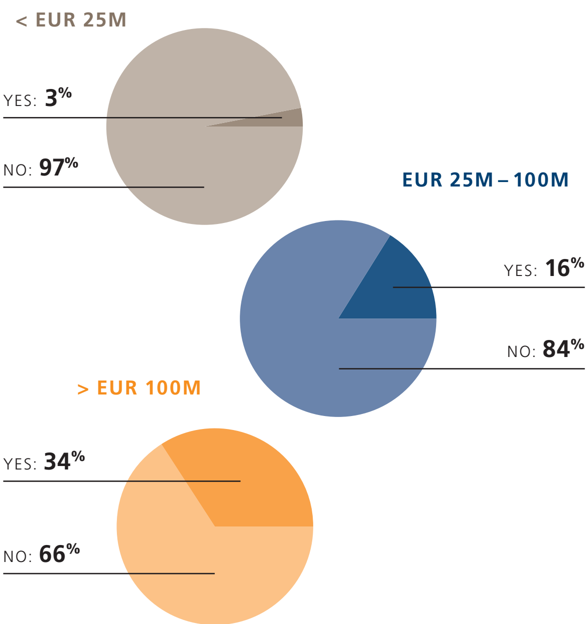
As reported in last year's Study, the same is true this year – the larger the deal value, the more likely W&I insurance will be used (35% of all deals exceeding a value of EUR 100m). We see that there has been a notable increase in the use of W&I insurance in EUR 25m – 100m range deals (27% of deals in 2017, compared with 16% in 2016) 6.2 6.3.

W&I insurance is most often used on bigger deals.

SECTION 6.2

W&I insurance

by purchase price (Europe-wide) 2016

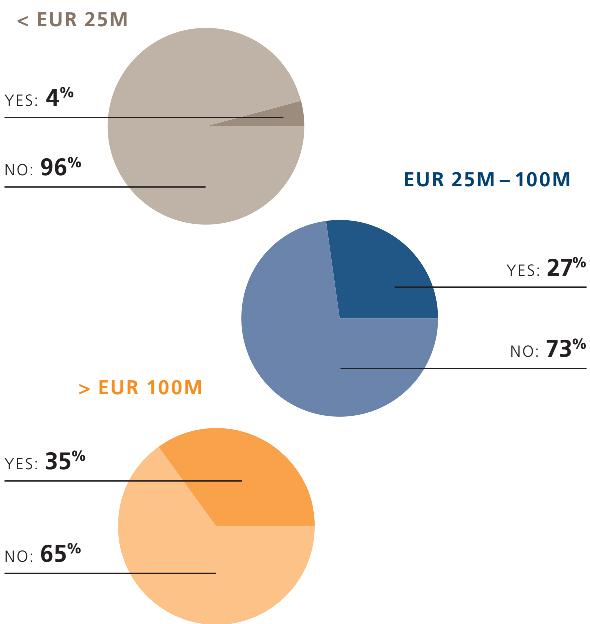


100% = all evaluated transactions

SECTION 6.3

W&I insurance

by purchase price (Europe-wide) 2017



100% = all evaluated transactions

Real Estate & Construction sector is most attracted to W&I insurance.

Real Estate & Construction remains the sector most attracted to W&I insurance (42% of all W&I deals in 2017), where buyers and sellers are often sophisticated real estate investors who are increasingly experienced and familiar with the product. The existence of a W&I insurance policy for real estate deals is often embedded at the term sheet stage (together with a statement as to which party will be paying for it) and frequently it will be made clear that the seller's liability under the deal will be capped at GBP 1 with the W&I insurance effectively being the buyer's sole recourse for claims 6.4.

SECTION 6.4

CMS Sector Analysis W&I insurance (all deals) 2017

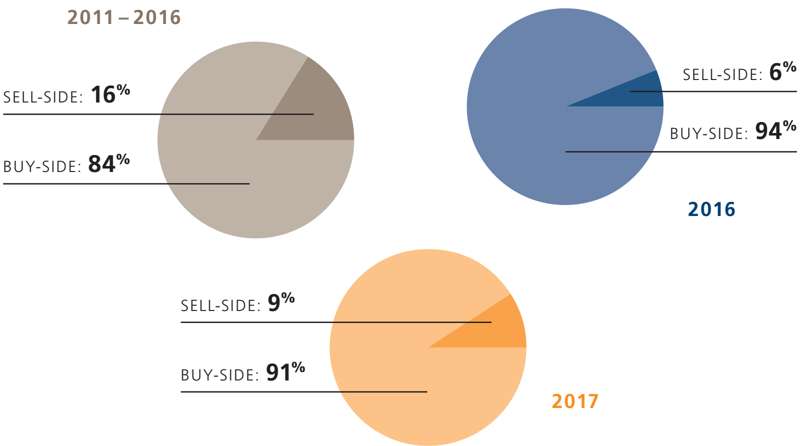
SECTOR	2017
HOTELS & LEISURE	7%
ENERGY	7%
CONSUMER PRODUCTS	9%
TECHNOLOGY, MEDIA & COMMUNICATIONS	9%
INFRASTRUCTURE & PROJECTS	4%
REAL ESTATE & CONSTRUCTION	42%
INDUSTRY	7%
BUSINESS (OTHER SERVICES)	15%
CMS AVERAGE	14%

100% = all evaluated transactions in the respective sector

A common instance of where W&I insurance is useful is where the sellers on a deal are a combination of a financial seller and members of management. The financial seller may be unable and/or unwilling to give any warranties other than title and capacity (or fundamental warranties) whilst the management team's share of the deal value could be small and therefore they may have limited ability to stand behind warranties. A solution here is for the buyer to purchase W&I insurance (perhaps funded by a contribution from the sellers by way of reduction in the purchase price) whereby an insurer provides an insurance policy for a specified amount of cover against potential claims for breach of warranty. The purchased cover can provide the buyer with protection above the level of liability the sellers are prepared to assume.

SECTION 6.5

W&I insurance 2011–2017



100% = deals in which W&I insurance was actually used

In the example described above, the type of W&I insurance policy would be a buy-side policy even if the sellers paid or contributed to the costs of its purchase. A seller is also able to take out a sell-side policy but instances of this are rare and buy-side policies account for 91% of the market 6.5.

BUYER POLICIES

91%

Specific Issues

The table below shows some typical features of W&I insurance and a comparison with the two previous years 6.6.

SECTION 6.6

W&I insurance and Comparison

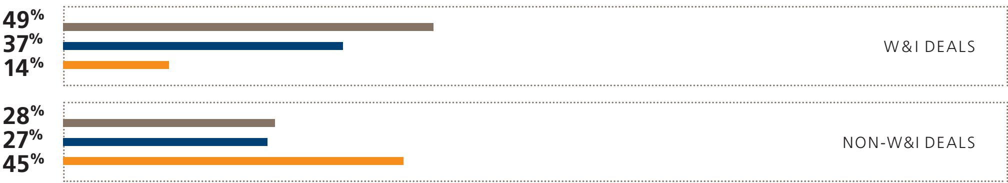
FEATURE	2015 AVERAGE	2016 AVERAGE	2017 AVERAGE
DE MINIMIS FOR SELLER	0.09%	0.11%	0.11%
BASKET THRESHOLD FOR SELLER	0.82%	1.06%	0.68%
— FIRST DOLLAR	87%	91%	77%
— EXCESS ONLY	13%	9%	23%
LIABILITY CAP OF SELLER	5%	9%	2%
LIMITATION PERIOD	22 months (excluding tax)	54 months (including tax)	Non-tax: · SPA: 22 months · Insurance: cover up to 26 months Tax: · SPA: 68 months · Insurance: cover up to 84 months
POLICY COVERAGE	28%	30%	34%
DEAL SIZE	not reported	EUR 277m	EUR 240.52m

In almost all W&I insurance policies the insurer will benefit from a *de minimis,* often GBP 20,000 in a UK transaction. This is regardless of whether the buyer and seller(s) have agreed to a *de minimis* in the sale and purchase agreement.

The deductible in a W&I insurance policy will drive the amount of the basket in the sale and purchase agreement. The data for 2017 indicates that in those 2017 deals involving W&I insurance, the basket exceeded 1% only 15% of the time compared to 45% where W&I insurance was not used. This is consistent with the market for W&I insurance, where the deductible in any policy will typically be around the 1% figure 6.7.

SECTION 6.7

Basket Thresholds for 2017 W&I deals + non-W&I deals



● Up to 0.5% ● > 0.5% – 1% ● > 1%
100% = all evaluated transactions

W&I insurance deals with 'excess only' basket increase.

Evidence suggests that in 2017, deals involving W&I insurance were more likely to feature a basket operating as 'excess only' (23% as opposed to 9% in 2016), perhaps mirroring the way in which the deductible in a W&I insurance policy works.

As would seem obvious, when a deal involves a W&I insurance policy, it is more likely that the seller will achieve a lower liability cap in its negotiation with the buyer. The buyer can then top up its protection relating to warranties by purchasing cover from the insurer on top of the cap agreed to by the seller(s) 6.8.

SECTION 6.8

Liability Caps for 2017 W&I deals + non-W&I deals

● W&I deals ● Non-W&I deals
100% = all evaluated transactions

LOWER LIABILITY CAP

54%

LESS THAN 10% OF PURCHASE PRICE

Cover is available in W&I insurance policies for particular time periods. Typically the available time periods in any policy will broadly match those agreed upon in the sale and purchase agreement **6.9**.

SECTION 6.9

Limitation Period for Warranty Claims for 2017 W&I deals + non-W&I deals

● Non-W&I deals ● W&I deals

100% = all evaluated transactions

Limitation period for warranty claims

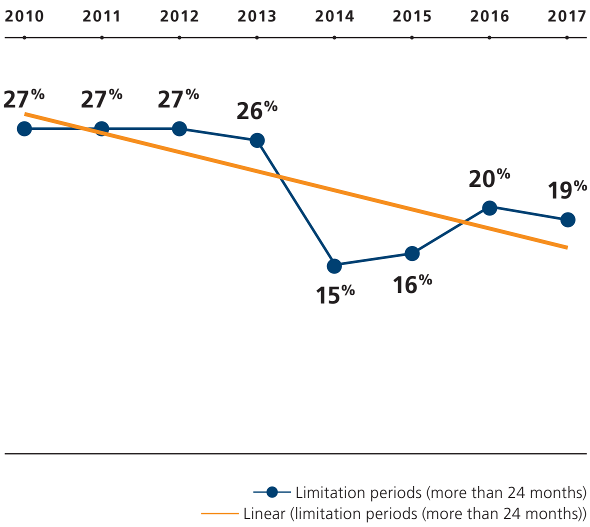
Sellers and buyers typically agree to reduce the statutory limitation period for warranty claims under a sale and purchase agreement by agreeing shorter limitation periods. This is seller-friendly because buyers have less time to bring warranty claims.

General Overview

SECTION 7.1

CMS Trend Index

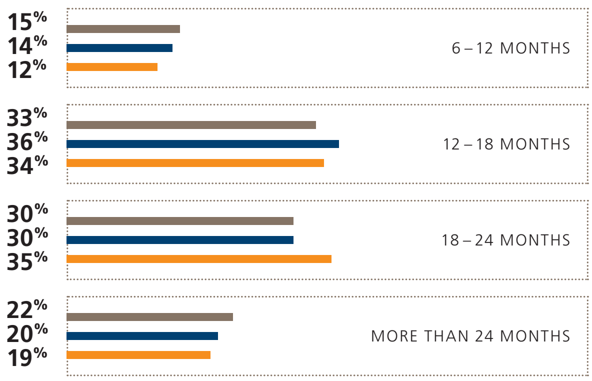
Limitation periods (more than 24 months)



OVERALL TREND

SECTION 7.2

Limitation Period for Warranty Claims 2010–2017



2010–2016 2016 2017

100% = all evaluated transactions

12–24 MONTH LIMITATION PERIODS

69%

In 2017 we noted a slight decrease in longer limitation periods (more than 24 months). That development is most pronounced in the larger deals (above EUR 100m), where there were half as many deals with limitation periods longer than 24 months compared with 2016. Overall, we see a slight general trend towards longer limitation periods (18–24 months), with a corresponding decrease in shorter limitation periods. This is buyer-friendly because buyers have more time to bring warranty claims 7.1.

Limitation periods for warranty claims of 12 to 24 months continue to be ever more standard in recent years (69% of deals compared with 66% in the previous year). We see a steady buyer-friendly trend towards longer limitation periods for warranty claims in 2017: although limitation periods of more than 24 months decreased from the previous year's level of 20% to 19% in 2017, limitation periods between 18–24 months increased from the prior-year figure of 30% to 35% in 2017 7.2.

Specific Issues

Previous studies revealed that parties agree on longer limitation periods for warranty claims in France historically. However, in 2017 only 26% of the French deals contained limitation periods for warranty claims longer than 24 months (33% in 2010–2016; 40% in the previous year).

Meanwhile, Southern Europe deals have the longest limitation periods, with 62% of deals containing limitation periods longer than 24 months (40% in 2010–2016; 58% in the previous year).

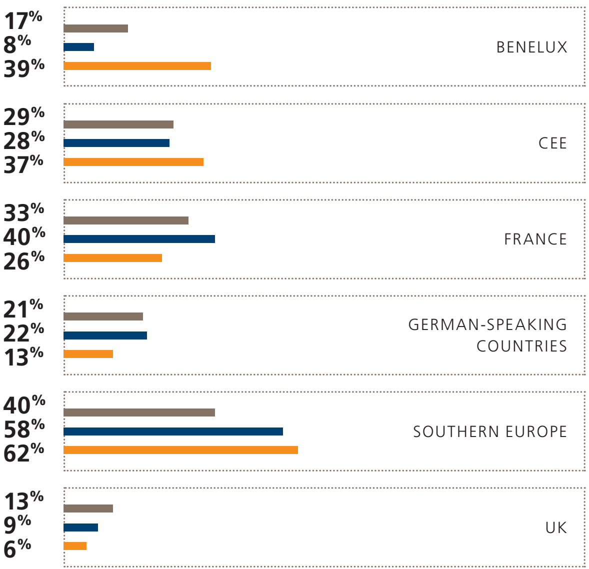
The German-speaking countries saw a notable drop in longer limitation periods for warranty claims in 2017. Only 13% of deals contained limitation periods for warranty claims longer than 24 months (21% in 2010–2016; 22% in the previous year). However, the usage of short limitation periods remained consistent (13% in 2016 and as the long-term average 2010–2016; 12% in 2017).

The shortest limitation periods for warranty claims tended to be in Southern Europe and the UK, where 19% and 14% of deals respectively contained limitation periods of up to 12 months 7.3 7.4.

> 24 MONTHS
LIMITATION PERIODS
19%

SECTION 7.3

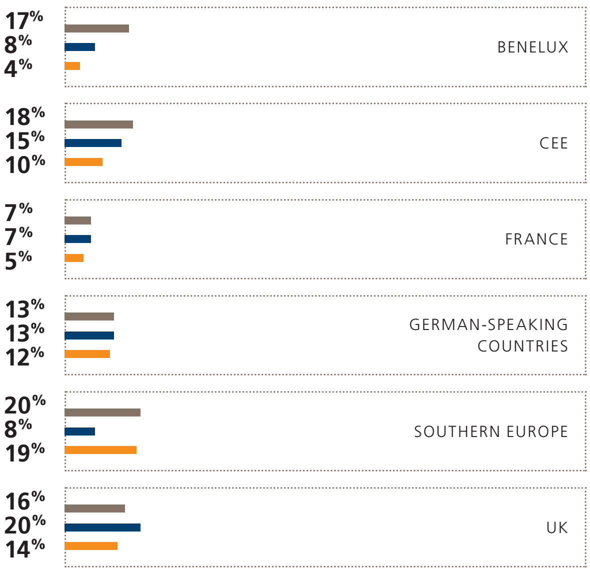
Limitation Periods for Warranty Claims
More than 24 months 2010–2017



2010–2016 ● 2016 ● 2017
100% = all evaluated transactions

SECTION 7.4

Limitation Periods for Warranty Claims
6–12 months 2010–2017



2010–2016 ● 2016 ● 2017
100% = all evaluated transactions

Shorter limitation periods especially in large deals; some European regions (Benelux, Southern Europe, CEE) go for longer periods

Sector analysis demonstrates that longer limitation periods (i.e. those exceeding 24 months) were most likely in the Hotels & Leisure and Consumer Products sectors (31% and 25% of deals recorded in those sectors, respectively).

The Industry sector, which typically saw longer limitation periods in 2016, was using shorter limitation periods in 2017 with only 15% of deals having limitation periods exceeding 24 months 7.5.

SECTION 7.5

CMS Sector Analysis

Limitation periods (more than 24 months)

SECTOR	2016	2017
BANKING & FINANCE	13%	15%
HOTELS & LEISURE	30%	31%
ENERGY	8%	14%
CONSUMER PRODUCTS	15%	25%
TECHNOLOGY, MEDIA & COMMUNICATIONS	14%	19%
INFRASTRUCTURE & PROJECTS	0%	0%
LIFESCIENCES	24%	19%
REAL ESTATE & CONSTRUCTION	23%	23%
INDUSTRY	30%	15%
BUSINESS (OTHER SERVICES)	28%	19%
CMS AVERAGE	20%	19%

100% = all evaluated transactions of the respective branch

Longest limitation periods in Hotels & Leisure and Consumer Products deals

Analysis by Deal Size

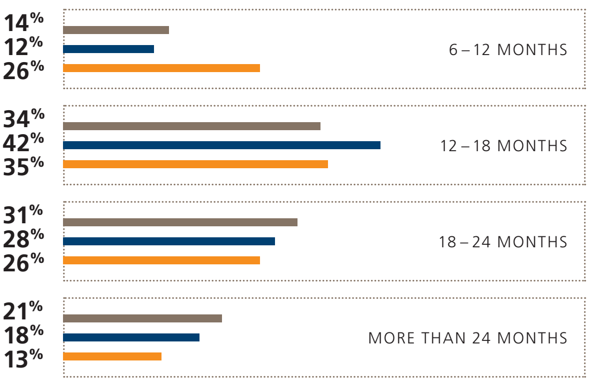
Limitation periods for warranty claims are less buyer-friendly in transactions with a value above EUR 100m. Only 6% of deals contained limitation periods exceeding 24 months in 2017 (compared to 13% of such deals in 2016).

Sellers and buyers are most likely to agree limitation periods of 12 to 18 months in transactions with a value between EUR 25m and EUR 100m (40% of such deals in 2017) 7.6 7.7.

Fewer large deals (13%) with long limitation periods (more than 24 months)

SECTION 7.6

Limitation Period for Warranty Claims by Purchase Price 2016

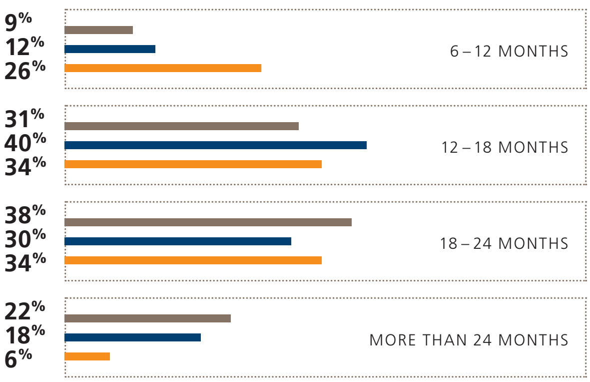


● < EUR 25m ● EUR 25m – 100m ● > EUR 100m

100% = all evaluated transactions

SECTION 7.7

Limitation Period for Warranty Claims by Purchase Price 2017



● < EUR 25m ● EUR 25m – 100m ● > EUR 100m

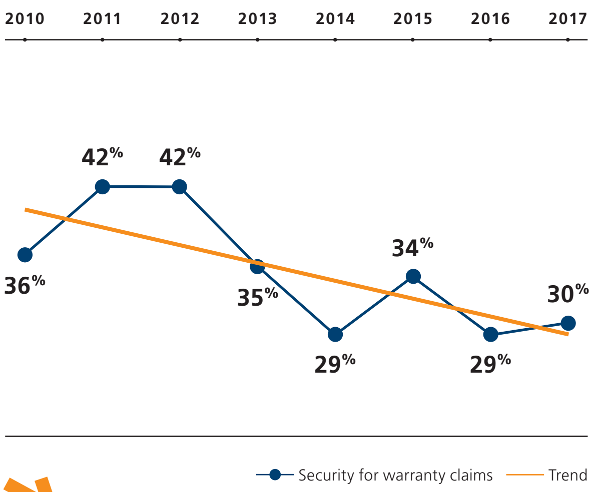
100% = all evaluated transactions

Security for warranty claims

The ongoing viability of a seller after an M&A transaction is often an issue for a buyer (for example, because the seller may become a mere shell company with no substantial assets after closing). In such cases the value of the buyer's warranty claims might be worthless. It is therefore buyer-friendly for the parties to agree on some form of security for warranty claims. The type and the value of the security depends on many factors, such as the probability of the occurrence of a warranty claim, the strength of the seller's covenant and the deal structure.

SECTION 8.1

CMS Trend Index Security for warranty claims



OVERALL TREND

More deals containing security for warranty claims.

General Overview

Compared with 2016 (29%), 30% of deals contained security for warranty claims in 2017, slightly arresting the seller-friendly trend in recent years for sellers to be able to avoid having to give security, a trend which may have been encouraged by the greater use of W&I insurance meaning that the buyer has less need for direct recourse to the seller in the first place, thereby avoiding the need for security. Once the parties agreed on using security for warranty claims, we noted a more seller-friendly trend regarding the specific forms of security used, e.g. escrow accounts 8.1.

FREQUENCY OF SECURITY

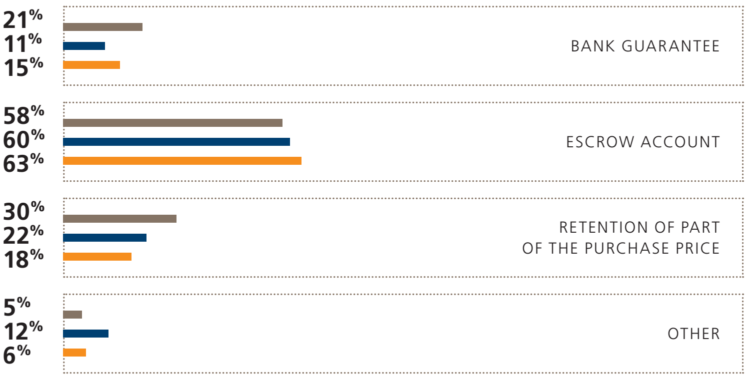
30%

Specific Issues

Retention of the purchase price is probably the most unpopular type of security among sellers, since a seller is then taking a risk on the buyer's solvency. It is therefore a seller-friendly trend that the number of deals in which the buyers were able to retain a part of the purchase price slightly decreased from 22% in 2016 to 18% in 2017. This is part of a consistent downward trend when taking into account the long-term average for 2010–2016 (30%) 8.2.

SECTION 8.2

Security for Warranty Claims 2010–2017



● 2010–2016 ● 2016 ● 2017
100% = transactions with safeguarding mechanism – more than one type of security possible

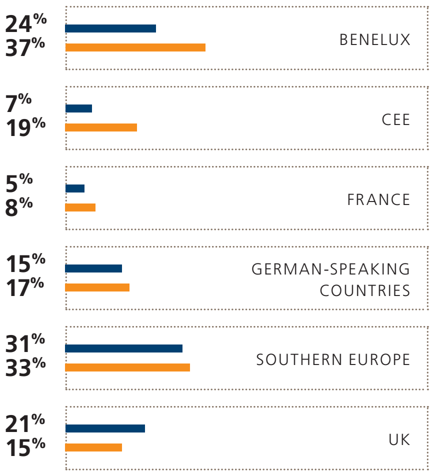
Escrow accounts are the most commonly used type of security. As part of the more seller-friendly trend in 2017 away from purchase price retention, their use increased to 63% compared with the previous year (60%). This increase is particularly driven by the popularity of escrow accounts in Benelux (37% in 2017 compared with 24% in 2016), Southern Europe (33% in 2017 compared with 31% in 2016) and in CEE (19% in 2017 compared with 7% in 2016). However, escrow accounts were less used in the UK (15% in 2017 compared with 21% in 2016) and are hardly used at all in France, where usage has always been less than 10% for deals (8% in 2017) where there is some security for warranty claims **8.3**.

PURCHASE PRICE RETENTION

18%

SECTION 8.3

Escrow Accounts 2016–2017



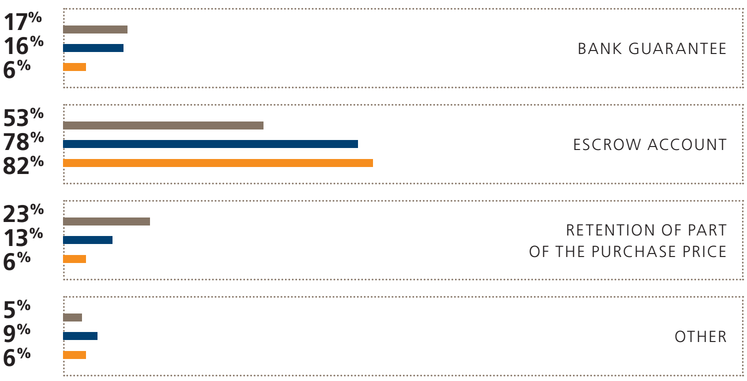
● 2016 ● 2017
100% = all evaluated transactions

Analysis by Deal Size

Escrow accounts are the most commonly used type of security.

SECTION 8.4

Security for Warranty Claims by Purchase Price 2017



● < EUR 25m ● EUR 25m – 100m ● > EUR 100m
100% = transactions with safeguarding mechanism – more than one type of security possible

Analysis of transactions with security for warranty claims by deal size demonstrates that retention of part of the purchase price is more common (23%) in deals with a value below EUR 25m.

Escrow accounts are much preferred in larger deals, being used where security for warranty claims is agreed in 82% of EUR 100m plus deals.

Other interesting observations are that the prevalence of the use of other security for warranty claims did not vary greatly according to deal size and that bank guarantees were used slightly less often in deals with a value above EUR 100m (6%, as against 15% generally) **8.4**.

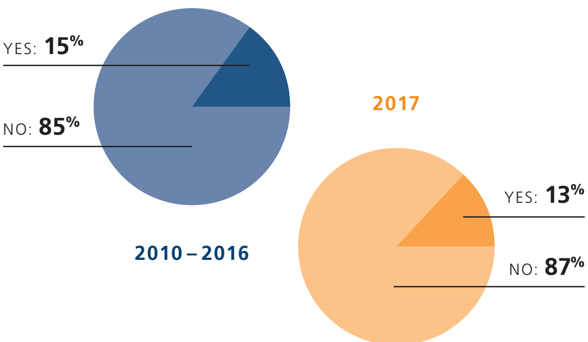
MAC clause

Material Adverse Change clauses (MAC clauses) allocate the risk of fundamental change occurring between signing and closing. MAC clauses entitle the buyer to terminate the agreement if a specific event materialises before closing. Such events are expressly defined in the contract and often subject to extensive and detailed negotiations. The seller will usually seek to exclude specific unavoidable events from triggering the MAC clause so that the risk of any fundamental change is borne by the buyer.

General Overview

SECTION 9.1

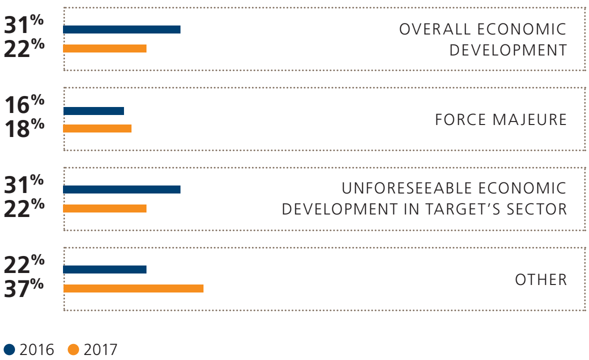
MAC Clauses
2010 – 2017



100% = all evaluated transactions

SECTION 9.2

MAC Clauses 2016 – 2017
Exemptions from material adverse change



100% = all transactions including a MAC clause – more than one exemption possible

MAC CLAUSE RATIO 2017

13%

In 2017, MAC clauses were used in only 13% of deals. This is the lowest ever percentage of deals, down from 2016 and the previous seven-year average of 15%. The continuing high success rate of sellers in resisting MAC clauses generally demonstrates their strong commercial position, especially in auction processes 9.1.

Although it remains challenging for buyers to negotiate general carve-outs from MAC clauses, there are often carve-outs from the MAC clause. Exemptions of overall or sector-specific economic developments together form a common exclusion type (44% of deals containing a MAC clause). There seems to be empty space at the beginning number of deals with "other" exemptions increased from 22% in 2016 to 37% in 2017 9.2.

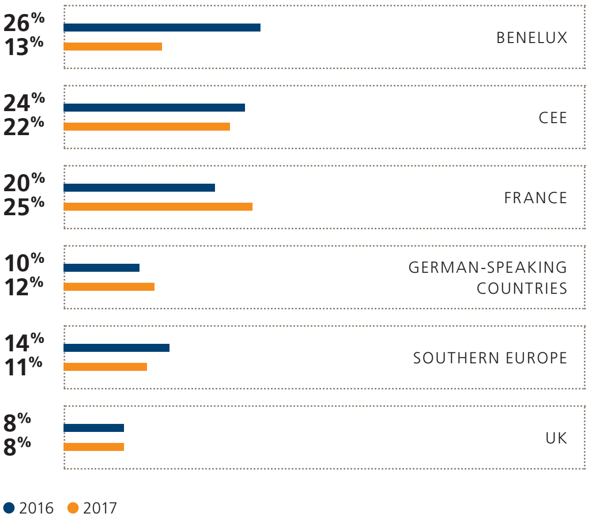
EXCLUSION OF ECONOMIC DEVELOPMENT

44%

Specific Issues

SECTION 9.3

MAC Clauses 2016–2017



100% = all evaluated transactions

Some inconsistent regional developments in the use of MAC clauses can be observed.

It is noteworthy that MAC clause usage increased again in France between 2016 and 2017 (from 20% to 25%), and in the German-speaking countries (from 10% to 12%), but remained unchanged in the UK (8%). On the other hand, in the same time period the use of MAC clauses decreased in Benelux (from 26% to 13%), in CEE (from 24% to 22%) and in Southern Europe (from 14% to 11%) 9.3.

MAC clause usage differs between countries.

SECTION 9.4

CMS Sector Analysis

Frequency of MAC clauses 2016–2017 in %

SECTOR	2016	2017
BANKING & FINANCE	8%	29%
HOTELS & LEISURE	16%	9%
ENERGY	4%	13%
CONSUMER PRODUCTS	9%	10%
TECHNOLOGY, MEDIA & COMMUNICATIONS	17%	11%
INFRASTRUCTURE & PROJECTS	0%	13%
LIFESCIENCES	11%	15%
REAL ESTATE & CONSTRUCTION	24%	19%
INDUSTRY	15%	12%
BUSINESS (OTHER SERVICES)	14%	9%
CMS AVERAGE	15%	13%

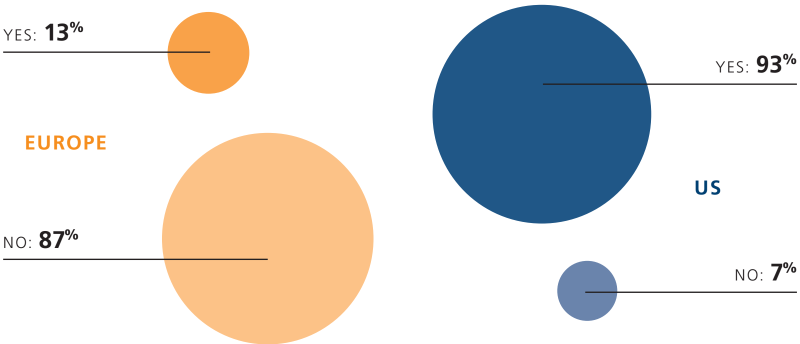
100% = all evaluated transactions in the respective sector

MAC clauses used most frequently in the Banking & Finance sector.

MAC clauses were most frequently used in the Banking & Finance sector (29%). However, the sector analysis shows inconsistent trends as well. Thus, an increasing trend towards MAC clause usage can be observed in the Infrastructure & Projects sector and Energy sector in particular, where over the period from 2016 to 2017 the use of MAC clauses notably increased by 13 percentage points in the Infrastructure & Projects sector and 9 percentage points in the Energy sector. In the same period we saw a decrease of 7 percentage points in the Hotels & Leisure sector, 6 percentage points in the Technology, Media and Communications sector and 5 percentage points in the Real Estate & Construction sector 9.4.

SECTION 9.5

MAC Clauses



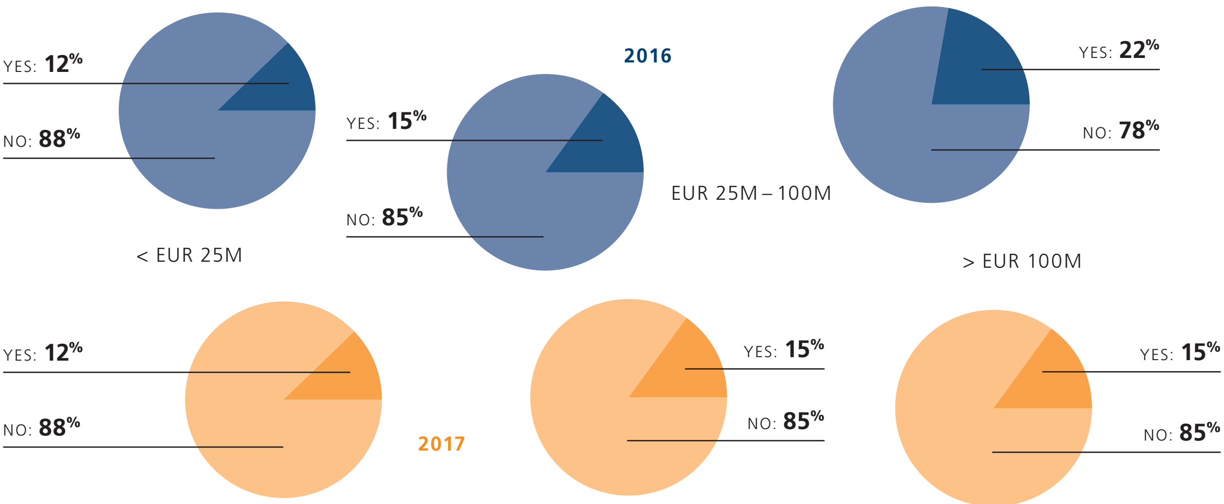
100% = all evaluated transactions
'Stand-Alone MAC', 'Back Door MAC' and mixed 'Stand-Alone/Back Door MAC'

In contrast to Europe, where only 13% of deals included MAC clauses, there were MAC clauses in 93% of US deals. This remarkable disparity is partly explicable by sellers' higher success in demanding deal certainty on controlled auctions in Europe and also by the greater number of transactions that sign and close simultaneously in certain European jurisdictions 9.5.

Analysis by Deal Size

SECTION 9.6

MAC Clauses by Purchase Price 2016–2017



100% = all evaluated transactions

Remarkable disparity compared with the US (93%).

In the past years we have noticed that transactions with higher purchase prices tend to have MAC clauses more often than transactions with lower purchase prices, perhaps due to the likely longer period between signing and closing and/or the perceived higher risk in financial terms caused by a fundamental post-signing change. 2017 has bucked this trend with exactly the same proportion of deals (i.e. 15%) of EUR 100m plus as those in the range EUR 25m–100m having a MAC clause. In 2016, 22% of the largest deals had a MAC clause, whilst in 2015 the figure was higher still at 30%, with mid-size deals standing at 15% and 18% respectively. This is a sure sign that sellers have been holding the upper hand 9.6.

Arbitration

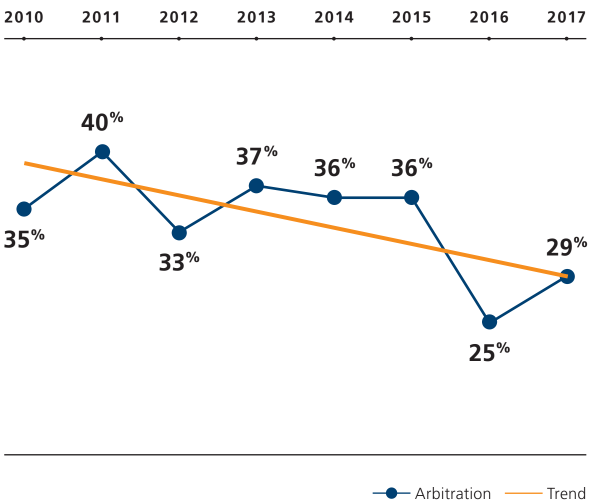
The effect of an arbitration clause is to require all disputes arising out of the deal to be decided before a private tribunal instead of a public court (litigation). Reasons for agreeing on arbitration include the desire to avoid courts in jurisdictions where proceedings are time consuming and the outcome is highly unpredictable, as well as the desire to prevent a public process. There are perceived downsides, such as the relatively "high costs of arbitrations administered by well-known arbitration institutions" and the concerns that potential efficiencies are not actually achieved in practice. However, since the enforcement of foreign judgements may still be difficult in some jurisdictions, the need to obtain an award that can be enforced in multiple jurisdictions is probably the strongest driving force for choosing arbitration.

General Overview

Arbitration is used as the dispute resolution mechanism in 29% of cases and has again slightly increased compared to 2016, where arbitration was used in 25% of the deals only, and compared with the previous seven-year average of 34% (2010–2016). Although the overall trend shows that arbitration is less popular in certain jurisdictions we see that arbitration is regaining popularity. The use of national rules as opposed to international rules to govern arbitration became more balanced in 2017 (national rules were used in 54% of deals with arbitration clauses compared to 63% in 2016 and the previous seven-year average of 61%). This trend away from national rules in favour of international rules reverses the steady trend in favour of national rules in previous years 10.1 10.2.

SECTION 10.1

CMS Trend Index Arbitration



RECENT TREND

OVERALL TREND

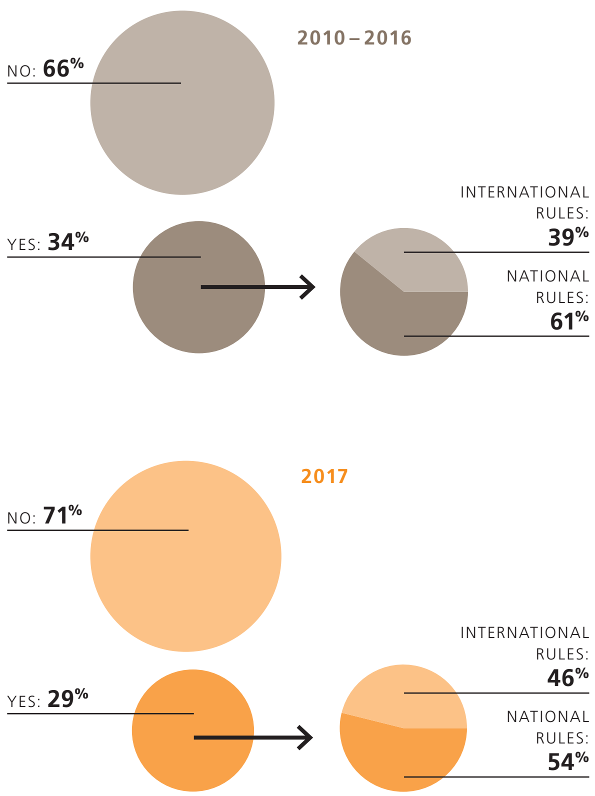
Arbitration less popular in certain jurisdictions

ARBITRATION CLAUSE RATIO 2017

29%

SECTION 10.2

Arbitration Clauses 2010–2017



100% = all evaluated transactions

NATIONAL RULES

54%

Specific Issues

Buyers and sellers agreed less often on arbitration in France (4% of deals in 2017, compared with 10% in 2016) and arbitration is still less popular in German-speaking countries than it was a few years ago (33% of the deals in 2017, compared with the previous seven-year average of 38%).

Arbitration clauses also remain rare in UK, where they were used in just 8% of deals in 2017 (seven-year average: 9%).

On the other hand, arbitration was used significantly more often as the dispute resolution mechanism in Benelux (23%), in CEE (66%) and Southern Europe (53%) compared with 2016 10.3.

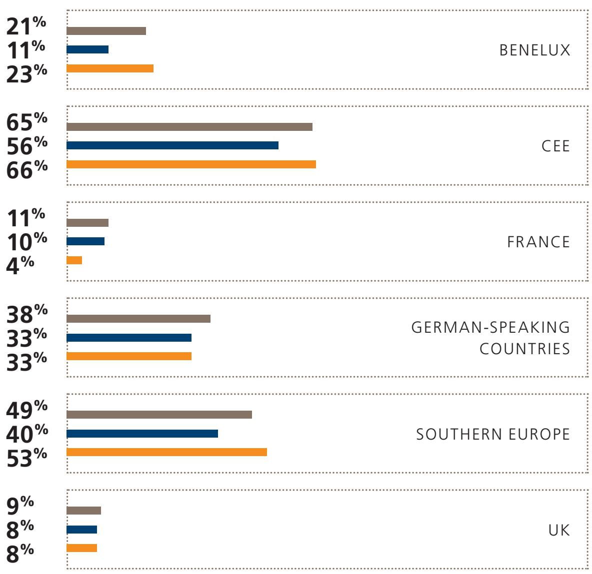
Compared with the US (17%), the use of arbitration is much more popular in Europe (29%) 10.4.

ARBITRATION CLAUSE RATIO IN CEE

66%

SECTION 10.3

Arbitration Clauses 2010–2017

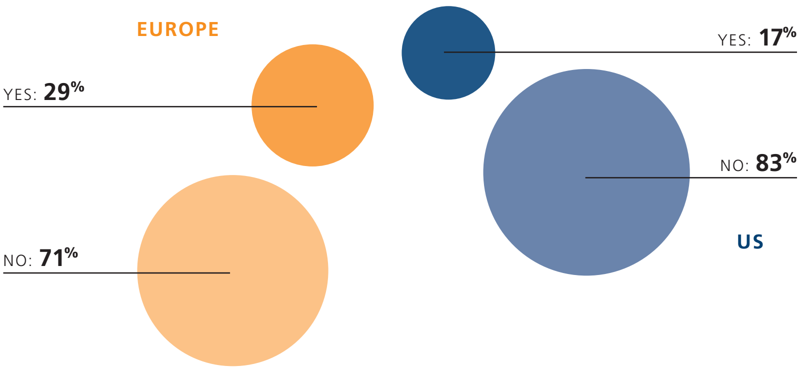


2010–2016 2016 2017

100% = all evaluated transactions

SECTION 10.4

Arbitration Clauses Europe / US Comparison



100% = all evaluated transactions

Compared to the US (17%), the use of arbitration is much more popular in Europe (29%).

Analysis by Deal Size

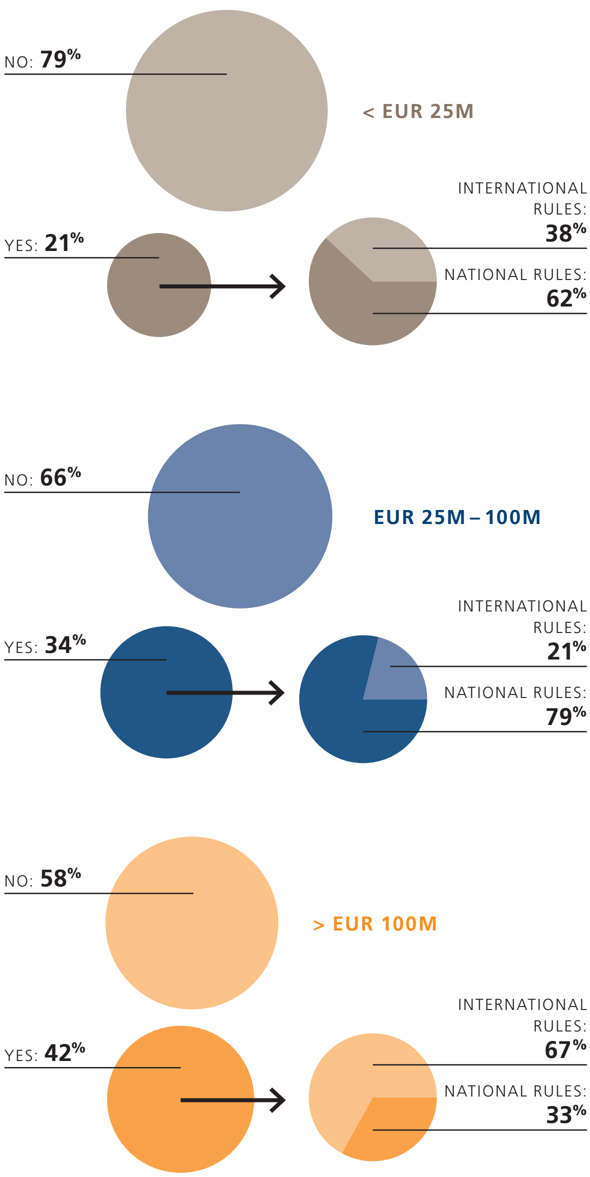
As already observed in 2016, transaction value continues to be a relevant factor in 2017 for the parties' decision whether or not to choose arbitration as the dispute resolution mechanism. Smaller deals (less than EUR 25m) contained arbitration clauses in about one out of four cases (26%). In deals of more than EUR 100m, 38% contained arbitration clauses, demonstrating that the bigger the deal, the more likely that arbitration is used.

In 60% of large EUR 100m plus deals, international rules governed arbitration, while in the majority of the deals under EUR 100m national rules were predominant. Generally, international rules were chosen more often in 2017 for deals below EUR 100m compared to the findings in 2016 10.5 10.6.

Transaction value seems to have been the driving factor in 2017 as to whether to choose national rules of arbitration (rather than international rules).

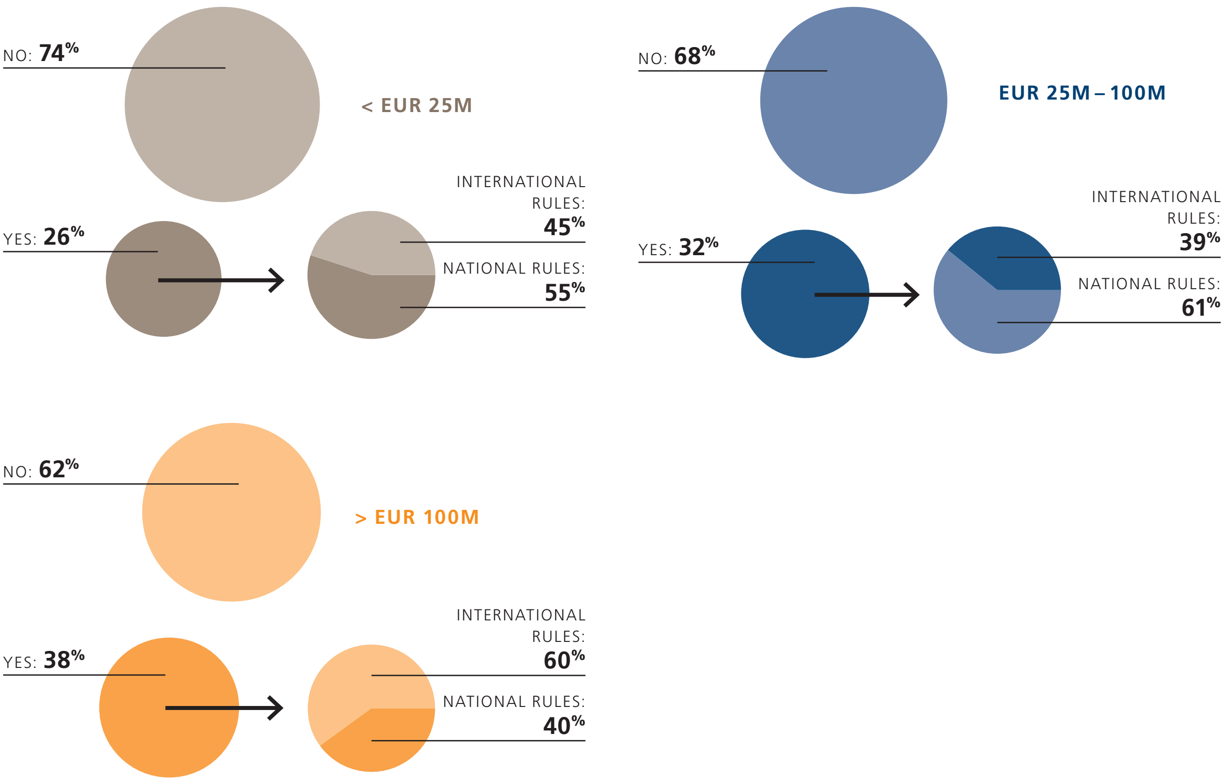
SECTION 10.5

Arbitration Clauses by Purchase Price 2016



SECTION 10.6

Arbitration Clauses by Purchase Price 2017



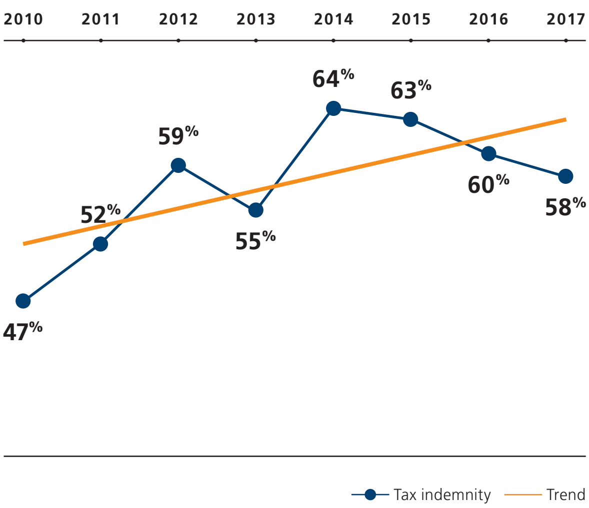
100% = all evaluated transactions

Tax

The rationale behind a tax indemnification provision is that the buyer wants to be held harmless for pre-closing tax risks. Tax indemnifications often include specific caps and time limitation periods. There are also different types of limitation periods for tax indemnity claims, namely 'absolute' limitation periods and 'relative' limitation periods. An 'absolute' limitation period bars tax claims by the buyer against the seller after a fixed date. A 'relative' limitation period is directly related to a decision by the relevant tax authority. In these cases, the limitation period (which is then usually very short) does not start until a relevant decision of a tax authority has been made.

SECTION 11.1

CMS Trend Index Tax indemnity agreed



RECENT TREND

OVERALL TREND

Little change in frequency of tax indemnity clauses

General Overview

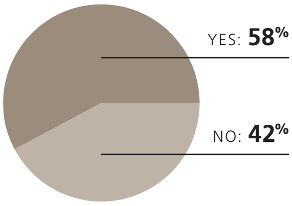
Tax indemnifications were agreed in 58% of the deals in 2017, which shows a slight decrease compared with the previous year, 2016 (60%), but equals the previous seven-year average 11.1 11.2. At the same time the number of deals containing a clause granting the sellers the right to participate in a future tax audit significantly decreased to 31% (2016: 50% and 2010–2016: 48%) 11.3.

SECTION 11.2

Tax Indemnity 2010–2016

Has tax indemnity been agreed?

2010–2016



100% = all evaluated transactions

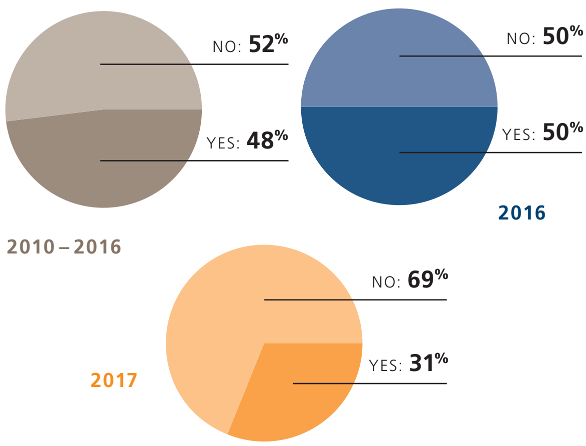
TAX INDEMNITY

58%

SECTION 11.3

Tax Indemnity 2010–2017

Participation right in a future tax audit

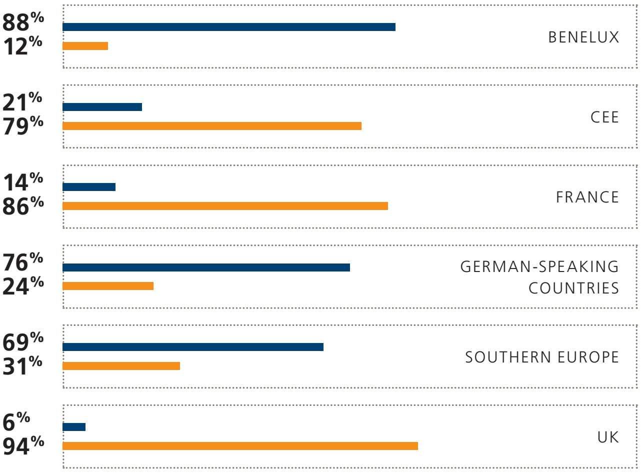


100% = all evaluated transactions with a tax indemnity clause

Specific Issues

SECTION 11.4

Tax Indemnity 2017 Absolute and relative limitation period



● relative ● absolute
100% = all transactions with tax indemnity clause

There are clear regional differences in the use of absolute and relative limitation periods. While relative limitation periods are still the norm in Benelux (88%), the German-speaking countries (76%) and Southern Europe (69%), it is the opposite in the UK, France and in CEE. Absolute limitation periods are the norm in the UK (94%), France (86%) and in CEE (79%). We observe that, depending on the region, the use of either absolute or relative limitation periods tends to be almost universal 11.4.

Regional variations dictate whether limitation periods are absolute or relative.

Analysis by Deal Size

Our deal size analysis demonstrates that for deal values of less than EUR 25m, in only 28% of the deals were the sellers able to secure a participation right in proceedings started by a tax authority. By contrast, sellers were more successful where deal values are above EUR 25m (40%) and above EUR 100m (34%).

We also see that tax indemnities are still more likely in larger deals (77% in EUR 100m plus deals, 59% in EUR 25m–100m range deals and 55% in sub-EUR 25m deals) 11.5.

SELLERS' PARTICIPATION RIGHT

28% OF DEALS < EUR 25M

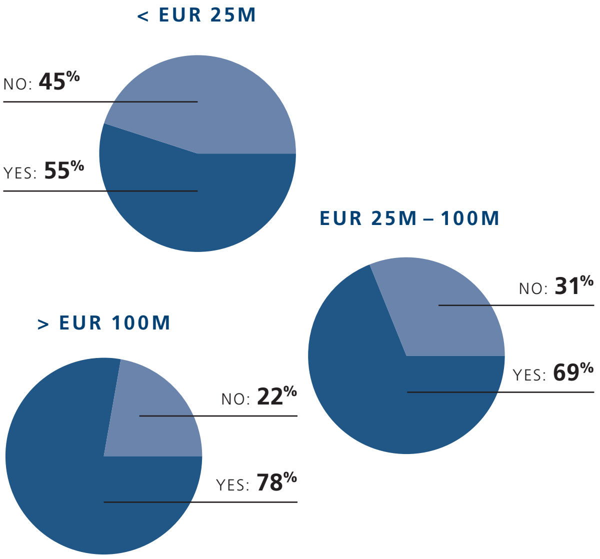
40% OF DEALS EUR 25M – 100M

34% OF DEALS > EUR 100M

SECTION 11.5

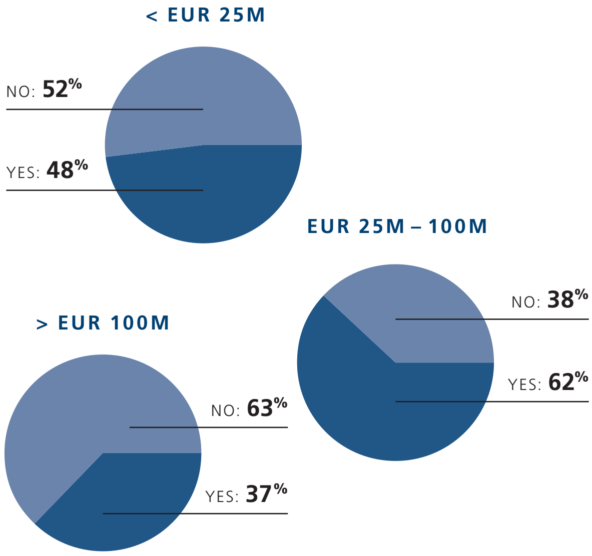
Tax Indemnity by Purchase Price 2016

Has tax indemnity been agreed?



100% = all evaluated transactions

Participation right in a future tax audit

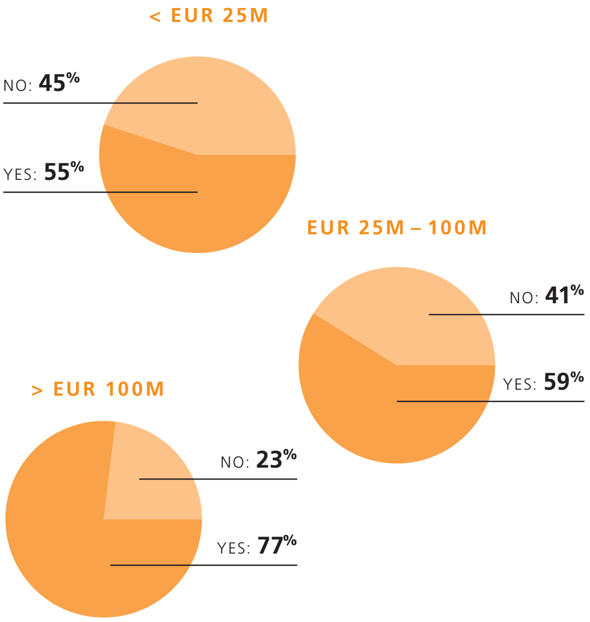


100% = all evaluated transactions with a tax indemnity clause

SECTION 11.5

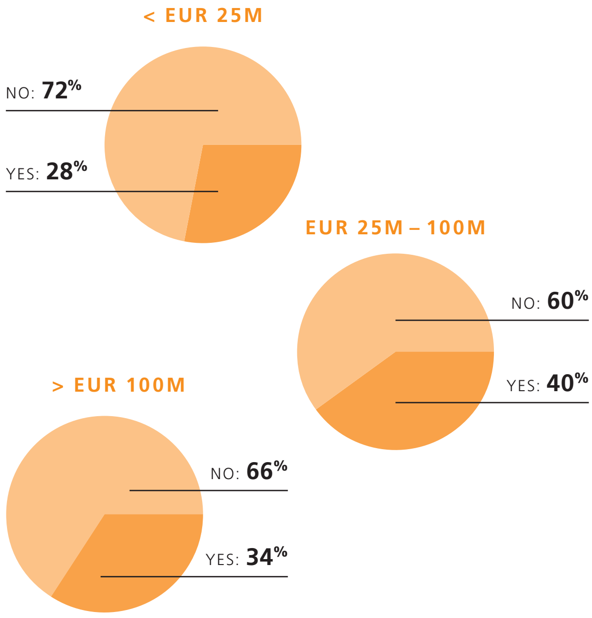
Tax Indemnity by Purchase Price 2017

Has tax indemnity been agreed?



100% = all evaluated transactions

Participation right in a future tax audit



100% = all evaluated transactions with a tax indemnity clause

Where you can find CMS

The Americas

Bogotá
Lima
Mexico City
Rio de Janeiro
Santiago de Chile

Europe

Aberdeen
Amsterdam
Antwerp
Barcelona
Belgrade
Berlin
Bratislava
Bristol
Brussels
Bucharest
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Cologne
Duesseldorf
Edinburgh
Frankfurt
Funchal
Geneva
Glasgow
Hamburg
Kyiv
Leipzig
Lisbon
Ljubljana
London
Luxembourg
Lyon
Madrid
Manchester
Milan
Monaco
Moscow
Munich
Paris
Podgorica
Poznan
Prague
Reading
Rome
Sarajevo
Seville
Sheffield
Skopje
Sofia
Strasbourg
Stuttgart
Tirana
Utrecht
Vienna
Warsaw
Zagreb
Zurich

Africa

Algiers
Casablanca
Luanda

Middle East

Dubai
Istanbul
Muscat
Riyadh
Tehran

Asia-Pacific

Beijing
Hong Kong
Shanghai
Singapore

Our latest CMS Corporate / M&A headline deals

ABB
Advised on all matters relating to the cross-border acquisition by ABB of the mission-critical communication business of the KEYMILE Group and on the acquisition of Tekomar.

Acciona
Advised on the sale of a 92.71% stake in Compañía Transmediterranea.

Bayerngas
Advised on a strategic joint venture with Stadtwerke München GmbH and the British energy and services company Centrica regarding the European oil and gas exploration and production business.

BP
Advised on its USD 1.38bn sale of the Magnus oil & gas field and interest in the Sullom Voe terminal to EnQuest.

euNetworks
Advised on the sale of a majority interest to Stonepeak Infrastructure Partners.

Haitong Bank
Advised on the sale of Empark Aparcamientos y Servicios to Macquarie Infrastructure and Real Estate.

IVG
Advised on the sale of TRIUVA, with assets under management of around EUR 9.8bn, to PATRIZIA.

Mid Europa Partners
Advised on the sale of laboratory businesses in the Czech Republic and Slovakia – the largest healthcare transaction in central Europe since 2008.

Nikola Tesla Belgrade Airport
Advised the largest airport in Serbia and the second largest airport in the Balkans in the preparatory activities for launching the concession procedure.

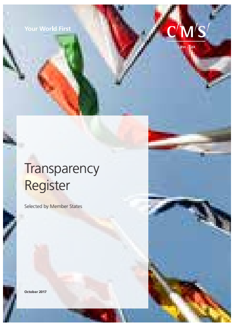
Phoenix Global Resources
Advised on its reverse acquisition of the holding company of PETSA, the Argentinian oil & gas exploration and production operator.

Sunrise
Advised on the CHF 500m sale of Swiss Towers to a consortium led by Spanish telecom infrastructure operator Cellnex Telecom.

Telefonica
Advised on the sale of its 40% stake in Telxius.

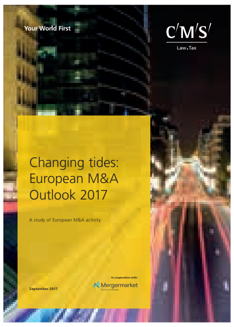
Sharing knowledge

Emerging Europe M&A Report 2017 / 18
Our latest report analyses trends in 15 emerging CEE / SEE countries based on EMIS M&A data for 2012 – 2017, and through a series of articles based on interviews with CMS partners takes a deeper dive into the hot topics and issues impacting M&A activity in the region. *(January 2018)*

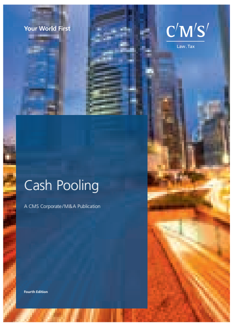


Transparency Register – Overview of Foreign Reporting Requirements
Among other measures designed to combat money laundering and terrorist financing, the 4th Money Laundering Directive requires the EU member states to set up registers of the ultimate beneficial owners of legal entities. It was left up to the individual member states how to implement the directive, and in doing so, member states have taken different approaches.

In order to give an initial overview, CMS has summarised the regulations in selected member states. Of particular relevance to shareholders are those countries in which direct and indirect shareholders have an active obligation to make any necessary notification. *(October 2017)*

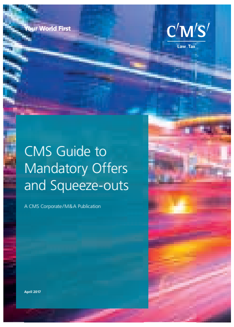


European M&A Outlook 2017
Our survey provides key insights into how both corporate and private equity (PE) firms are adapting their M&A strategies to a new European landscape, and how they are looking beyond the continent to tap into new geographic, product and customer markets. The report canvassed the opinions of 230 Europe-based executives, from corporates and private equity firms, assessing dealmaking sentiment for the European M&A market in the year ahead. *(September 2017)*



Cash Pooling
Cash pooling enables corporate groups to minimise expenditure incurred in connection with banking facilities through economies of scale. Cash pooling agreements must be carefully structured in order to minimise the risks of civil or criminal liability of the participating group companies and their officers, also considering tax issues. In this context, this brochure provides an overview of the risks of civil / criminal liability associated with cash pooling in 27 jurisdictions in which CMS is represented and discusses the various means by which such liability may be avoided. *(June 2017)*

Shareholder Activism: A European Perspective
In recent years, there has been significant growth in shareholder activism. Each European jurisdiction has its own characteristics and, to some extent, its own laws. The publication aims to explain the landscape across Europe's main markets, and to highlight the key differences in each of those markets. *(June 2017)*



Guide to Mandatory Offers and Squeeze-Out
This guide provides an overview of the current legal framework and practice governing public takeovers and squeeze-outs in a total of 26 jurisdictions (18 EU member states, Albania, Bosnia-Herzegovina, Russia, Serbia, Switzerland, Turkey and Ukraine as well as China) and provides contact details of experienced legal advisors active in this field. *(April 2017)*

To receive copies of the publications shown, please contact our CMS Corporate / M&A team at: corporate@cmslegal.com

Methodology

The Study includes deals which were structured either as a share sale or an asset sale, including transactions where a seller held less than 100% of the target company's share capital, provided this represented the seller's entire shareholding in the target company. The Study also includes property transactions which involved the sale or acquisition of an operating enterprise such as a hotel, hospital, shopping centre or comparable business, and not merely a piece of land. Internal group transactions were not included in the Study. The data has been divided for comparative purposes into four European regions. The countries included in each of these regions are as follows:

- Benelux: Belgium, The Netherlands and Luxembourg
- Central and Eastern Europe (CEE): Bulgaria, Croatia, Czech Republic, Hungary, Poland, Romania, Serbia and Ukraine
- German-speaking countries: Austria, Germany and Switzerland
- Southern Europe: Italy, Spain and Portugal

France and the United Kingdom are presented as individual categories.

Transactions included in the Study cover the following sectors:

- Banking & Finance
- Hotels & Leisure
- Energy
- Consumer Products
- Technology, Media & Communications
- Infrastructure & Projects
- Lifesciences (pharmaceutical, medicinal and biotechnical products)
- Real Estate & Construction
- Industry
- Business (Other Services)

Comparative data from the US was derived from the "2016 and the first half of 2017 Private Target Mergers & Acquisitions Deal Points Study" produced by the Mergers & Acquisitions Market Trends Subcommittee of the Mergers & Acquisitions Committee of the American Bar Association's Business Law Section.

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Sources: Mergermarket, Thomson Reuters, Bloomberg; by deal count.

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