



Structuring Your Deal in Today's Active M&A Market

June 9, 2022

Mark Stoneman

Always exceed expectations through teamwork and excellent client service.

Agenda

- Introduction
- ABA Study Background
- Using the Data
- Applying the Data to Your Deal
 - Easy Conclusions
 - Clear Trends
 - Strange Conclusions
- New Data
- Other Places to Look

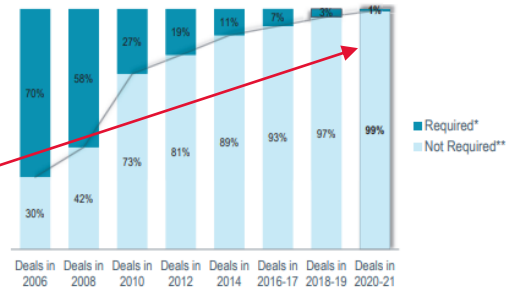


ABA “Private Target” Deal Points Study

■ History

- Generally published every other year since 2006
- Based upon small sample of publicly available deals (private target, public acquirer)
- Seems to have some impact on the market

CONDITIONS TO CLOSING
LEGAL OPINIONS (NON-TAX) OF TARGET'S COUNSEL
(All deals: includes simultaneous sign-and-close deals)



Comparison of ABA Study and Market

■ Market

- More than 4,700 reported deals in North America just in Q1 2022
- Mean transaction is ~\$130 million

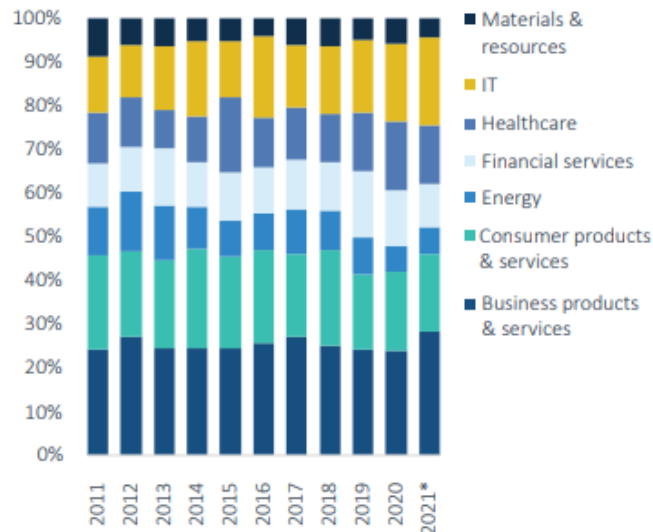
■ ABA Study

- 2020-Q1 2021 study based upon 123 transactions (less than 1% of market)
- Mean transaction value ~\$233 million, but median transaction is ~\$180 million
- Approximately 29% of deals are valued at less than \$100 million



M&A Market—Industry Coverage

Share of global M&A value by sector



Source: PitchBook | Geography: Global

*As of December 31, 2021



Armstrong
Teasdale

atllp.com

© 2022 Armstrong Teasdale LLP

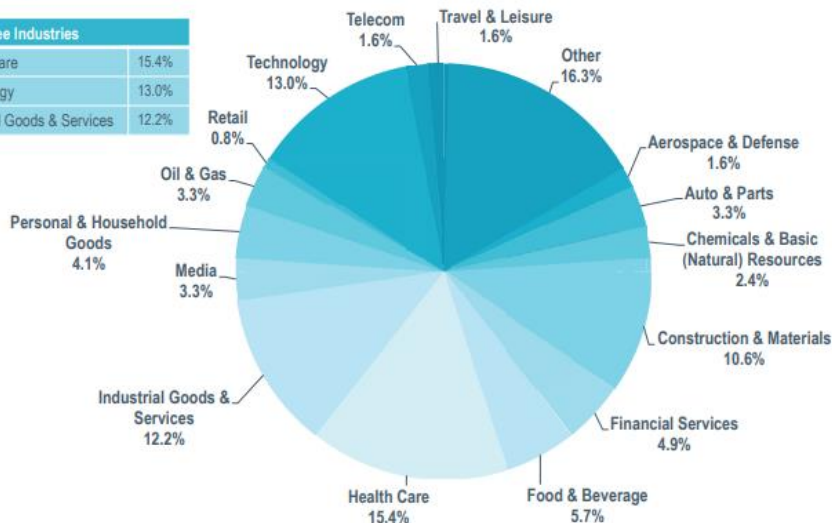
ABA Study—Industry Coverage

PRIVATE TARGET STUDY SAMPLE OVERVIEW

(by industry)

Top Three Industries

Health Care	15.4%
Technology	13.0%
Industrial Goods & Services	12.2%



MSA Market Trends Subcommittee, Mergers & Acquisitions Committee, https://www.americanbar.org/groups/business_law/committees/ma/deal_points/

Private Target Study 12/30/2021,
page 7

Comparison of ABA Study to Others

- The ABA study focuses on more granular legal terms than other studies.
- Other studies often focus on quasi-financial terms (e.g., escrow terms, etc.).
- SRS study follows the same format as the ABA study but includes private party buyers. Can be skewed by VC-backed sample.



ABA Study Provides Granular Legal Detail

CONTENTS

I. FINANCIAL PROVISIONS	9	F. Business Performance/Pandemics	76
A. Post-Closing Purchase Price Adjustments	10	VI. SANDBAGGING/NON-RELIANCE	77
B. Earnouts	18	A. "Sandbagging"	78
C. Termination Fees	22	B. Non-Reliance/No Other Representations	81
II. PERVASIVE QUALIFIERS	25	C. Non-Reliance/No Other Representations, "Sandbagging," and "10b-5" Representation Correlations	83
A. Definition of Material Adverse Effect ("MAE")	26	VII. INDEMNIFICATION	86
B. Knowledge	37	A. Survival/Time to Assert Claims	87
III. TARGET'S REPRESENTATIONS AND WARRANTIES	40	B. Types of Damages/Losses Covered	91
A. Financial Statements	41	C. Indemnification for Claims "If True"	94
B. "No Undisclosed Liabilities"	43	D. Baskets	95
C. Compliance with Law Representation	45	E. Eligible Claim Threshold	101
D. "10b-5"/Full Disclosure Representation	46	F. Materiality Scrape	102
E. #metoo Representation	49	G. Caps	105
F. Privacy Representation	50	H. Third Party Claims	110
G. Cybersecurity Representation	51	I. Indemnification as Exclusive Remedy	114
IV. COVENANTS	52	J. Escrows/Holdbacks	116
A. Updating of Disclosure Schedules	53	K. Stand-Alone Indemnities	119
B. Notice of Breaches	55	L. Reductions Against Buyer's Indemnification Claims	120
C. Operation in Ordinary Course	56	VIII. REPRESENTATIONS AND WARRANTIES INSURANCE	122
D. No Shop/No Talk	60	IX. DISPUTE RESOLUTION	129
V. CONDITIONS TO CLOSING	61	A. Post-Closing Representation of Shareholders	130
A. Accuracy of Target's Representations	62	B. Attorney-Client Privilege Carve Out	131
B. Buyer's MAC Condition	70	C. Waiver of Jury Trial	132
C. No Legal Proceedings Challenging the Transaction	71	D. Alternative Dispute Resolution	133
D. Legal Opinions	73		
E. Appraisal Rights	74		

Using the Data

- **Good for Internal Use**

- Helps validate reasonable positions (and identify aggressive ones)
- Helps educate deal team on key legal points and issues

- **Use on Offense is Risky**

- It is often easy to differentiate from the study based on facts and circumstances of your deal
- Typically, best to focus on those areas where study is nearly conclusive
- If you do quote the study, be sure to be accurate



Using the Data

▪ Limitations

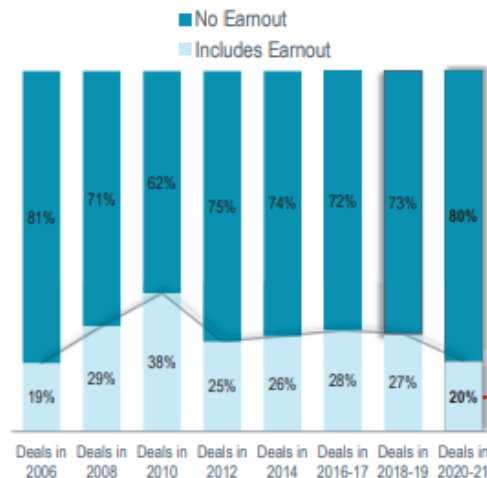
- Cannot isolate which deals in the data set are similar to your deal (but other tools can, to provide this analysis)
- Parties may use the study to negotiate for “majority” positions, even when the deal includes favorable “minority” positions
- There are a few instances where the study terms diverge from what seems to make sense; existence of the study makes it hard to argue against these, even when logic is on your side



Using the Data – Digging Deeper

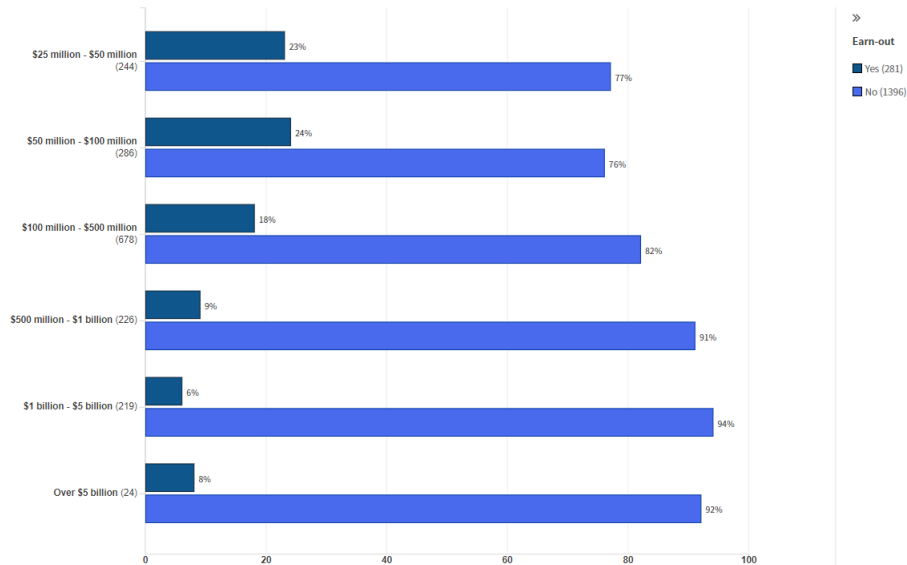
- This slide suggests that earnouts are falling out of favor and were in the range of 20% (the second-lowest across the study)
- This information, however, varies when you dig deeper

EARNOUTS



Using the Data – Digging Deeper; Deal Size

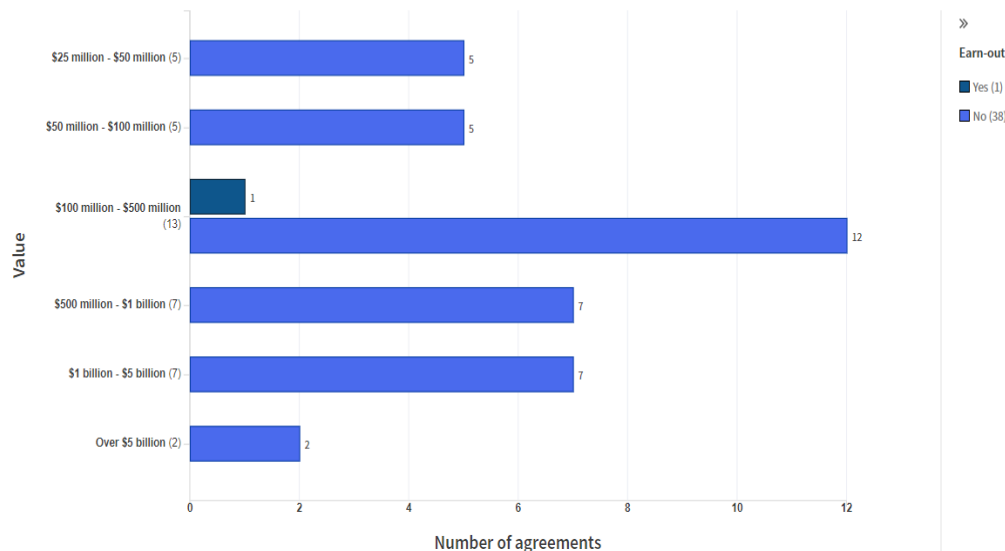
- This slide is based upon a longer term data set of almost 1,700 deals and shows 16% of the deals with Earn-outs. Notably, this slide shows that earn-outs are more prevalent at smaller deal sizes.



Using the Data – Digging Deeper; Industry Analysis—Utilities

- The prior slide shows 16% of the deals with Earn-outs. This is a smaller subset of deals, but exclusively in the Utility industry. Here, there is only 1 earnout-deal (2.6%).

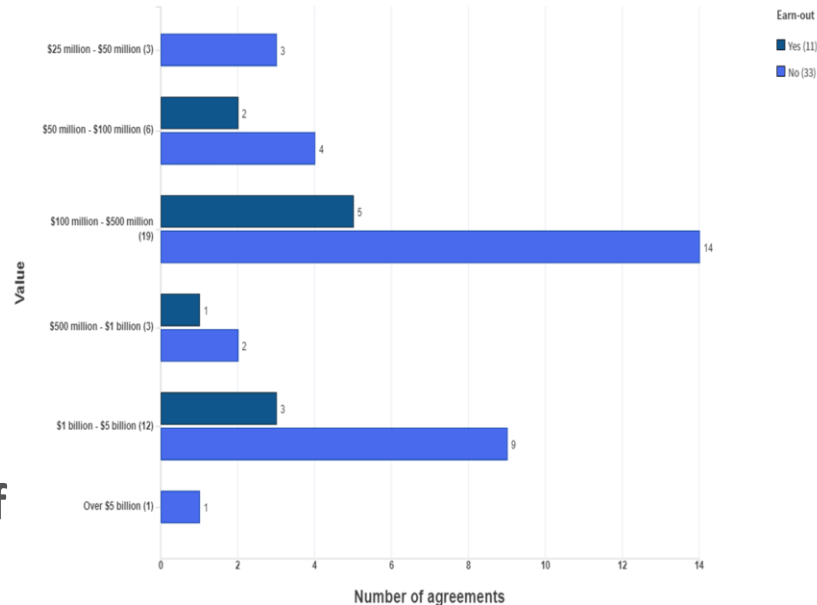
Number of Selected Industry sector Deals by Value and Earn-out [\(39 Agreements\)](#)



Using the Data – Digging Deeper; Industry Analysis—Insurance

- Here is the same analysis, but based only upon deals in the insurance industry, in which case the prevalence of earn-outs increases to 22.4%
- In short, deeper analysis can demonstrate more granular information than the survey itself

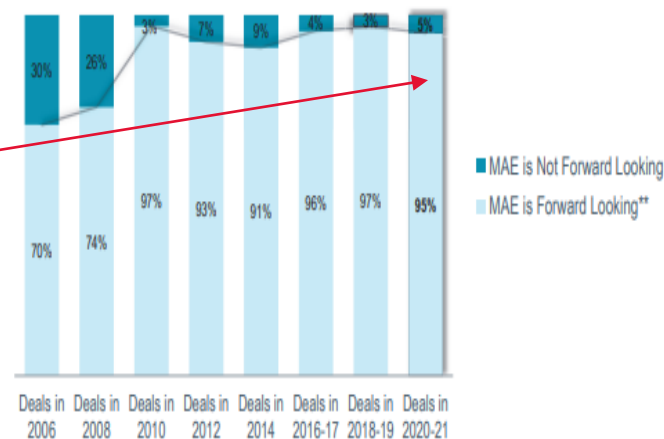
Number of Selected Industry sector Deals by Value and Earn-out (44 Agreements)



Easy Conclusion – Material Adverse Effect

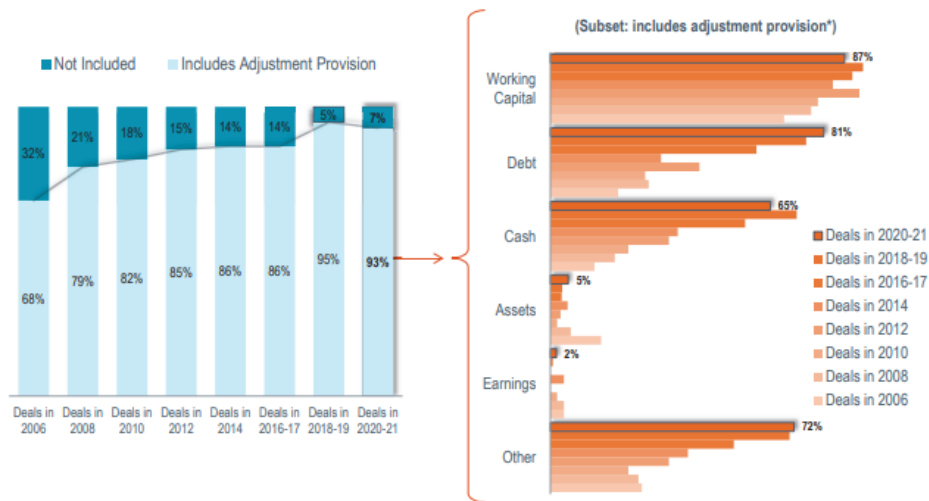
- 99% of sampled deals define “Material Adverse Effect” (MAE)
- 95% of those include “forward looking language” (i.e., “would reasonably be expected to have” a MAE)
- But 93% of the transactions don’t include the impact on the target’s “prospects” as a part of an MAE

“Material Adverse Effect” means any result, occurrence, fact, change, event, or effect that has, or *could reasonably be expected to have*, a materially adverse effect on....



Easy Conclusion – Purchase Price Adjustments

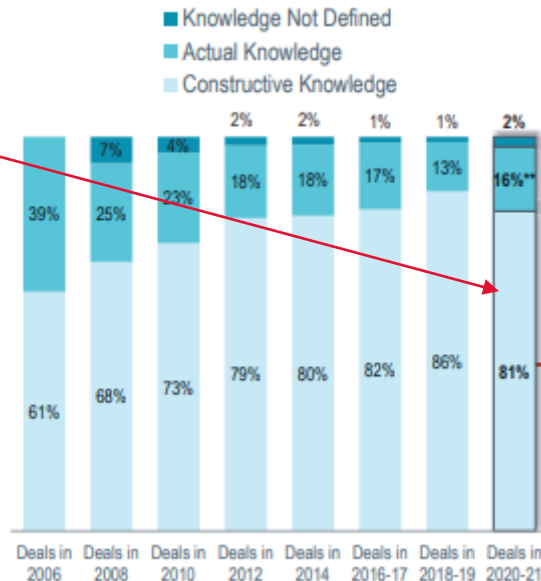
FINANCIAL PROVISIONS POST-CLOSING PURCHASE PRICE ADJUSTMENTS



* 86% of the post-closing purchase price adjustments were based on more than one metric.

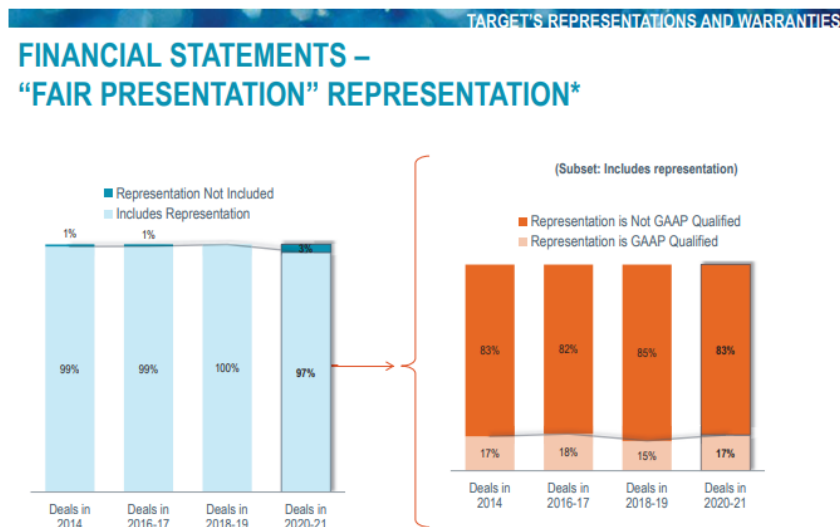
Easy Conclusion – Seller Knowledge

- “Constructive” knowledge standard is included in 81% of sampled deals
- 75% of the time, requires “due or reasonable” inquiry
- 98% of the time the “knowledge parties” are specifically identified



Easy Conclusion – Financial Statements

- **97% of the deals contemplate a “Fair Presentation” Representation:**
 - In 83% of those, it is not qualified by reference to Generally Accepted Accounting Principles (GAAP)
 - May still have “prepared in accordance with GAAP” rep
- **92% include a “no undisclosed liabilities” representation (98% of which are not subject to a “knowledge” qualification)**

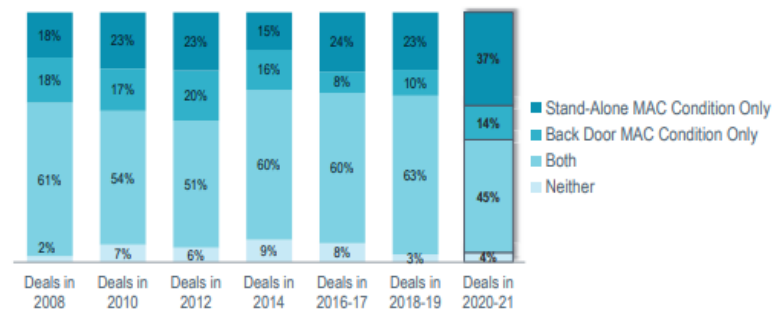


* Excludes four deals with no financial statements representation.



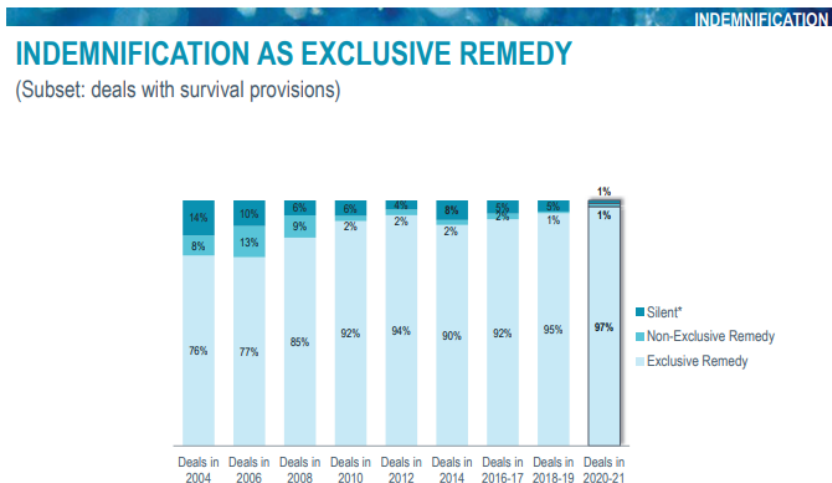
Easy Conclusion – MAC Condition to Close

- **96% of sampled deals include some type of MAC Condition:**
 - Allows buyer to walk in the event of a “Material Adverse Change”
 - Buyers generally view this as the seller’s business risk before closing, only shifting to buyer at closing
 - Frequently, buyer’s funding commitments are subject to the same condition, such that buyer feels strongly about passing this along to seller



Easy Conclusion – Exclusive Remedy

- 97% of sampled deals include indemnification as exclusive remedy:
 - Intended to limit common law claims that might circumvent negotiated limits on indemnification
 - Can be subject to exceptions for fraud



Easy Conclusion – Fraud Carve-Outs

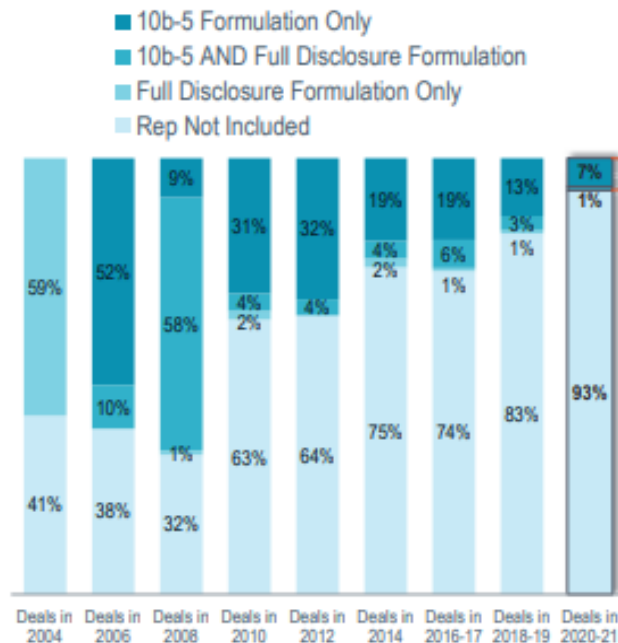
- **Fraud is Typically Carved-Out of Numerous Limitations:**
 - Survival Limitations 91%
 - Indemnity Baskets 93%
 - Indemnity Caps 93%
 - Exclusive Remedy Provisions 92%
- **But note potential effect of “Non-Reliance” Provisions on fraud claims “outside of the contract”**



Clear Trends – “10b-5” Reps

- **10b-5 and similar representations are steadily disappearing (93% absent)**

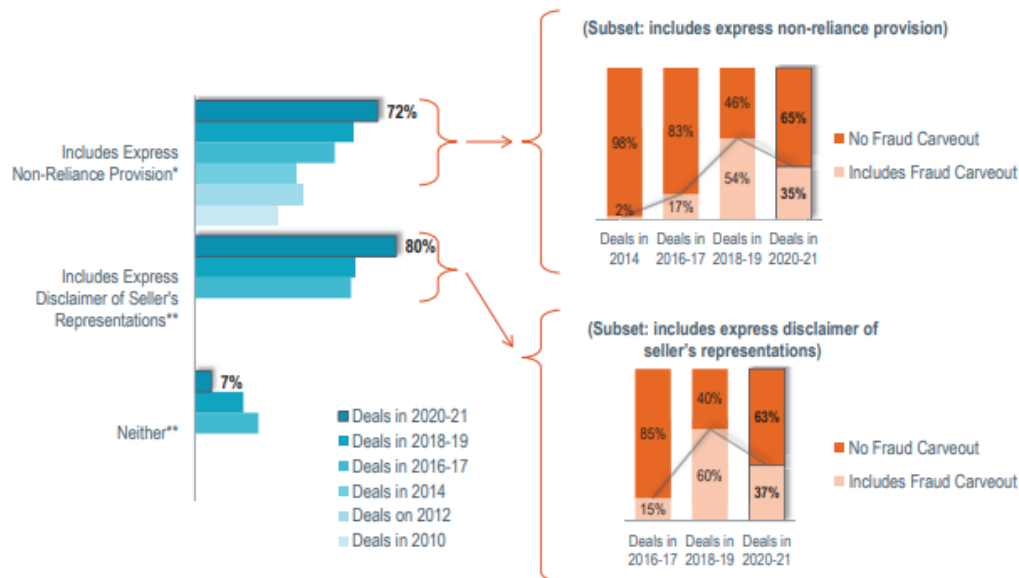
- Puts burden on buyer to seek representations on areas where buyer is reliant
- Be careful about “add-backs” and other adjustment to financials for valuation purposes
- Note that this trend correlates with seller’s market



Clear Trends – Non-Reliance Clauses

SANDBAGGING/NON-RELIANCE

NON-RELIANCE / NO OTHER REPRESENTATIONS

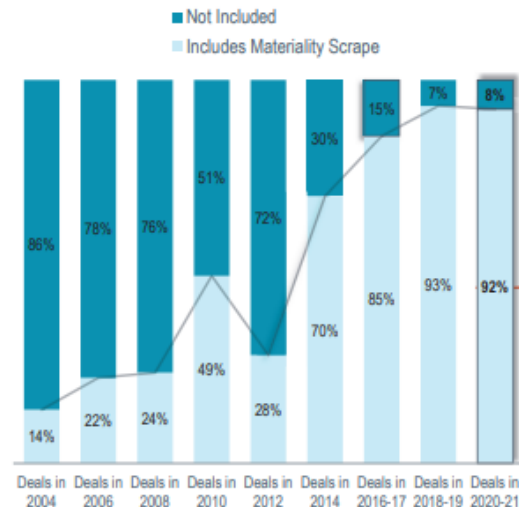


Clear Trends – Materiality Scrape

- Some form of “Materiality Scrape” now very common:
 - Favors Buyer, limits “materiality” qualification to “basket”
 - In 12% of these deals, the scrape is limited to calculation of damages only (i.e., doesn’t also impact determination of whether breach occurred)

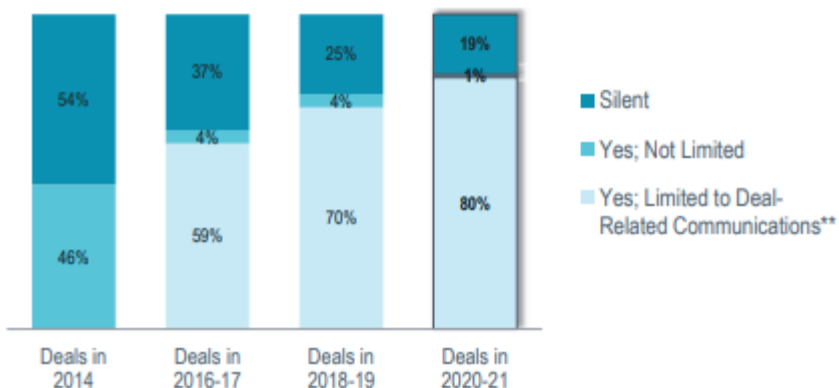
MATERIALITY SCRAPE

(materiality qualification in reps disregarded)
(Subset: deals with baskets)



Clear Trends – Attorney/Client Matters

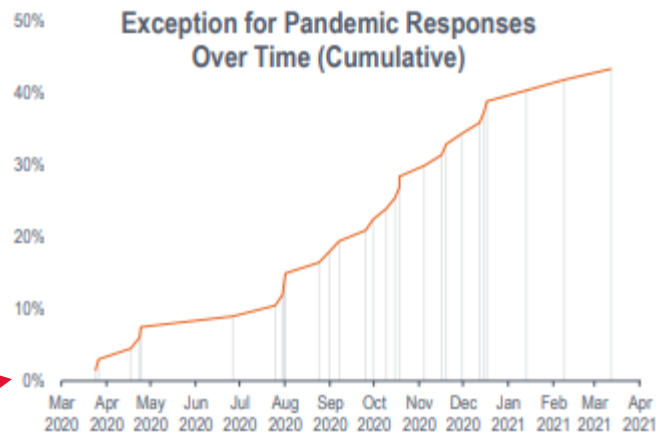
- **Attorney/Client Carve-Out increasingly recognized:**
 - Now covered in 80% of relevant deals
 - Trend likely based upon influential article in 2009 and follow-on case in 2013



Clear Trends – Increased Adaptation

- While slow to follow some trends, agreements have tracked increased sensitivity in some areas:

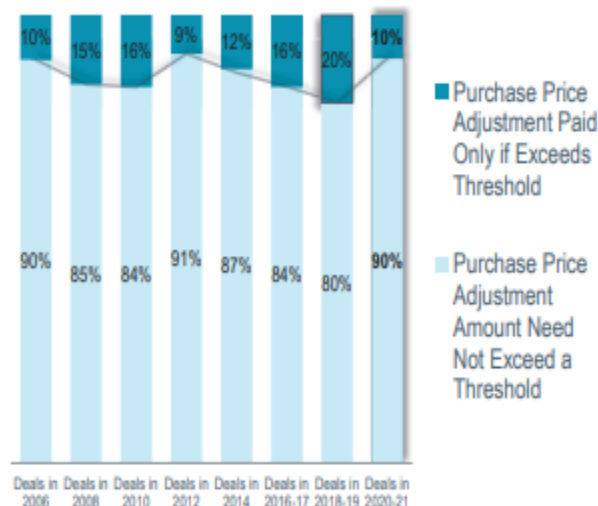
- COVID-19 Representations in 32% of deals
- #metoo representation in 37% (up from 13%) of deals
- Cybersecurity and privacy representations in 67% of deals
- Graph shows monthly increase in exception related to pandemic response (fast reaction from declaration of pandemic on 3/11/20)



Strange Conclusions—Thresholds on Price Adjustment

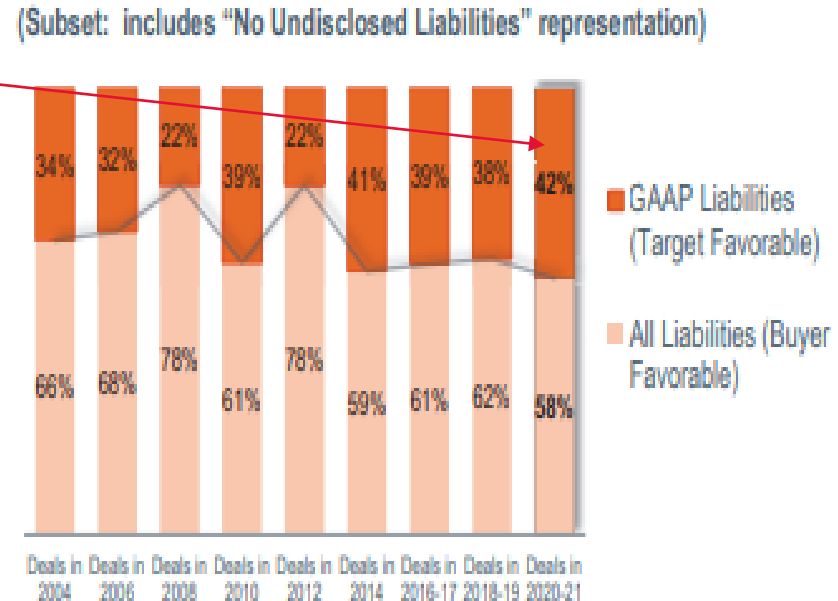
■ Some back-and-forth on this trend:

- Good arguments that such thresholds shouldn't be used
- Threshold can unintentionally create ill will between parties or drive bad incentives



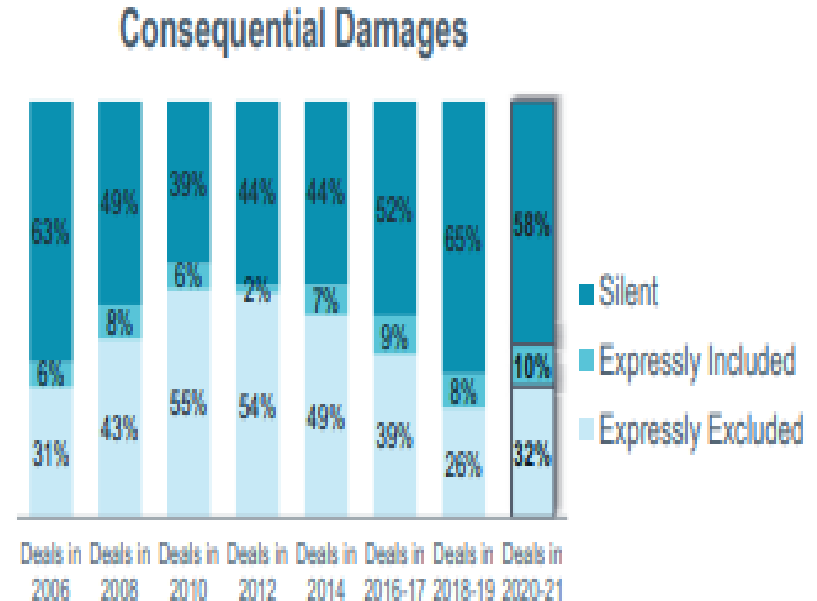
Strange Conclusions—GAAP Limitation on Undisclosed Liabilities Representation

- 42% of the deals limit the “no undisclosed liabilities” representation to liabilities defined under GAAP
 - This is a seller-favorable orientation that causes this representation to add nothing new to the generic financial statement’s representation
 - In short, this significant representation (in 92% of the deals) is qualified so it adds no additional value
 - This seller-orientation corresponds to seller strength in the market



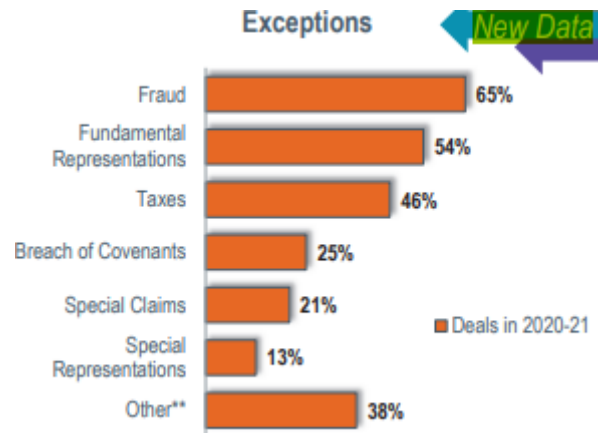
Strange Conclusions—Ability to Recover Consequential Damages

- 32% of the deals still expressly exclude right to recover Consequential Damages:
 - Could severely limit buyer's remedies
 - Although these deals often have an exception for third party claims, this ignores the issue
 - Trend seems to be reversing in light of influential articles published in 2008 and 2015



New Data—Risk Beyond Escrow

- In those instances where there is an escrow or holdback, but that is not the only remedy (61% of deals), the instances to the right highlight the prevalence of exceptions:



New Data—Termination Fees

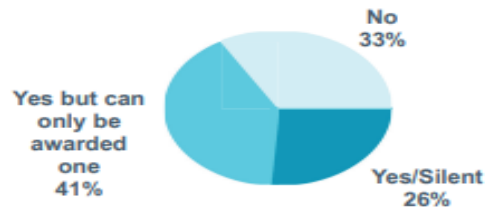
FINANCIAL PROVISIONS

TERMINATION FEES

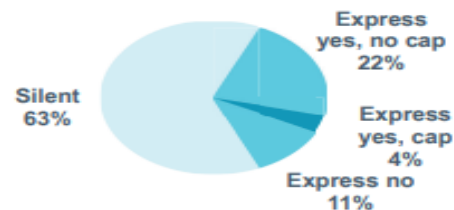
(subset: deals with determinable termination fees)



Entitled to seek payment of fee and specific performance?



Is party seeking payment entitled to costs/expenses incurred?



Receipt of fee precludes breach damages?



Armstrong
Teasdale

atllp.com

© 2022 Armstrong Teasdale LLP

New Data—More RWI Information

- Representation and Warranties Insurance (RWI) has increasingly been recognized in the study
- Note that all RWI considerations are not necessarily apparent from the document
- New data point showing sellers mandating protection of policy post-closing (which only makes sense when seller also benefits from policy)

REPRESENTATION AND WARRANTIES INSURANCE POST-CLOSING COVENANTS TO MAINTAIN RWI POLICY*



Buyer will not amend the subrogation or third-party beneficiary provisions contained in the RWI Policy benefitting Seller, or otherwise amend or modify the RWI Policy in a manner adverse to Seller, without Seller's prior written consent.

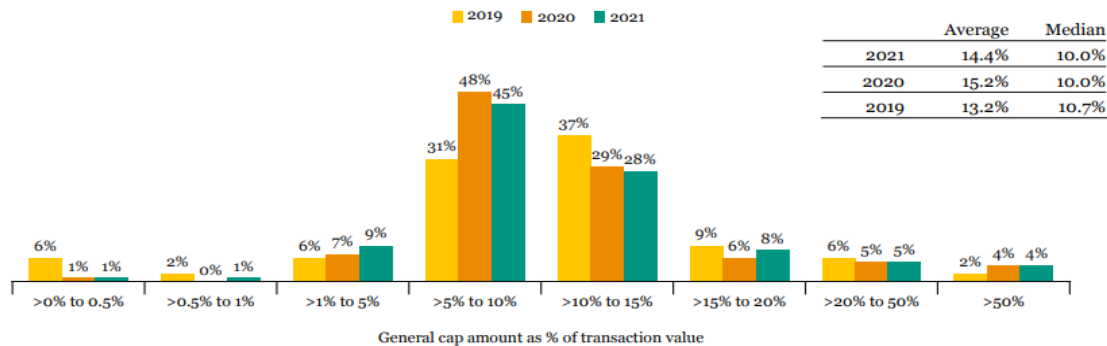
Includes Post-Closing RWI Covenant(s)



Other Places to Look—SRS; Analysis of CAPs and RWI

Caps as a Percentage of Transaction Value: No RWI Identified

Details, 2019–2021

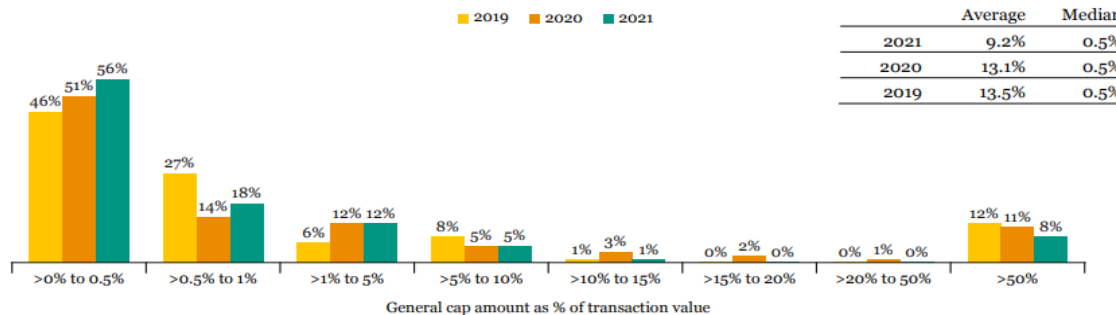


Other Places to Look—SRS; Analysis of CAPs and RWI

Caps as a Percentage of Transaction Value: RWI Identified

KEY FINDING

Details, 2019–2021





Mark Stoneman

314.552.6629 / mstoneman@atllp.com



Armstrong
Teasdale

atllp.com

© 2022 Armstrong Teasdale LLP

Sources

- SRSACQUIOM 2022 M&A Deal Terms Study
- ABA Private Target Mergers & Acquisitions Deal Points Study, 2020 and Q1 2021
- Practical Law Database (maintained by Westlaw)

