

CMS European M&A Study 2022

Fourteenth Edition

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Disclaimer

The results of the Study, the contents of this report and the conclusions which they present do not necessarily reflect the views of any member of CMS, the lawyers or the support staff who assisted with their preparation. Over 5,500 M&A transactions are evaluated in the Study, the vast majority of which were negotiated. There were many differences between the underlying agreements we analysed. In order to compare the results, individual provisions were categorised, a process which required a degree of subjective judgment. Although certain trends can be deduced from the Study, each transaction has individual features which are not recorded in the Study and to which no reference is made. As a result, the conclusions presented in the Study may be subject to important qualifications that are not expressly articulated in them.

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Introduction

We are delighted to bring you the annual CMS European M&A Study reflecting deals signed in 2021. This Study covers a year of record levels of M&A activity throughout Europe and the rest of the world. The market bounced back spectacularly from the drop off experienced in the early stages of the COVID-19 pandemic in 2020.

This edition of the CMS European M&A Study covers nearly 500 deals on which CMS offices in Europe advised in 2021. This is a record number of deals in one year and is reflective of the current M&A boom. This year's Study marks the 14th consecutive year for the Study. The size of deal sample and range of countries reflected in this Study means it remains a valuable resource for M&A practitioners across Europe.

Last year was clearly an extraordinary one as M&A recovered and then accelerated away. As a firm we reported on 90 more deals as compared to 2020, an unprecedented 22% increase in deal activity year on year. Overall, we saw that normal deal metrics applied in those transactions with a reversion away from the 'buyer-friendly' approach we found in 2020 and a return to the more standard seller and buyer positions that applied before the pandemic. It may be that normal service had resumed.

As with previous Studies we have included a comparison against US practice, by comparing the results of the American Bar Association's most recent edition of the Private Target Mergers & Acquisitions Deal Points Study. This Study includes for the first time results in respect of M&A transactions throughout the Nordic region, reflecting the input from CMS Kluge, which joined CMS in 2021. We have also included some commentary from our offices in MENA, Asia Pacific and LATAM, by way of general comparison against the European results, for those readers that have an interest in those markets.

As we go to press, the unlawful invasion of Ukraine has just commenced and whilst we remain positive about future deal activity in Europe, we must be cautious about how these events will play out. Many of the drivers of the activity in 2021 continue to apply. The response of governments, corporates and the general public to the COVID-19 pandemic has paid dividends but there are increased risks and uncertainties and there may be further macro risks in the future. Pre-invasion M&A activity was continuing at pace as dealmakers focus on M&A to accelerate growth and shape their future business profiles, although we wait to see how robustly this will continue.

We are grateful for the continued positive feedback we have received from clients and others as to the output from this annual report and trust that this remains the same for this year's Study. We hope the 2022 version of the CMS European M&A Study provides helpful insight into market practice to assist in preparing for any contemplated transaction.



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Executive summary

This Study covers 498 share and asset deals on which CMS advised during 2021. This is a record number of deals for one year and is reflective of the current M&A boom. We observed that normal deal metrics applied in most of those transactions, a reversion away from the particularly 'buyer-friendly' approach we found in 2020, and a return to more standard seller and buyer positions. It may be that normal service had resumed.

The increase in the use of locked boxes and the decrease in liability caps may appear to reflect a more 'seller-friendly' environment but this was counterbalanced by continued 'buyer-friendly' positions still trending in certain areas, suggesting a return to the position which applied prior to the pandemic. There was a sharp increase in the use of earn-outs with those determined by reference to profits over a two-year period becoming more common and W&I insurance continues its inexorable rise, particularly in the UK and Germany.

Highlights

- The effects of the Covid-19 pandemic on transactions in the early part of 2020 have now fully disappeared and the increase in M&A activity has resulted in a return to familiar patterns in the deal metrics which we measure. The Study reflects the more standard approach to risk sharing that we saw before the pandemic.
- One notable feature in 2021 was a significant increase in the use of earn-out structures. We had expected such an increase in 2020, reflecting the impact of the pandemic. The increase in their use to 26% of deals was repeated across almost all jurisdictions. There was also an increase in applying EBIT/EBITDA as the earn-out criterion instead of turnover, perhaps showing that parties that more stable economic conditions are in place. Earn-outs are now generally measured over a period of up to 24 months, with a drop in longer time periods.
- Transactions featuring purchase price adjustment (PPA) provisions returned to pre-pandemic levels, suggesting that a greater proportion of buyers are once again able to insist on such adjustments. In contrast, the use of a locked box structure in non-PPA transactions increased significantly, perhaps reflective of a more stable economic environment.
- Two-thirds of transactions now have a limitation period of 12 to 24 months, which is back to the 11-year average. *De minimis* levels and basket sizes also decreased in size, with a significant proportion of baskets now at less than 0.5% of the purchase price.
- The number of deals with liability caps of less than 50% of the purchase price increased, reflecting a return to the levels of liability caps prevailing before the pandemic. In particular, those deals with a cap of less than 10% of the purchase price increased significantly to 22% from 16% in 2020. For small deals, the purchase price is still most likely to be the agreed liability cap.
- W&I insurance in European transactions returned, significantly so in the UK and Germany, and nearly half of larger transactions now have W&I cover as standard. Our prediction that the drop-off in W&I insurance experienced in 2020 would not persist has proved correct. The application of W&I insurance is giving rise to significant benefits to sellers, with lower basket thresholds and lower liability caps, even though the buyer is apparently paying the premium in most cases.
- As with previous Studies we have included a comparison against US practice, by comparing the results of the American Bar Association's most recent edition of the Private Target Mergers & Acquisitions Deal Points Study. The same differences we have seen over the years of the Study between US and European market practice remain, with the notable exception of earn-outs, which appear to have declined in the US whilst increasing markedly with respect to our European deals.

2021 results at a glance

CMS Trend Index

	2010–2020	2020	2021
DEALS WITH PURCHASE PRICE ADJUSTMENT	45%	44%	47%
DEALS WITH A LOCKED BOX (WHERE NO PURCHASE PRICE ADJUSTMENT)	48%	51%	59%
EARN-OUTS	19%	21%	26%
— SHORT EARN-OUTS (12 MONTHS OR LESS)	24%	24%	34%
— LONG EARN-OUTS (36 MONTHS OR MORE)	22%	26%	15%
— EBIT/EBITDA-BASED EARN-OUTS	42%	46%	48%
— TURNOVER-BASED EARN-OUTS	32%	31%	21%
DE MINIMIS	70%*	74%	74%
BASKET	66%	68%	67%
— LOWER BASKET (LESS THAN 1% OF PRICE)	57%*	58%	67%
— HIGHER BASKETS (MORE THAN 1.5% OF PRICE)	26%*	25%	16%
— FIRST DOLLAR RECOVERY	79%	82%	84%
LIABILITY CAPS			
— NO CAPS	13%	12%	9%
— LESS THAN 50% OF PRICE	54%	49%	57%
— LESS THAN 10% OF PRICE	13%	16%	22%
LIMITATION PERIODS			
— 12–18 MONTHS	32%	30%	29%
— 12–24 MONTHS	64%	66%	66%
— MORE THAN 24 MONTHS	22%	23%	25%
SECURITY FOR WARRANTY CLAIMS	32%	29%	28%
— RETENTION FROM PRICE	29%	32%	41%
— ESCROW ACCOUNT	57%	48%	43%
MAC CLAUSE	15%	15%	16%
ARBITRATION CLAUSE	33%	32%	33%
— APPLICABILITY OF INTERNATIONAL RULES RATHER THAN NATIONAL RULES	40%	33%	32%

* Data only available for 2011–2020

Key conclusions

Purchase price adjustments –

In 2021 there was an increase in the use of purchase price adjustment (PPA) clauses in M&A agreements (47% compared with 44% for 2020). This seems to reflect a return to the level of PPA provisions seen pre-pandemic and is reflective of more recent average application. This may suggest that a greater proportion of buyers are once again able to insist on PPA provisions.

Locked box Transactions –

For 2021, there was a big increase in the application of locked box arrangements for non-PPA transactions (59% in 2021 compared with 51% in 2020). This increase is even more marked when compared against the average usage of 48% for the period 2010 to 2020. This is probably symptomatic of a wider acceptance of locked box provisions once it is agreed that a PPA provision will not apply.

Earn-outs –

The frequency of earn-outs jumped by 5% to 26% – a percentage higher even than the most recent US statistics (where earn-outs typically had been more popular than in Europe). This in part may be explained by a small increase in the number of deals transacted in the Technology, Media & Communications and Life Sciences sectors (which are most popular for earn-outs) but also more generally parties using earn-outs to ensure the price paid for a business is measured over a longer period rather than purely by reference to financial years dominated by the pandemic.

Warranty & Indemnity insurance –

The drop in use of W&I insurance shown in last year's study, as predicted, was not repeated and 2021 saw an increased use overall in Europe up to 19% of deals. This is dwarfed by the new data from the US in the most recent ABA Study where the comparable figure is 65%. However, when looking at the statistics for medium sized and large deals, those numbers in Europe jumped to 33% and 47% respectively.

De minimis – This year's Study shows a continuation in the flattening of the number of transactions which include a *de minimis* clause at 74%, consistent with the trend over the last four years and the same percentage as in 2020. We think this demonstrates that a *de minimis* clause is now the predominant market norm across most European jurisdictions. There was, however, a marked drop in the level of *de minimis* provisions, with 39% (as compared to 30% in 2020) of deals applying a *de minimis* of less than 0.1% of the purchase price.

Baskets – Basket sizes are decreasing in size, with a very significant proportion now at less than 0.5% of the purchase price. Baskets were applied in 67% of European transactions in 2021 which broadly represents a return to the average for the years since 2017. That said, baskets at the lowest level from EUR 1 to 0.5% of the purchase price jumped up to 36% of transactions compared to 27% in 2020. It is notable that most baskets in 2021 (67%) were equal in value to up to 1% of the purchase price and the remainder (33%) were more than 1% of the purchase price. This drop perhaps indicates a more 'buyer-friendly' approach and may also result from the wider use of W&I insurance.

Liability caps – In 2021 there was a big increase in the number of deals with liability caps of less than 50% of the purchase price, reflecting a reversion to the liability caps prevailing before the pandemic. The proportion of deals with liability caps equal to the purchase price remained constant at 30% but those with a cap of less than 10% of the purchase price increased significantly to 22% from 16% in 2020. The amounts of those caps are also subject to significant variation depending on deal size. Liability caps for larger transactions are decreasing and fewer of these transactions have caps equal to the purchase price. For small deals the purchase price is still most likely to be the agreed liability cap.

Limitation periods – In 2021 (as in 2020) limitation periods were longer. The frequency of limitation periods of more than 24 months is almost reaching the high points of the first years of the Study and applied in 25% of deals in 2021 (which is also above the 11-year average of 22% for the period from 2010 to 2020). In contrast to previous years, deal size appears not to have been a driving factor in the duration of limitation periods.

Security for warranty claims – 28% of deals contained security for warranty claims in 2021 (down 1% when compared to 2020). The 'seller-friendly' trend of recent years continued to permit sellers to avoid having to provide security – a trend that may have been encouraged by the greater use of W&I insurance, meaning that buyers require less direct recourse to the seller. The use of escrow accounts has also decreased sharply to 43% of deals (compared with the average of 57% for the period 2010 to 2020). Where the parties used security for warranty claims, we noted a 'buyer-friendly' trend regarding the specific forms of security used, e.g. purchase price retention.

MAC clauses – In 2021, MAC clauses were used in 16% of the deals we analysed. This is a slight increase both when compared with 2020 and the 11-year average (both 15%). This may indicate that sellers have been more successful in resisting MAC clauses because of their strong commercial position. If a MAC clause is included, exemptions on the basis of overall economic developments (26%) have regained popularity in 2021, where these have formed part of 59% of the deals (2020: 51% and 2010 to 2020: 61%).

Arbitration – Arbitration was used as the dispute resolution mechanism in 33% of deals reviewed in 2021. This marks a slight increase compared to 2020 (32%), following a steady increase in recent previous years (2016: 25%; 2017: 29%; 2018: 33%). The current popularity of arbitration as a dispute resolution mechanism is consistent with its long-term popularity over the course of the previous 11 years (2010 to 2020).

Tax – Tax indemnities were agreed in 60% of the deals in 2021. This shows a levelling off over recent years and reflects a slight decrease from the high of 64% in 2014. If a tax indemnity was agreed, most limitation periods were absolute (64%), which is 'seller-friendly', and only 41% of deals contained a clause granting the seller the right to participate in a future tax audit.



Deal drivers

Main deal drivers 2018–2021

	2018–2020	2020	2021
ENTRY INTO NEW MARKETS	45%	45%	43%
ACQUISITION OF KNOW-HOW (WITHOUT ACQUI-HIRE TRANSACTIONS)	20%	17%	22%
ACQUISITION OF A TEAM OF EMPLOYEES (I.E. ACQUI-HIRE TRANSACTIONS)	15%	14%	14%
ACQUISITION OF A COMPETITOR	23%	22%	32%
ACQUISITION OF A SUPPLIER	6%	6%	7%
DIGITALISATION	2%	2%	4%
OTHER	23%	24%	19%

This year's Study again sought to identify the main deal drivers for each relevant transaction. There was a significant increase in deals comprising the acquisition of a competitor (from 22% to 32%), perhaps representative of post-pandemic opportunism as buyers seek consolidation of similar revenues and costs. Other than that we found a broadly consistent result to previous years with most deals seeing a buyer wishing to enter a new market.

The details for 2021 were as follows:

- 43% of the deals covered represented the entry into a new market by the buyer
- 36% of all deals were either the acquisition of know-how or acqui-hire transactions
- 32% of the deals were the acquisition of a competitor

The rise in the proportion of acquisitions concerning know-how and digitalisation from 19% to 26% is also perhaps reflective of the M&A market generally and the opportunities which have arisen as a result of technology changes arising from the pandemic. It still remains of note that 19% of this year's deals had a range of other drivers – again demonstrating the variety of underlying reasons for entering into M&A transactions.



Non-compete provisions

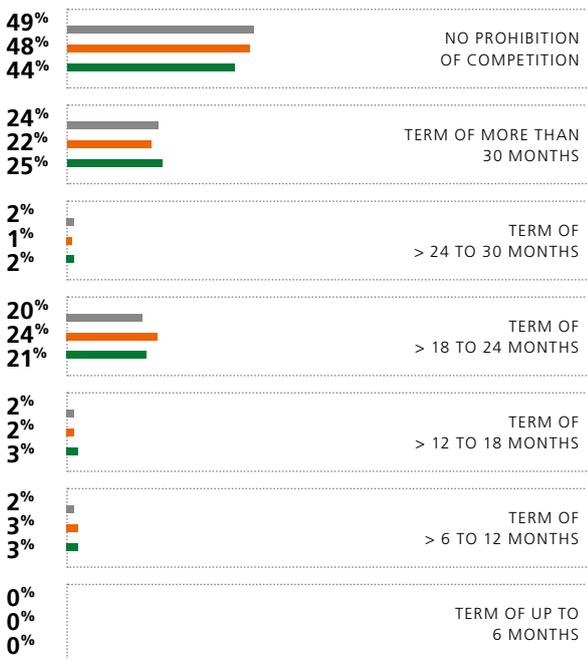
It remains the case that most deals covered in the report do not include a provision which restricts the future activities of the seller. In 2020 nearly half (48%) did not include a provision and this has seen a significant decrease in 2021 (44%). This may reflect the ability of sellers, such as private equity, to ensure complete flexibility of their post-completion business affairs or a reversion to the pre-pandemic norm.

In most European jurisdictions the time period for which a non-compete can be legitimately enforced

against a seller is limited by anti-trust rules and public policy issues. Where there is a restriction, the duration of non-compete clauses has remained very static with the most common restrictive periods being for either two years or for more than 30 months. There was a significant increase in the application of non-compete provisions in the UK (up to 63% from 45%), just slightly behind the Southern European countries (up to 64% from 49%) and in CEE (up to 39% from 29%), but otherwise there was a decline in their use.

Non-compete

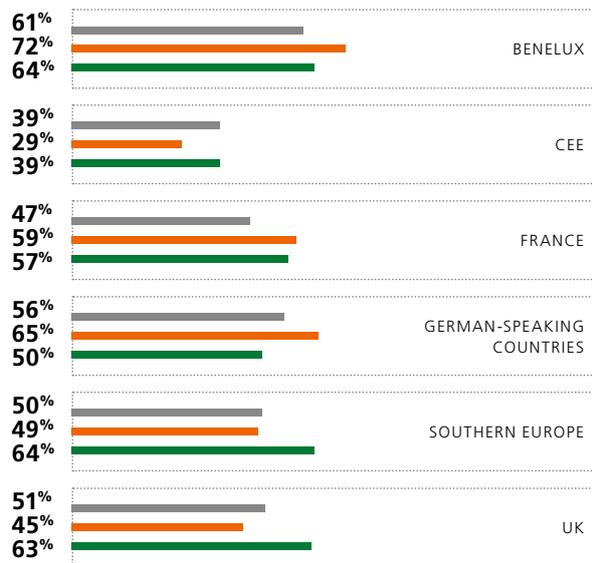
Duration of non-compete clauses 2010–2021



● 2010–2020 ● 2020 ● 2021
100% = all evaluated transactions

Non-compete

Deals containing a non-compete clause and term of more than 30 months 2010–2021



● 2010–2020 ● 2020 ● 2021
100% = all evaluated transactions

Warranty coverage

In this year's Study we repeated our enquiries as to the overall nature of the warranty cover. As before, we found that warranties regarding the target's most recent financial statements, post balance sheet conduct of business, compliance and operations are very common and apply in up to (or even more than) 75% of all agreements. Specific warranties about the target's profitability and its pensions position are, however, much less usual (56%) and very few agreements only contain title and capacity warranties (6%).

Warranties/Limitations of liability

Warranties Used 2020/2021

	2020	2021
ONLY TITLE AND CAPACITY WARRANTIES	7%	6%
WARRANTIES REGARDING THE TARGET'S FINANCIAL STATEMENTS	77%	81%
COMPLIANCE WARRANTY	79%	79%
OPERATIONAL WARRANTIES	74%	75%
WARRANTIES WITH REGARD TO CONDUCT OF BUSINESS	74%	74%
WARRANTIES WITH REGARD TO PENSION SCHEMES	50%	56%
WARRANTY REGARDING THE TARGET'S FINANCIAL SITUATION	47%	49%

100% = all evaluated transactions with warranties included in the agreement
Multiple warranties may apply

CMS European/US risk allocation comparison

With excellent timing, at the end of 2021 the American Bar Association published its most recent edition of the Private Target Mergers & Acquisitions Deal Points Study (“**ABA Study**”) and so we have some up to date US data against which to undertake our annual European/US comparison. For the record it should be noted that the ABA Study’s sample size was 123 deals executed and/or completed in 2020 and the first quarter of 2021 with a transaction value range of between USD 30m and USD 750m. The ABA Study is a study exclusively of publicly available agreements where a private company is acquired by a public company and thus it is likely that the deals analysed by the ABA Study can be considered strategic M&A (as opposed to deals involving a private equity-backed financial sponsor).

As mentioned in last year’s study, we are also aware of the SRS Acquiom report which similarly tracks deal points on US deals. SRS Acquiom is a transfer/paying agent and whilst the deals in its report are self selected it is arguably a broader set of deals than that covered by the ABA Study.

For the first time we have separately included the relevant figures from the SRS Acquiom report from May 2021 in the table below as it is interesting to compare both US studies. In the bullet points below, the US percentages will refer to those in the ABA Study unless otherwise stated.

Overall, whilst the percentages set out in the table on the next page below show some significant changes in respect of individual deal points, the same differences between US and European market practice remain, with the notable exception of earn-outs.

- Market practice in Europe in respect of purchase price adjustments has remained consistent in the range of around 45% over the past eight years, whilst in the US a PPA features in almost all deals (93%).
- Working capital adjustments remain the most frequently used component of a PPA in the US (87% of deals involving a PPA) albeit the use of debt adjustments has risen notably to 81% and 86% of the PPAs were based on more than one metric. In Europe the position is more varied. Whilst working capital adjustments gained popularity (up 6% to 44%) they remain much lower than the equivalent in the US. In Europe cash and debt adjustments are most popular, at 57% of deals involving a PPA.
- In 2021 earn-outs became seemingly more popular in Europe (at 26% of deals) than in the US (20%). This reversed the trend from previous years. The ABA Study indicates that earn-outs are decreasing in popularity in the US, while the SRS report indicates the reverse (although the percentages are broadly the same). One thing to note, however, is that the ABA Study’s value range starts at USD 30m and, as reported in the Deal Size Comparison section of this Study, it is clear in Europe that earn-outs are more popular on smaller deals (i.e. less than EUR 25m). In any event, there appear to have been notably opposing trends, as in Europe earn-outs have been on the rise (from 13% to 15% in the years 2010 to 2013), while they have been falling or have remained static in the US, from a 38% high-point in 2010.
- 2021 also saw the US experiencing a complete switch in market practice in terms of earn-out measurement criteria as turnover (revenue) rose from 29% to 41% whilst EBIT/EBITDA fell from 31% to 11%. The SRS report similarly shows most earn-out deals are revenue-based but contrastingly indicates profit-based metrics are on the rise. In European earn-outs EBIT/EBITDA was significantly the most popular metric upon which to determine the earn-out, at 48%.
- There is practically no change in the data relating to *de minimis* financial limitations – seen in almost three-quarters of European deals but only 38% of US deals. We have previously suggested that the dominance of ‘excess only’ baskets in the US means that also to include a *de minimis* might be regarded as overkill. The rapid emergence of W&I insurance in the US market will also likely prompt parties to query the necessity of additional financial limitations.
- The growth in W&I insurance in the US markets could also explain the drop in frequency of basket financial limitations (down 7% to 90%) albeit this clearly still represents a feature being used in the vast majority of US deals. In Europe the use of baskets has remained static at approximately two-thirds of deals.
- The basis for recovery pursuant to the relevant basket limitation clause is also often very different. In the US, 75% of baskets operate as ‘excess only’ baskets or as a deductible (where recovery is only permitted above the relevant threshold) but in 2021 such a feature occurred in just 16% of the

European deals involving a basket. 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) – 84% compared to 13% in the US.

- The value at which the basket is set is often debated. In the US there appears great consistency in that the vast majority of analysed deals have a basket equal to 1% or less of the purchase price albeit this is made up as to 56% at 0.5% or less and 40% between 0.5% and 1%. In Europe there is more variety (perhaps again explained by the greater range in deal sizes the Study analyses) with deals involving baskets at 1% or less rising to 67% in 2021.
- The growth in W&I insurance and the consistent US approach to having low liability caps sees a 4% increase in 2021 to 99% of US deals having the seller’s liability capped at under 25% of the purchase price. Only 41% of European deals have caps on liability at up to 25% of the consideration.
- A MAC clause is almost always a feature on a US deal (96%). It is far less common in European deals (only 16%).
- Security for claims as a feature on deals fell in popularity on both sides of the Atlantic albeit most considerably in the US (down 20% to 63%) where it remains comfortably more common than in Europe. In the US it may well be that

a form of security is required less if W&I insurance is involved whereas in Europe the costs and compliance involved for instance in establishing escrow accounts is making them unpopular.

- The W&I insurance boom in the US has continued to such an extent that the ABA Study reports that nearly two-thirds (65%) of its analysed deals involved W&I insurance. Whilst the presence of W&I insurance in Europe grew again in 2021 to 19%, this figure just does not compare with its popularity in the US market.

Brian Hendry, Head of Mergers & Acquisitions at W&I Insurance broker Paragon International Insurance notes the following in relation to the US RWI market:

“The US Reps & Warranties insurance (RWI) market expanded to an even greater extent in 2021 and where one out of two US deals took a buyer-side RWI policy in 2020, this moved to 6.5 in every ten deals. The demand expanded to such an extent that standard market rates of 2.75%–3.5%, increased from late June to 4.5%–5% in Q4 – and in certain cases touched 6%. It is expected that this level of rate resulted from the sheer volume of Q4 transactions and that 2022 has started to ease back.”

The table below sets out a quick reference of the differences described above and also provides a comparison to previous data:

Europe/US differences

	2020 EUROPE	2021 EUROPE	2018 / 2019 US ABA	2020 / 2021 US ABA	2021 US SRS
PURCHASE PRICE ADJUSTMENT	45%	47%	95%	93%	90%
WORKING CAPITAL ADJUSTMENT	41%	44%	92%	87%	88%
EARN-OUT DEALS	21%	26%	27%	20%	19%
DE MINIMIS	73%	74%	39%	38%	28%
BASKET	66%	67%	97%	90%	85%
BASKET THRESHOLD (1% OR LESS)	62%	67%	97%	96%	90%
‘EXCESS ONLY’ RECOVERY (BASKET)	20%	16%	74%	75%	45%
‘FIRST DOLLAR’ RECOVERY (BASKET)	80%	84%	23%	13%	38%
SUB-25% LIABILITY CAPS	43%	41%	95%	99%	90%
MAC CLAUSES	15%	16%	97%	96%	98%
SECURITY FOR CLAIMS	29%	28%	83%	63%	N/A
W&I INSURANCE USED	17%	19%	52%	65%	N/A

CMS deal size analysis

The Study describes deals as ‘small’, ‘medium’ and ‘large’ depending on the values involved and highlights differences in deal terms between them. The deal sizes we use are as follows:

- Deals with values of up to EUR 25m are the small deals;
- Deals with values of between EUR 25m and EUR 100m we call medium sized deals; and
- Deals with values over EUR 100m are the large deals.

The below table shows the highlights for 2021.

The following bullet points identify (i) some changes since last year and (ii) the main differences, in each case, when comparing large deals with small and medium sized deals:

- Purchase price adjustments (PPAs) continue to appear more frequently on medium sized deals (58%) and large deals (50%) although in fact the percentages

for smaller deals and medium sized deals increased and those for large deals dropped. The relatively high percentages continue to support the view that as long as the pandemic continues buyers want to retain the ability to check the correct price is paid.

- Notwithstanding the above, there has been an increase in the use of locked box mechanisms across all deal sizes, which possibly shows that financial due diligence providers are growing more confident about assessing locked box balance sheets the financial diligence providers are able properly to verify locked box balance sheets.
- Continuing the trend from prior years, earn-outs remain rare on the large deals (only 12% and down 1% from 2020). Most notably in 2021 we experienced a 9% jump in popularity in the use of earn-outs on small deals (up to 29% from 20%) whilst the percentages for medium sized and large deals were broadly static.
- EBIT/EBITDA are the most popular basis on which to measure earn-outs on the small and medium sized deals but on large deals it appears the parties prefer to use turnover.

2021 results at a glance

Deal size comparison

	< EUR 25M	EUR 25M – 100M	> EUR 100M
PURCHASE PRICE ADJUSTMENT (PPA)	42%	58%	50%
LOCKED BOX (NO PPA)	56%	62%	71%
EARN-OUTS	29%	26%	12%
— SHORT EARN-OUTS (12 MONTHS OR LESS)	33%	36%	44%
— LONG EARN-OUTS (MORE THAN 36 MONTHS)	12%	18%	33%
— EBIT/EBITDA-BASED EARN-OUTS	51%	45%	33%
— TURNOVER-BASED EARN-OUTS	20%	16%	44%
LIABILITY CAP (LESS THAN 10% OF PRICE)	13%	29%	46%
LIABILITY CAP (LESS THAN 25% OF PRICE)	30%	53%	65%
W&I INSURANCE USAGE	7%	33%	47%
LIMITATION PERIOD (OF MORE THAN 24 MONTHS)	28%	19%	22%
SECURITY FOR WARRANTY CLAIMS	28%	29%	22%
ESCROW ACCOUNT (IF SECURITY FOR WARRANTY CLAIMS IS AGREED)	35%	57%	53%
MAC CLAUSE	14%	18%	20%
ARBITRATION	32%	39%	30%
TAX INDEMNITY CLAUSE	56%	70%	62%



- Earn-out durations tend to be between six and 24 months on the small and medium sized deals whereas on large deals they are either short (44% are six to 12 months) or long (33% are over 36 months).
 - Liability caps for large deals are decreasing and fewer have caps equal to the purchase price. For 46% of large deals and 29% of medium deals the liability cap is less than 10% of the purchase price whereas a liability cap only applies in 13% of small deals. For small deals the purchase price is most likely to be the agreed liability cap and applies in 35% of those deals.
 - 2021 again showed the continuing trend that W&I insurance is most likely to be adopted on deals with larger values. W&I insurance was purchased on 47% of deals with a purchase price exceeding EUR 100m, which is broadly the same as 2020's figures. There was a 4% increase on usage to 33% on deals with values between EUR 25m and EUR 100m, whilst W&I insurance remains relatively uncommon on the small deals (7% of deals under EUR 25m), where perhaps the cost of the premium is not justified.
 - The 'buyer-friendly' trend for longer limitation periods on large deals was demonstrated again this year with a 4% rise in the use of limitation periods longer than 24 months. There was a marginal drop in the percentages for limitation periods longer than 24 months in respect of the small and medium sized deals albeit those figures remain roughly equivalent to one quarter of deals.
 - The frequency of security arrangements dropped marginally for small and medium sized deals – just about continuing the trend reported last year. Figures for the large deals remained static. The use of escrow accounts as a means of security fell in popularity by 10% for small deals (their costs not being justified when the purchase price is low) but increased 11% for large deals and remained broadly the same for medium sized deals.
- It is difficult to draw firm conclusions from the deal size data. Certainly it appears clear that the costs involved in buying W&I insurance or setting up escrow accounts do not appear justified on small deals and parties prefer to deal with risk allocation via the purchase agreement. There is sufficient data as regards the use of PPAs and earn-outs to support the view that parties are preferring pricing structures which enable them to sense check and revisit the numbers after closing rather than fix the price, but the reverse is the case on the large deals (which is consistent with years prior to the pandemic).

CMS European regional differences

This Study includes for the first time the results in respect of M&A transactions throughout the Nordic region, reflecting the input from CMS Kluge, which joined CMS in 2021. Kluge is one of Norway's fast growing law firms, with a significant presence in the Scandinavian market and a strong position within the energy, construction, infrastructure and public sectors.

We continue to see marked differences in market practice on certain deal metrics between the European regions:

- PPA provisions and locked boxes in non-PPA transactions have reverted to pre-pandemic levels across Europe, with significant increases their use in France, the Southern European countries and the UK.
- The use of 'first dollar' baskets across the European region is beginning to converge, with significant increases in the Southern European countries and France.
- The overall increase in deals with liability caps of less than 50% of the purchase price was particularly reflected in a drop off of higher caps in the UK and Southern European countries.
- The take up of W&I insurance cover has increased significantly in Benelux, the German-speaking countries and the UK but remains low in France and the Southern European countries.
- Limitation periods for warranty claims of more than 24 months are relatively prevalent in CEE, France and the Southern European countries and otherwise are generally less than 24 months.
- Data room disclosure remains of limited application in France and the Southern European countries but is otherwise broadly applied across the remainder of Europe.
- The decline in the use of escrow accounts has accelerated in all countries and they are now very rarely used in the UK, France and the German-speaking countries.
- The use of MAC clauses is low in the UK, the German-speaking countries and Benelux but remains relatively high in CEE and the Southern European countries.

The Study demonstrates the following specific differences in market practice throughout the relevant areas within the European region as follows:

In Benelux:

- W&I insurance increased: there was a significant increase in the application of W&I insurance in the Benelux countries with 17% of transactions being covered in 2021 compared to the average of 9% for the period 2010 to 2020.
- Data Room disclosure: there was a big decrease in the acceptance of general disclosure of the data room for transactions in Benelux, with this concept applying in 40% of such transactions compared with 69% in 2020.

In CEE:

- PPA provisions increased: there was a big jump in the application of PPA clauses in the CEE region, so they applied in 53% of transactions compared to 41% in 2020, a reversion to the more recent average of 50% of the period 2010 to 2020.
- Arbitration clauses remain popular in CEE: in 2021, 75% of CEE deals included an arbitration clause and this is some way ahead of the European average, where only 33% of relevant deals included such a clause.

In German-speaking countries:

- Earn-outs more frequently used: there was an increase in the use of earn-outs in the German-speaking countries in 2021, with 30% of transactions including such a provision compared with the average of 23% in respect of the period for 2010 to 2020.
- W&I insurance increased: there was a significant increase in the application of W&I insurance in the German-speaking countries, with 17% of transactions being covered in 2021 compared to the average of 7% for the period 2010 to 2020.



In France:

- PPA provisions increased: there was a large jump in the application of PPA clauses in France, so they applied in 42% of transactions compared to the average of 35% for the period 2010 to 2020 and there was a corresponding increase to 71% (compared to the average of 52%) in the use of locked box provisions for non-PPA transactions.
- Limitation periods are longer in France: in 2021, 45% of French transactions had a warranty limitation period of more than 24 months and 35%, with periods of between 18 to 24 months, which was itself an increase from the previous year at 20%.

In Southern Europe:

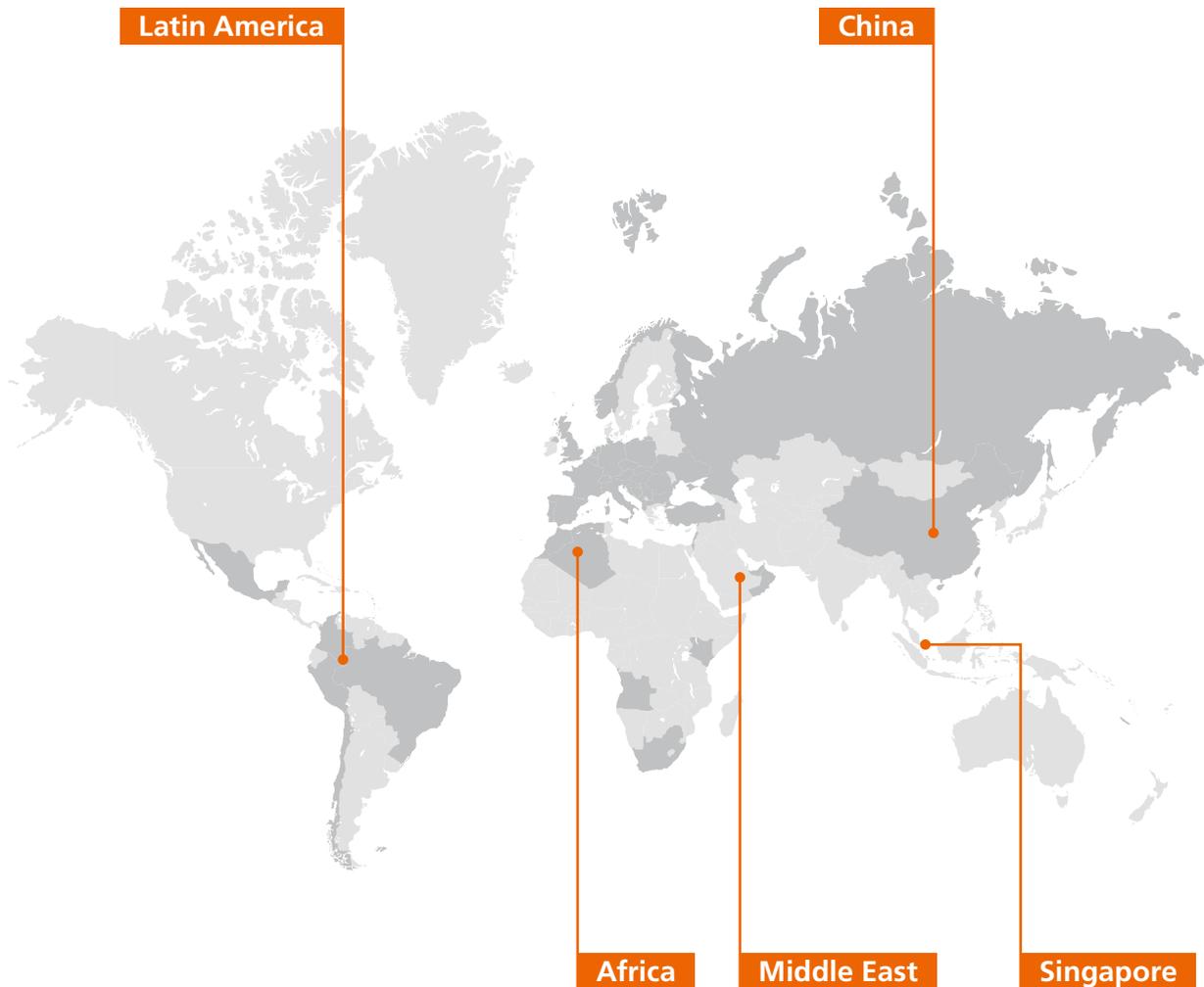
- Earn-outs more frequently used: there was an increase in the use of earn-outs in Southern European countries in 2021, with 32% of transactions including such a provision compared with 21% in 2020 and ahead of the European average of 26% for earn-out transactions.
- Liability Caps have decreased: in 2021, 60% of transactions in the Southern European countries had a liability cap of more than 50% of the purchase price, which was a big decrease from the previous year at 76%.

In the United Kingdom:

- Locked Box use returns: for UK transactions in 2021 without a PPA, a locked box structure was applied in 48% of those transactions, which was a significant increase from the previous year's level of 30% and a return to the average of 44% of the period 2010 to 2020.
- W&I insurance increased in the UK: in 2021, 33% of all reported transactions had some element of W&I cover, which was an increase from 27% in 2020 but is still ahead of the other European regions, which range from 3% to 17% in application.
- Liability Caps have decreased: in 2021, 41% of transactions in the UK had a liability cap of more than 50% of the purchase price, which was a big decrease from the previous year and average for the period 2010 to 2020 at 55%.

CMS markets outside Europe

Our colleagues in CMS offices in Singapore, Middle East, Africa, Latin America and China have commented as regards specific differences in market practice on M&A transactions on which they advise in their jurisdictions as follows:



Singapore

» Cross-border deals in South East Asia predominantly include arbitration (more often, adopting the Singapore International Arbitration Centre Rules with Singapore as the seat). This is because foreign court judgments are typically not enforceable in South East Asian countries, whilst a final arbitral award from a New York Convention contracting country is generally enforceable in the majority of jurisdictions in the region.

Middle East

» It is comparatively rare to find locked box structures in Middle East transactions. This is primarily due to a lack of confidence in the underlying financial information and a lack of familiarity with the structure. It is more common to have no PPA provisions, a completion accounts mechanism or (less commonly) an earn-out. W&I Insurance is still in its infancy. However, in recent years we have seen a strong appetite for underwriters to engage with the region, and have seen a number of transactions where W&I has been used successfully. We anticipate that, as the market becomes more informed, it will become a more common feature.

Africa

» The African M&A market is demonstrating a noticeable uptick in the use of the locked box mechanism. It is a simpler and more sophisticated mechanism for sellers compared to the traditional PPA mechanisms. This makes it an attractive mechanism for sellers who are looking to conclude transactions swiftly, and with less risk. It also leads to time and cost efficiencies. We are also seeing shifts in the legal market away from the traditional approaches to implementation and closing, as demonstrated by the increase in locked box structures.

Latin America

» Due to market volatility and client concerns arising from the pandemic, parties have begun to negotiate more detailed preliminary documents such as term sheets, MOUs and letters of intent to ensure that the parties have a good business understanding of the transaction. As a result we have seen an increase in provisions catering for contingent purchase price formulas.

China

» We see purchase price adjustment clauses in most of the M&A deals in which we have been involved in China. Following the European example, the use of liability caps has also become increasingly common and a specific percentage of the transfer price or a fixed cap is used.



Key messages

This edition of the CMS European M&A Study covers nearly 500 deals on which CMS offices in Europe advised in 2021. This is a record number of deals we have covered for one year and is reflective of the current M&A boom. Last year was clearly an extraordinary one as M&A activity recovered and then accelerated away.

As a firm we reported on 90 more deals as compared to 2020, an unprecedented 22% increase in deal activity year on year. The effects of the COVID-19 pandemic on transactions have now fully disappeared and the increase in M&A activity has resulted in a return to familiar patterns in the deal metrics which we measure. The Study reflects the more standard, evenly-balanced, approach to risk sharing that applied before the pandemic.

It may be that normal service has therefore resumed. Specifically the Study indicates:

- PPA provisions returned to pre-pandemic levels, suggesting that a greater proportion of buyers are once again able to insist on such adjustments.
- The use of a locked box structure in non-PPA transactions increased, albeit back to more recent average levels.
- *De minimis* levels of less than 0.1% of the purchase price were more common and basket sizes also decreased, with most at 1% of the purchase price or less.
- The number of deals with liability caps of less than 50% of the purchase price increased, reflecting a reversion to the liability caps prevailing before the pandemic.
- Almost two-thirds of transactions had a limitation period of more than 18 months, which is only a slight increase in the length from last year but way ahead of the 11-year average.

One anomaly in 2021 was the significant increase in the use of earn-out structures – an increase we anticipated last year. This increase to 26% of deals was reflected across almost all jurisdictions. There was also an increase in applying EBIT/EBITDA as the earn-out criteria instead of turnover, which possibly indicates that parties consider economic conditions to be more stable. Earn-outs are now generally measured over a period of up to 24 months, with a drop in longer time periods.

W&I insurance in European transactions returned, significantly so in the UK and German-speaking countries, and nearly half of larger transactions now have W&I insurance cover as standard. Our prediction that the drop-off in W&I experienced in 2020 would not persist has proved correct. The application of W&I is giving rise to significant benefits to sellers, with lower basket thresholds and lower liability caps, even though the buyer is apparently paying the premium in most cases. It was also reported that W&I insurers were already close to reaching their annual budgets in early 2021, and therefore were becoming more selective and even, in some cases, deferring available cover until 2022.

The data used in the Study is not publicly available and is based on privately negotiated transactions in which CMS acted as an adviser 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

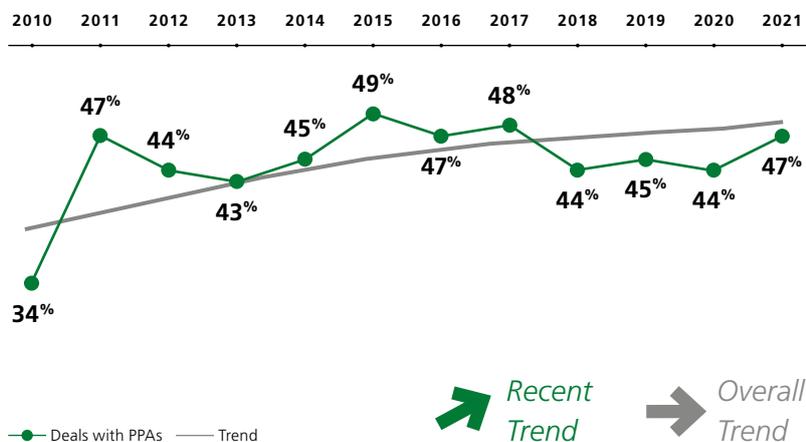
Purchase Price Adjustment (PPA) clauses are designed to ensure the correct amount is finally payable by the buyer for the target business. Adjustments can arise by reference to the target company's debt and cash position or to its working capital or overall net asset position at completion. The parties to the M&A agreement thereby achieve certainty that the final purchase price reflects the actual debt, cash, working capital or net asset position.

That said, PPA provisions may however result in uncertainty as to the final purchase price at the time of signing. Several months or even years may elapse before the price is agreed or determined. Some may feel this is impractical and therefore prefer 'locked box' provisions. In such cases, the seller warrants the accuracy of an agreed balance sheet and covenants that there are no leakage payments (e.g. dividends and management charges) from the target.

General Overview

In 2021 there was an increase in the use of purchase price adjustment clauses in M&A agreements (47% compared with 44% for 2020). This seems to signal a return to the level seen pre-pandemic in the application of such provisions and is reflective of the more recent average. This may suggest that more buyers are once again able to insist on PPA provisions. There was however a big increase in the application of locked box arrangements for non-PPA transactions (59% in 2021 compared with 51% in 2020). This increase is even more marked when compared against the average usage of 48% for the period 2010 to 2020.

CMS Trend Index

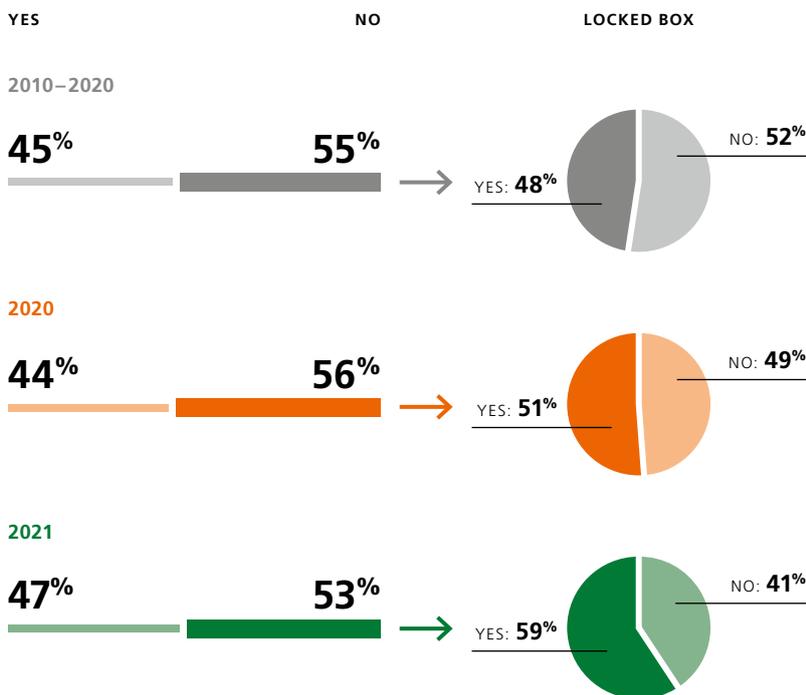


PPA provisions returned to pre-pandemic levels suggesting that more buyers are once again able to insist on such adjustments

PPA ratio 2021

47% ↗

Purchase Price Adjustment 2010–2021



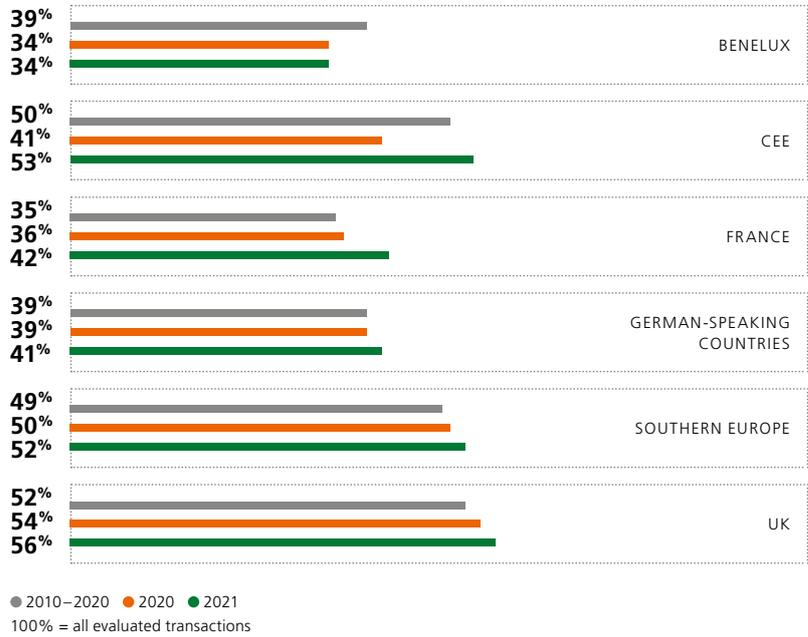
100% = all evaluated transactions

Specific Issues

Regional Differences

The use of PPAs continues to increase in application across the European jurisdictions, which possibly indicates greater buyer power in the negotiation of such a key provision. The UK remains as the region with the highest application, at 56% of transactions, but it is broadly the same in CEE and the Southern European countries at 53% and 52%. In each case this represents an increase of nearly 4% over the average for the period 2010 to 2020 ahead of Benelux, France and the German-speaking countries at 34%, 42% and 41% respectively. The increase in application for France and in CEE was dramatic. The increase in the application of PPA clauses across Europe over the period from 2010 to 2020 has otherwise only been gradual.

Time Trend Europe



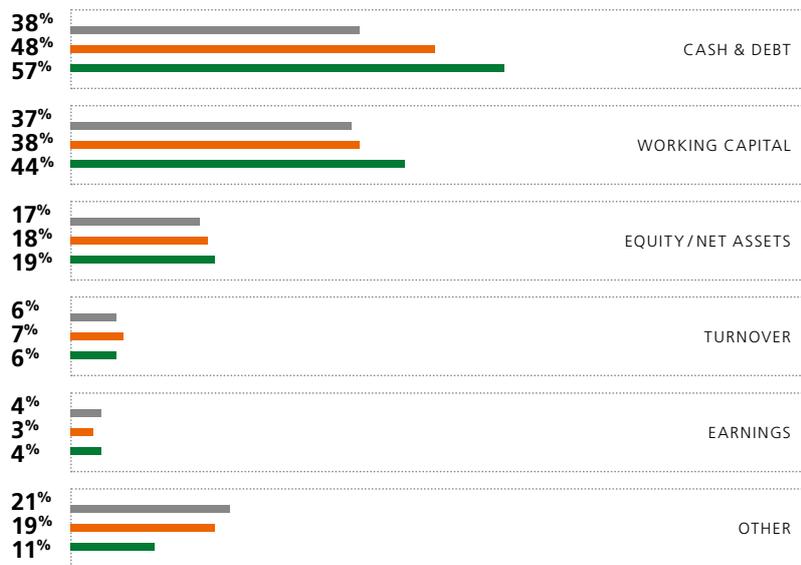
The use of a locked box structure in non-PPA transactions increased, albeit back to more recent average levels



Net Debt/Working Capital Adjustments

Net cash and working capital are becoming by far the predominant elements in calculating PPAs. The application of cash/debt as the adjustment factor in a PPA transaction increased significantly in 2021 to 57% compared to 48% compared to 48% the previous year, and this is a massive uplift on the 38% rate for the period 2010 to 2020. The use of working capital as the determinant of the final purchase price has also increased significantly from 38% for 2020 to 44% for 2021, which is also an increase compared to the 2010 to 2020 average of 37%. This is really significant as working capital adjustments can give rise to major changes in the expected purchase price for a transaction and may reflect that sellers and buyers are more comfortable about trading performance.

Chosen Criteria



● 2010-2020 ● 2020 ● 2021

Cash & debt does not include 'cash only' and 'debt only'

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

Net cash and working capital are the predominant elements in calculating PPAs



Sector Differences

We have analysed the sector breakdown in relation to PPA and locked box mechanisms. The average application of locked boxes in 59% of non-PPA transactions broadly applied across all the sectors except for the higher proportions in Energy & Climate Change, Consumer Products, Technology, Media & Communications and Life Sciences transactions (at 62%, 66%, 68% and 67% respectively). There was a very sharp decline in respect of transactions in the Financial Institutions and Hotels & Leisure sectors at 44% and 33% (from 75% and 63% in 2020). This is likely to be reflective of greater confidence in these sectors as the pandemic subsides. The use of locked boxes in the Real Estate sector remains relatively low at 36%, which is consistent with the purchase price in such transactions being determined by reference to a fixed valuation rather than against a balance sheet with a number of moving parts.

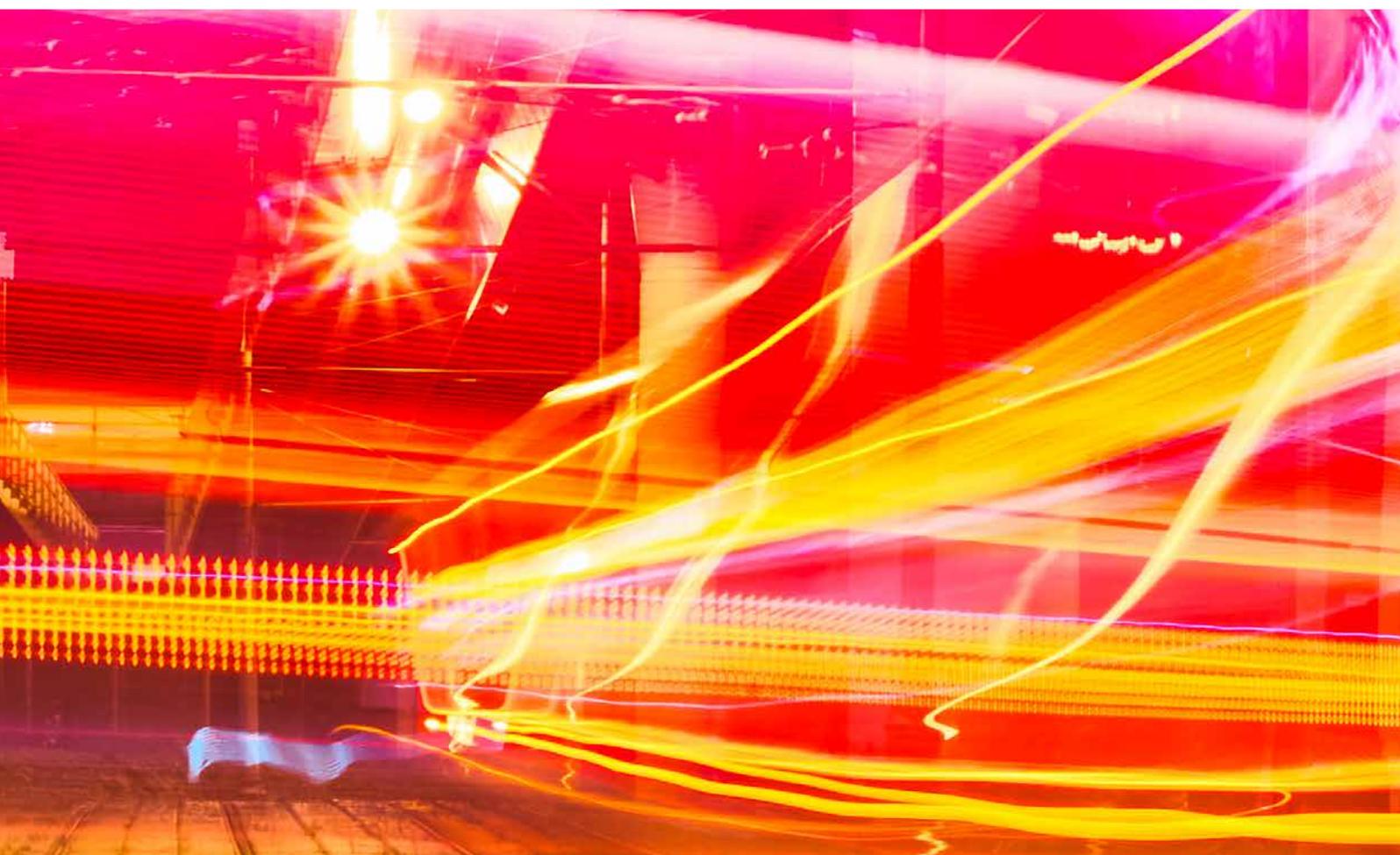
Frequency of Locked Box Mechanism

SECTOR	2010 – 2020	2020	2021
BANKING & FINANCE	50%	75%	44%
HOTELS & LEISURE	46%	63%	33%
ENERGY & CLIMATE CHANGE	47%	61%	62%
CONSUMER PRODUCTS	57%	55%	66%
TECHNOLOGY, MEDIA & COMMUNICATIONS	50%	48%	68%
INFRASTRUCTURE & PROJECTS	29%	33%	50%
LIFE SCIENCES & HEALTHCARE	53%	35%	67%
REAL ESTATE	32%	29%	36%
INDUSTRY	54%	56%	68%
BUSINESS (OTHER SERVICES)	47%	41%	55%
CMS AVERAGE	48%	51%	59%

100% = transactions with no purchase price adjustment mechanism in the respective sector

*Locked box usage
in the Life Sciences sector*

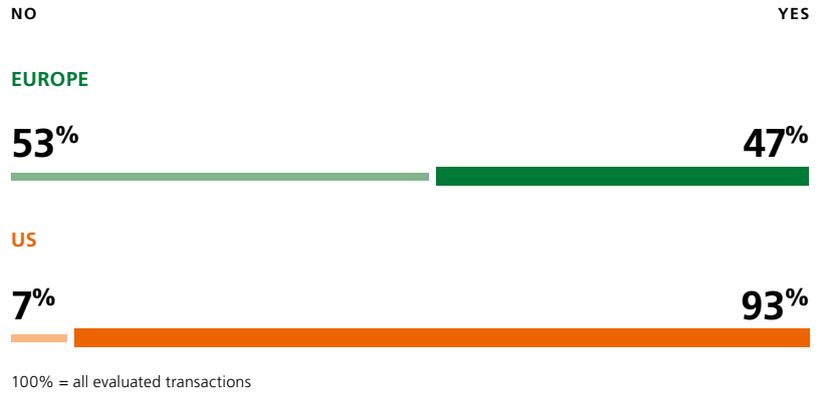
67% ➔



European/US Differences

The very significant disparity between the US and European markets in relation to PPAs continues to apply. Most US deals will include some form of PPA (usually with working capital as the adjusting factor). The most recent figures suggest that 93% of US deals include a PPA compared with 47% of our European deals. It seems likely that the US regards a PPA as standard in the market. In European deals there seems to be more scope for negotiation as to the preferred approach to PPA provisions albeit that in 2021 there has been an increase in their application.

Purchase Price Adjustment Europe/US

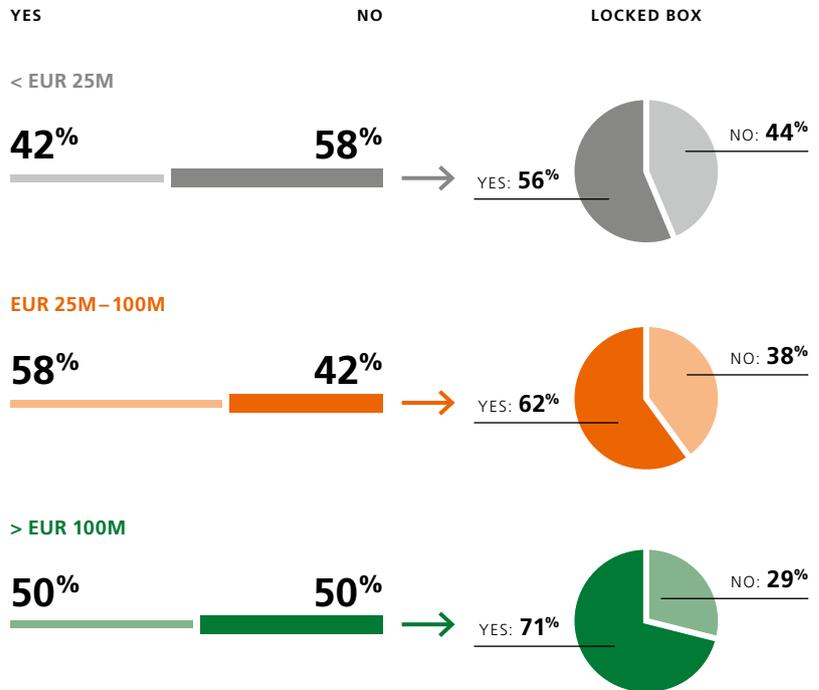


Analysis by Deal Size

The increase of locked boxes in non-PPA transactions was most marked for large deals (above EUR 100m), where 71% were locked box transactions (up from 52% in 2020). For small deals (below EUR 25m), locked boxes in non-PPA transactions were up to 56% from 48% in 2020 and in medium sized deals (between EUR 25m and EUR 100m) locked box usage in non-PPA transactions increased to 62% compared with 60% for 2020. There was a slight decrease in the proportion of PPA transactions for large deals (more than EUR 100m) at 50% (down from 53% in 2020) but for all other deal sizes the proportion of PPA transactions increased (42% for sub EUR 25m deals and 54% for deal sizes between EUR 25 and EUR 100m).

The increase of locked boxes in non-PPA transactions was most significant in large deals

Purchase Price Adjustment 2021



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)



Earn-out

An earn-out provides for additional purchase price to be paid after completion, typically by reference to the performance of the acquired business over an agreed period after completion. By doing this the seller and buyer share the risks and rewards of how the target business performs following completion. A seller may receive a higher overall price than on a deal where all the proceeds are paid on completion but is likely to be required to remain engaged with the business and must wait to receive that enhanced value. Buyers get to ensure the final overall purchase price is linked both to historic and present financial performance and may well be able to insist on the continued engagement with the business of key sellers.

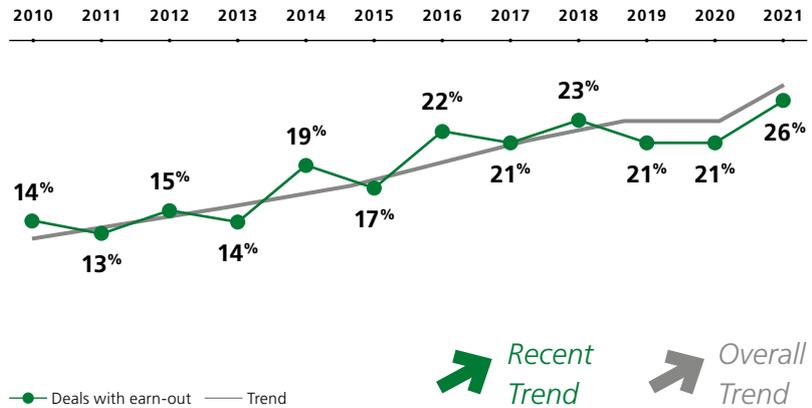
General Overview

In last year's Study we said that we had anticipated the COVID-19 pandemic would trigger a marked increase in the use of earn-outs but the statistics from 2020's deals showed little change. We did however predict that 2021 could see an increase, due to deals being agreed in principle and negotiated in 2020 but not implemented till 2021. The increase can clearly now be seen for 2021 as the frequency of earn-outs jumped 5% to 26% – a percentage higher even than the most recent US statistics. This in part may be explained by a small increase in the number of deals transacted in the Technology, Media & Communications and Life Sciences sectors (which are most popular for earn-outs) but also more generally parties using earn-outs as a means to ensure the price paid for a business is measured over a longer period rather than purely by reference to financial years dominated by the pandemic.

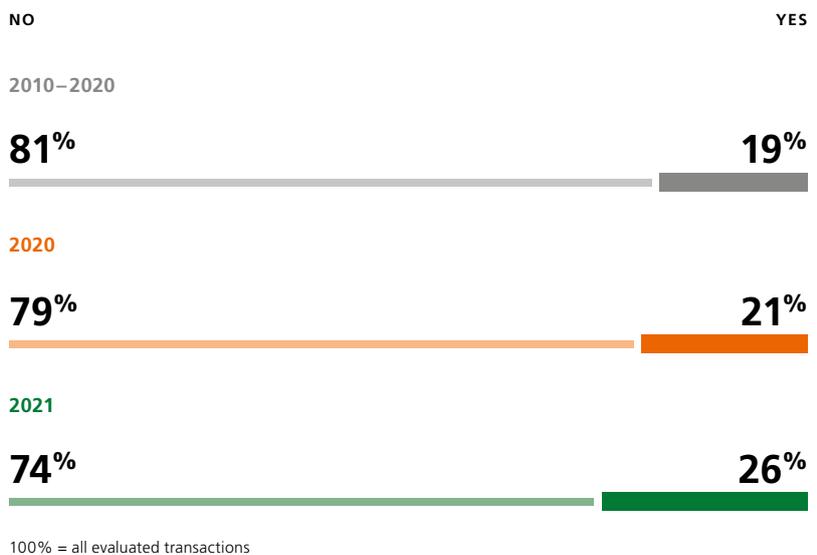
Earn-out popularity ➔

The frequency of earn-outs jumped to its highest level ever and ahead of the US for the first time

CMS Trend Index



Earn-out 2010–2021



Specific Issues

Sector Differences

Life Sciences continues to be the most popular sector for earn-outs at 44% of those deals, topping the table from Technology, Media & Communications at 34%. Nearly every sector experienced increased popularity in the use of earn-outs both when compared against 2020's figures and the 11-year average. There was some sign that conventional market practice had returned, with significant falls in the frequency of earn-outs in both the Real Estate & Construction and Infrastructure & Project Finance sectors, returning somewhat to the levels typically seen in the last decade.

Frequency of Earn-out Mechanism

SECTOR	2010 – 2020	2020	2021
BANKING & FINANCE	15%	25%	21%
HOTELS & LEISURE	10%	10%	16%
ENERGY & CLIMATE CHANGE	16%	18%	29%
CONSUMER PRODUCTS	18%	22%	23%
TECHNOLOGY, MEDIA & COMMUNICATIONS	25%	25%	34%
INFRASTRUCTURE & PROJECTS	9%	25%	0%
LIFE SCIENCES & HEALTHCARE	31%	43%	44%
REAL ESTATE	12%	20%	7%
INDUSTRY	17%	11%	22%
BUSINESS (OTHER SERVICES)	22%	21%	29%
CMS AVERAGE	19%	21%	26%

100% = all evaluated transactions of the respective sector

Life Sciences and Technology, Media & Communications are the most popular sectors for earn-outs

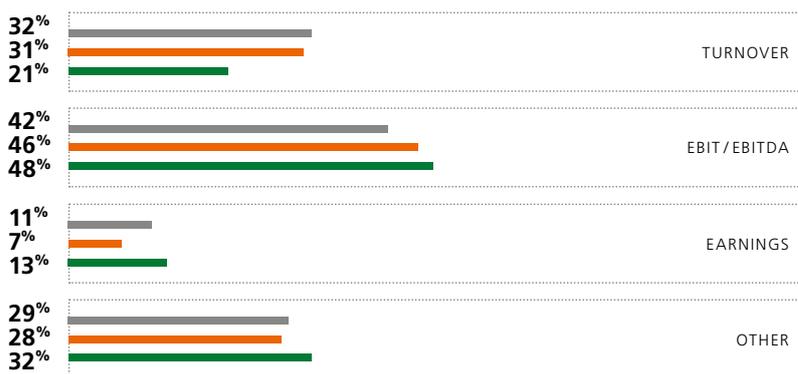
Earn-out Determination

With a 2% rise to 48%, EBIT/EBITDA keeps its position as the most popular metric on which to determine an earn-out and is now 6% higher than its average level for the past 10 years. By contrast it appears parties abandoned reference to turnover as an earn-out measure, as its use fell 10% to 21%.

EBIT/EBITDA-based earn-outs

48% ➔

Time Trend



● 2010-2020 ● 2020 ● 2021

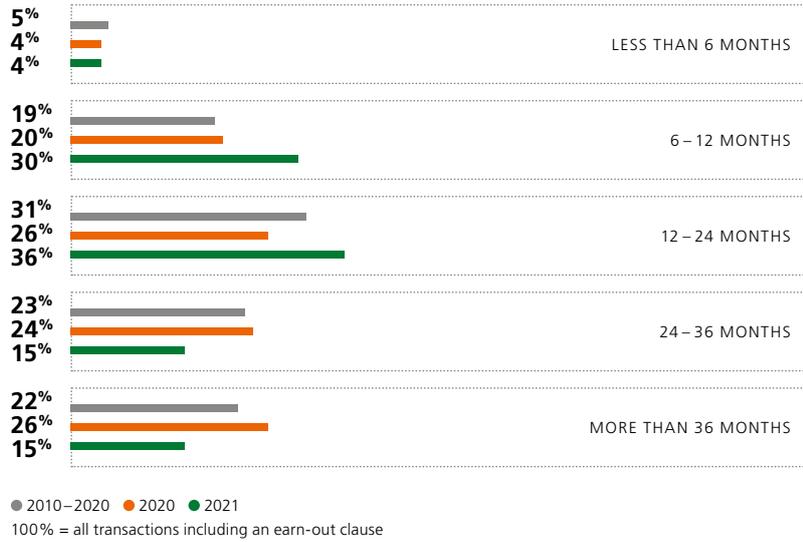
100% = all transactions including an earn-out clause – multiple criteria may apply

Earn-out Duration

2021 saw the reverse to the increase in longer earn-out periods reported in last year's Study and instead there was an increase in shorter earn-out periods. A 10% increase in earn-outs measured over both six to 12 months (up to 30% from 20%) and 12 to 24 months (up to 36% from 26%) was balanced by a corresponding fall in those measured over 24 to 36 months (down 9% to 15%) and more than 36 months (down 11% to 15%). This marks a somewhat surprising return to the conventional trend experienced over the last decade of earn-outs most commonly being measured over 12 to 24 months – as stated in last year's Study, we had been expecting perhaps that longer earn-outs would be required to smooth out any extraordinary effect the pandemic may have had a business's financial performance.

Earn-out periods reverted to 12 to 24 months

Duration of Time Periods Relevant for Assessment of Earn-out



Earn-out periods of six to 12 months

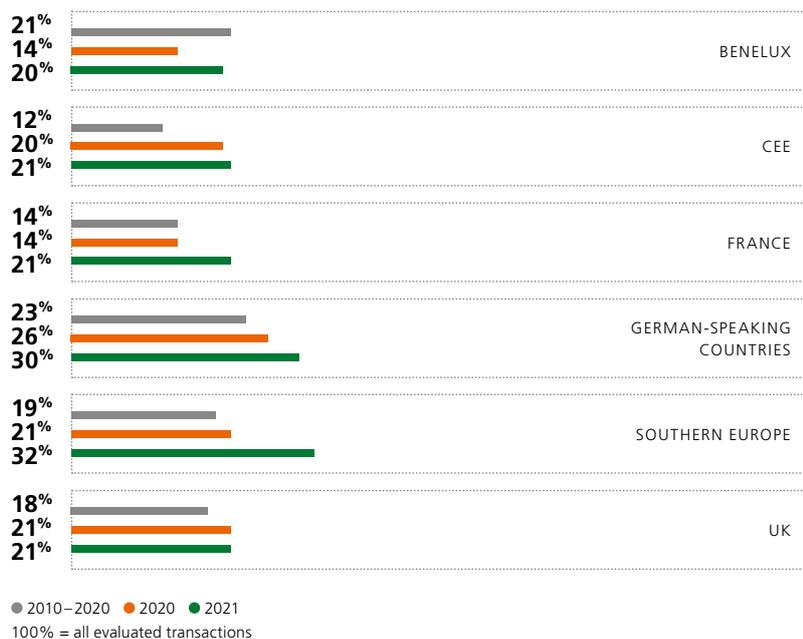
30% ➔

Earn-out duration ➔

Regional Differences

As stated above, overall there was a 5% increase in the use of earn-outs in deals across all of the CMS European territories and the 26% figure is the highest level seen over the past decade. The relevant graph demonstrates that the high-point is similarly reflected in Benelux, France, the German-speaking countries and Southern European countries (each of which experienced significant surges in 2021) but the level was relatively static in the UK.

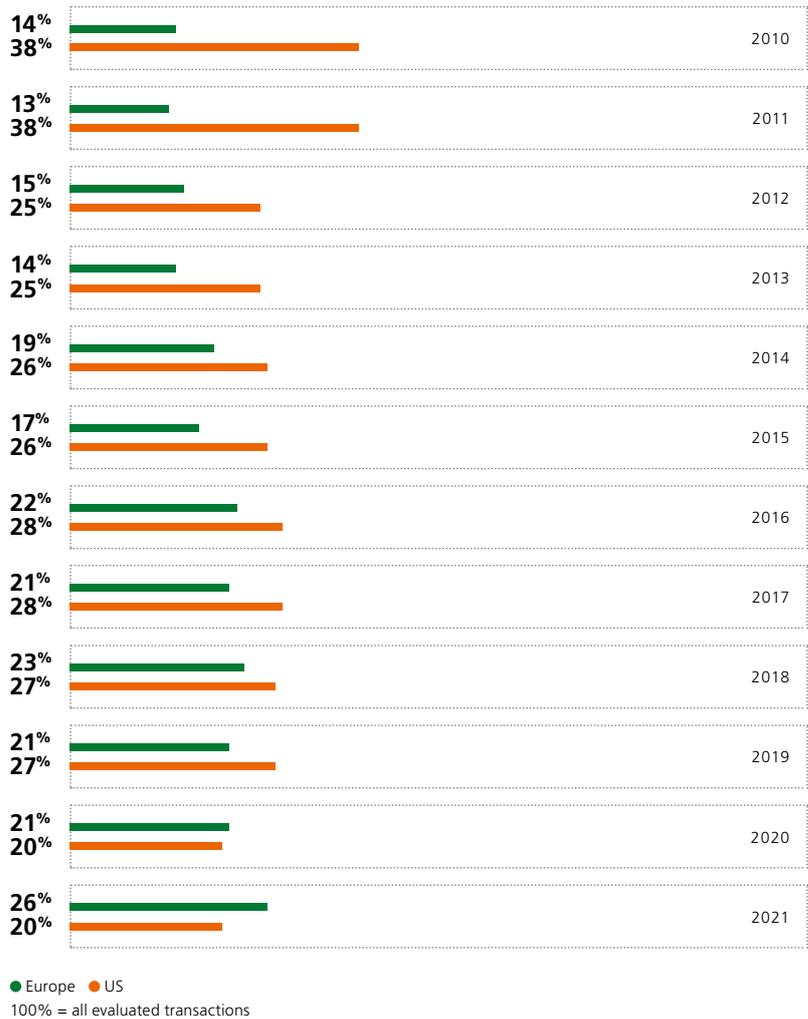
Time Trend Europe



European/US Differences

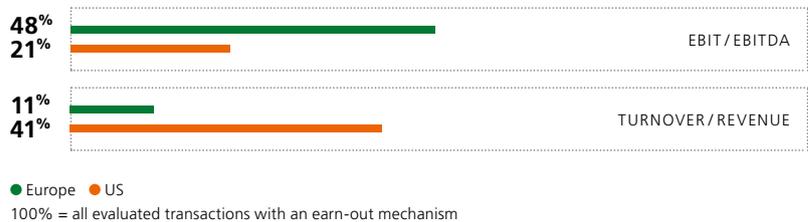
For the first time since the inception of the Study earn-outs appeared to be more common in Europe than in the US. Over the last decade there has been an upward trend in Europe whilst popularity in the US levelled off (after a stark decrease between 2010 and 2012) and this year's ABA Study notes a 7% fall in earn-out use (down to 20% from 27%). 2021 also saw the US experiencing a complete switch in market practice in terms of earn-out measurement criteria as turnover (revenue) rose from 29% to 41%, whilst EBIT/EBITDA fell from 31% to 11%. Unfortunately, the ABA Study does not contain a narrative to its statistics (and analyses significantly fewer transactions) and some of the terminology differs from ours, so it is not directly possible to explain the significant change demonstrated in the latest ABA Study. Colleagues in the US note that revenue-based multiples are typically used in technology deals or transactions where targets are in growth mode. Profit-based multiples are used for more mature companies. With interest rates so low, it makes sense that companies may be able to achieve exits at earlier stages in their life cycle, which would give some explanation to the use of revenue-based metrics.

Earn-out Europe/US



Earn-out Europe/US

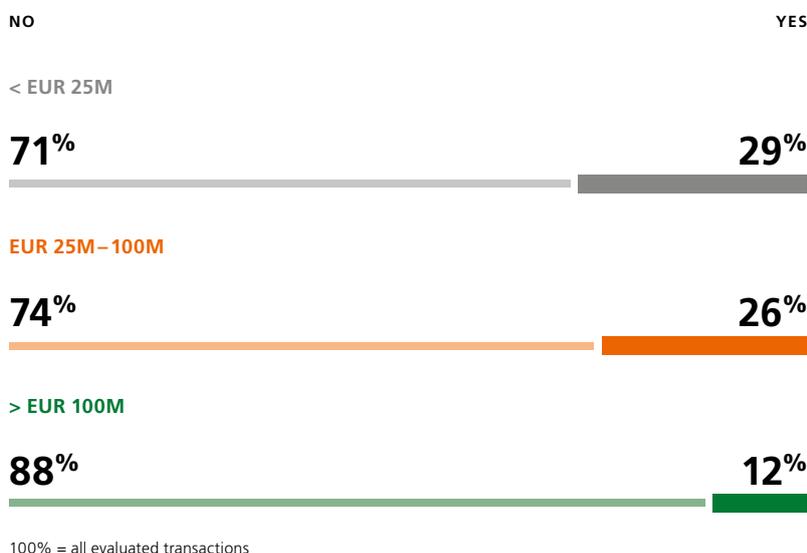
Earn-out criteria



Analysis by Deal Size

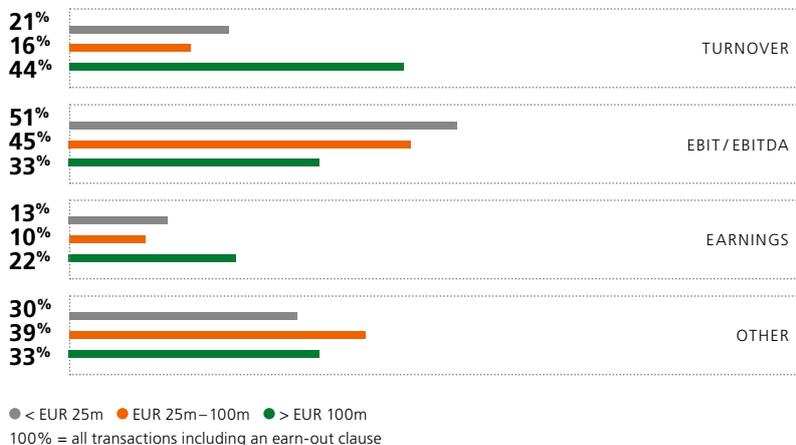
These three graphs highlight certain differences in the earn-out data depending on transaction value. Consistent with prior years, earn-outs were most frequently used on small deals (below EUR 25m). Most notably in 2021 we experienced a 9% jump in the popularity of earn-outs on small deals (up to 29% from 20%) whilst the percentages for medium sized and large deals were broadly static. EBIT/EBITDA are the most popular basis on which to measure earn-outs on the small and medium sized deals but on large deals it appears the parties prefer to use turnover.

Earn-out 2021



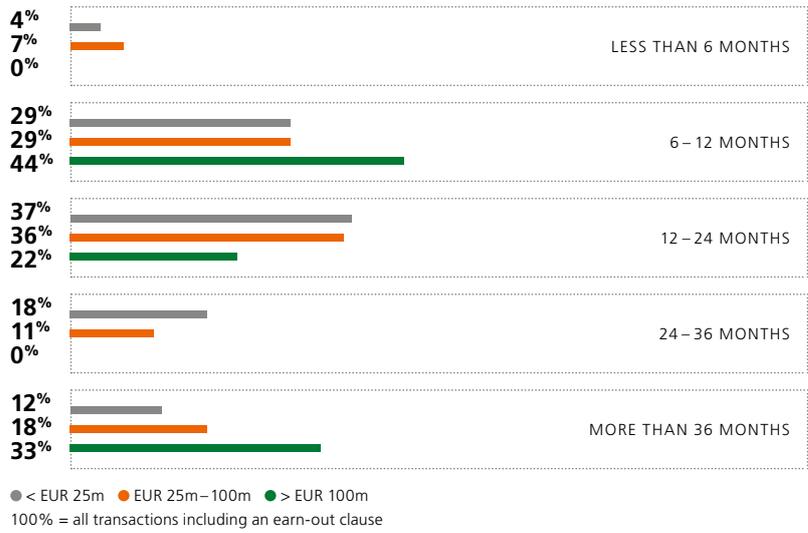
There was a big jump in the popularity of earn-outs on small deals

Comparison of criteria used for earn-out by purchase price 2021



Earn-out durations tend mostly to be six and 24 months on small and medium sized deals, whereas on large deals they are either short (44% are six to 12 months) or over 36 months (33%).

Duration of Time Periods Relevant for Assessment of Earn-out





De minimis

Most M&A agreements provide that the buyer is prevented from bringing certain warranty claims below an agreed minimum amount. That minimum amount is referred to as the *de minimis*. If a warranty claim is less, then the claim is automatically excluded. The seller is thereby protected from potential liability for small claims. However, the *de minimis* arrangement may not be appropriate for deals with full W&I insurance cover, as this is reflected in the W&I insurance policy itself.

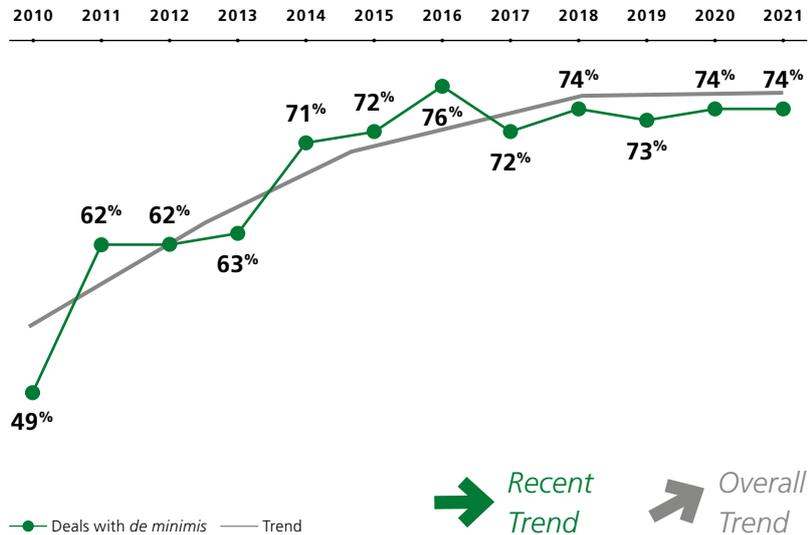
General Overview

This year's Study shows a continuation in the consolidation of the number of European transactions which include a *de minimis* clause. The 74% figure is consistent with the trend over the last four years and the same percentage as in 2020. We think this demonstrates that a *de minimis* is now the predominant market norm across most European jurisdictions.

De minimis ratio 2021

74% →

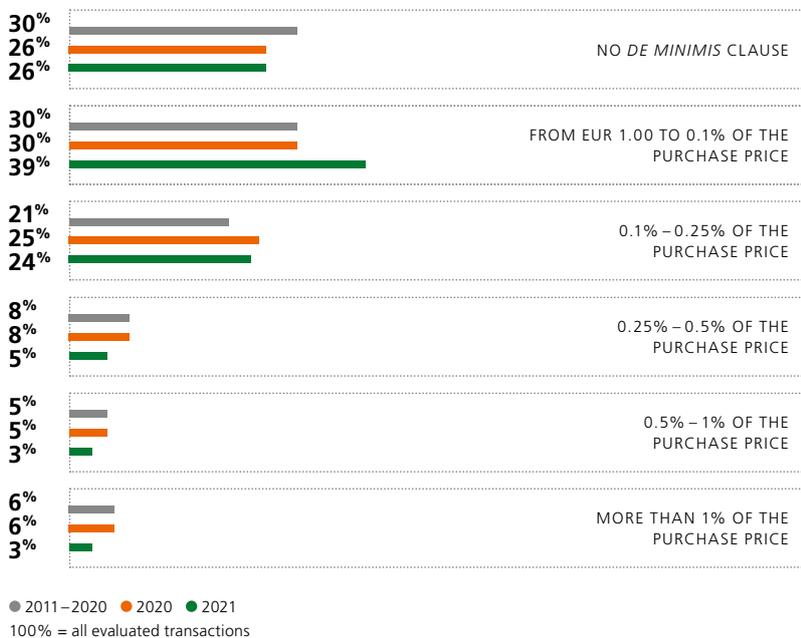
CMS Trend Index



De minimis levels

De minimis levels are generally less than 0.25% of the purchase price. However, in 2021 there was a marked decrease as most transactions had a *de minimis* of less than 0.1% of the purchase price with a significant increase to 39% from 30% in 2020. The use of a *de minimis* at 0.1 to 0.25% of the purchase price was broadly static at 24% compared to 25% in 2020. The difference is made up of the large decrease in the proportion of transactions with *de minimis* levels of more than 0.5% of the purchase price (6% compared to 11% in 2020). The overall results perhaps indicate that buyers are prevailing in the negotiation of lower *de minimis* levels.

De Minimis Levels 2011–2021



De minimis < 0.1% of purchase price

39% ↗

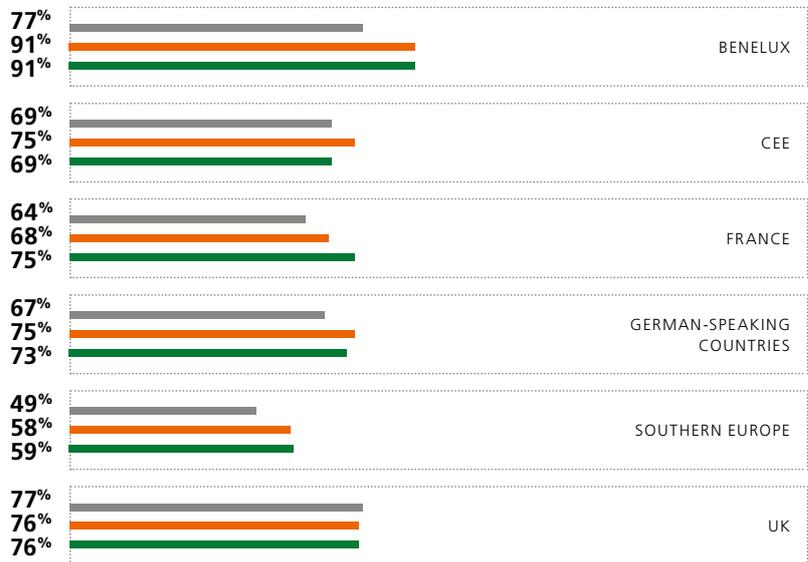
De minimis levels of less than 0.1% of the purchase price were more common

Specific Issues

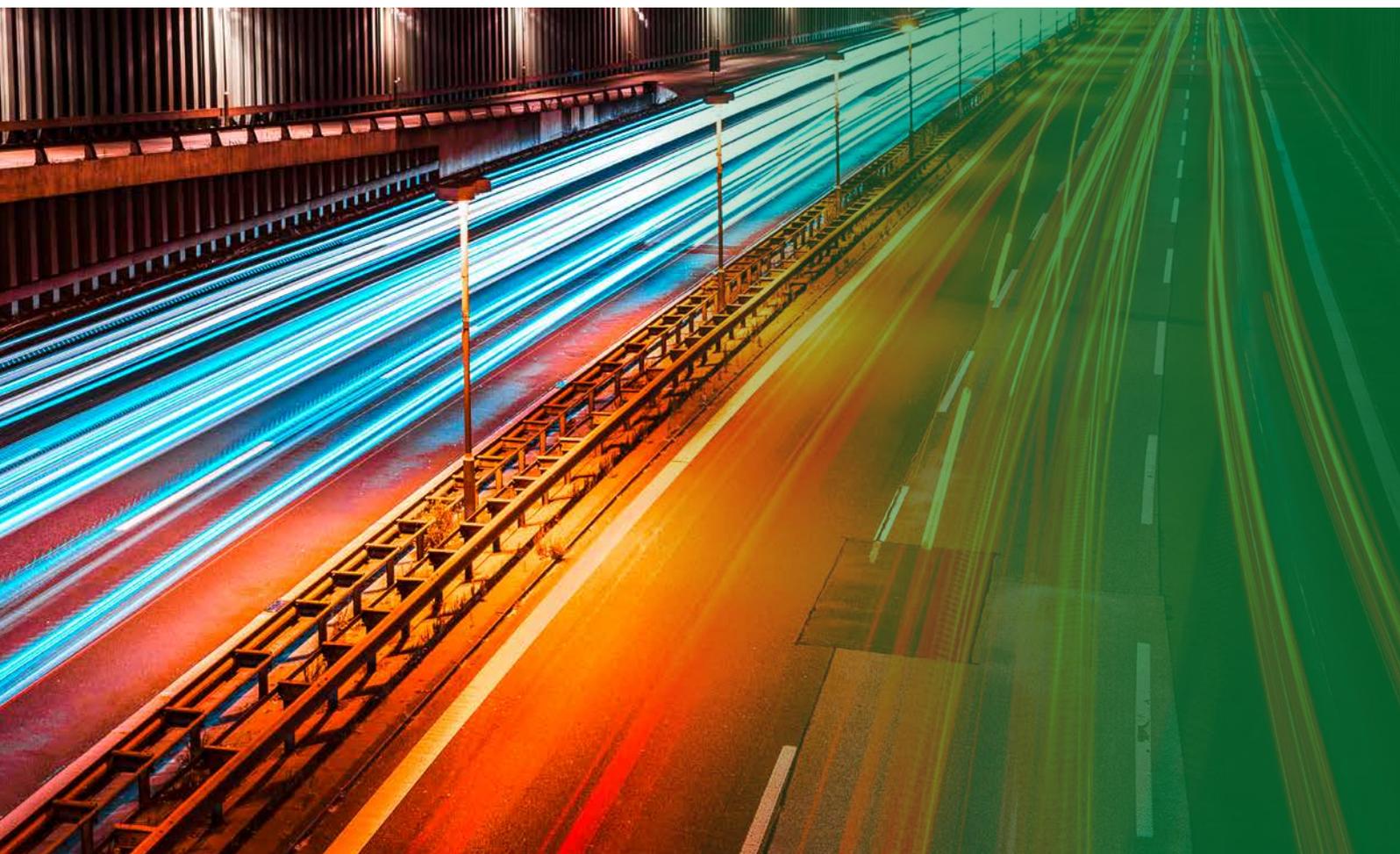
Regional Differences

The application of *de minimis* clauses across Europe continues to vary. The range varies from 91% for Benelux transactions to 59% for Southern European countries although most regions applied such clauses in nearly three-quarters of all deals. In the UK, CEE, the German-speaking countries and France the percentages were 76%, 69%, 73% and 75% respectively. This seems to indicate an overall trend across all European deals with an increase in France and a decrease in CEE.

Time Trend Europe



● 2010-2020 ● 2020 ● 2021
100% = all evaluated transactions





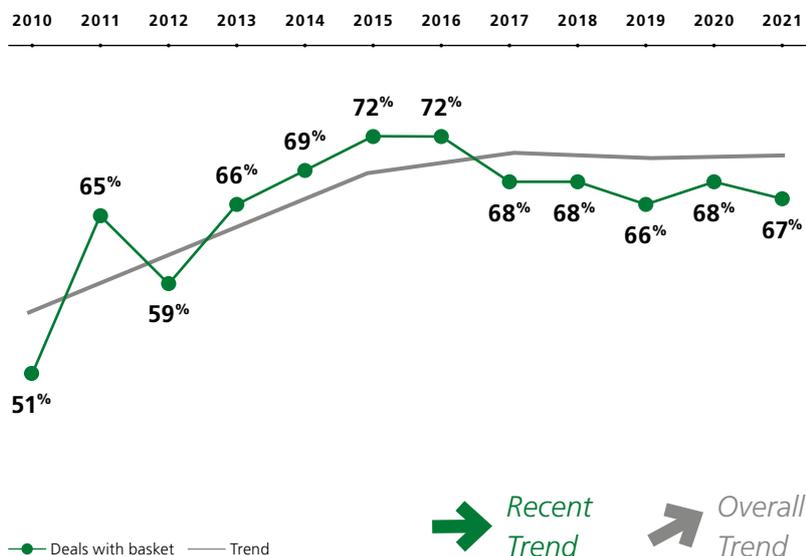
Basket

Most M&A agreements also have a basket provision which prevents warranty claims from being made where the total amount claimed in respect of all warranties is less than an agreed 'basket' amount. This is usually agreed as a percentage of the purchase price. On an "excess only" basis, the buyer can recover only that proportion of any warranty claim or claims that exceeds the basket threshold, whereas with a 'first dollar', once the buyer has a warranty claim or claims that reach the basket threshold, the buyer can recover the whole amount claimed. For deals with full W&I insurance cover a basket provision is usually not required as this is reflected in the W&I insurance policy itself.

General Overview

There was a slight decrease in the application of baskets in European transactions at 67% for 2021 compared with 68% for 2020 which, broadly represents the average for the years since 2017. This level most likely reflects the use of W&I insurance, particularly in the UK, where the basket may not be as relevant if the equivalent liability is assumed by the W&I insurer. The correlation between the application of a basket and a *de minimis* provision continues to apply although the recent trend is that a *de minimis* applies to a greater extent than a basket (returning to the more recent average of 74% versus 67%).

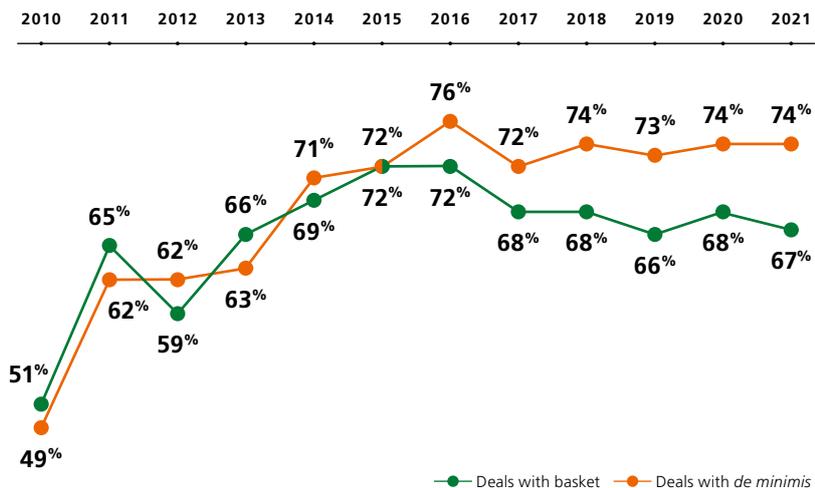
CMS Trend Index



Basket ratio 2021

67% ➔

Comparison: Existence of De Minimis and Basket



Specific Issues

Size of Baskets

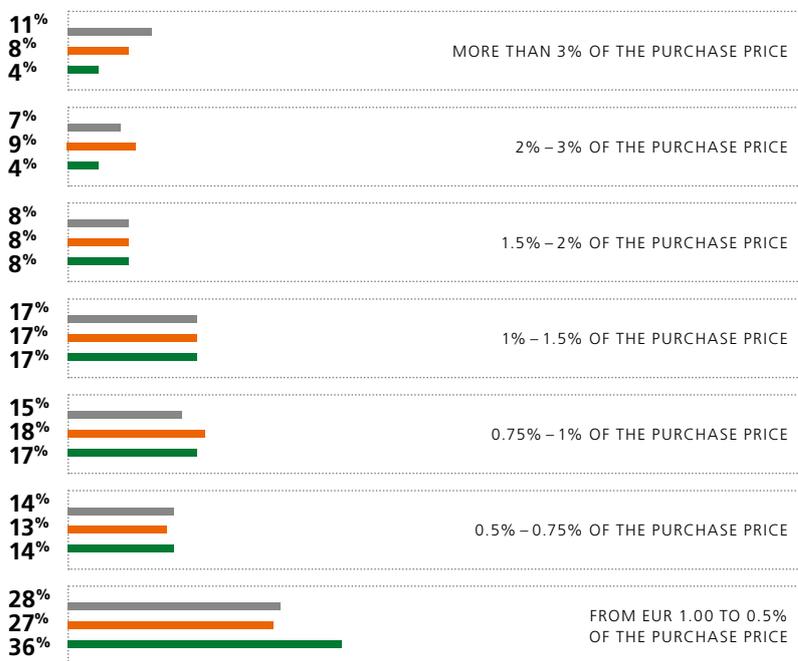
Most baskets in European transactions are of the 'first dollar' type. A 'first dollar' basket is usually larger than an 'excess only' basket. It is notable that most baskets in 2021 (67%) were equal in value to up to 1% of the purchase price and the remainder (33%) were at more than 1% of the purchase price. There was a big jump in baskets at the lowest level from EUR 1 to 0.5% of the purchase price for 36% of transactions compared to 27% in 2020. There was a significant decrease in the percentage of baskets in the 2% and above range to just 8% of transactions as compared with the average of 18% for the period 2011 to 2020. This indicates that basket sizes are decreasing in size with a very significant proportion now at less than 0.5% of the purchase price.

Size of basket 

Impact of W&I Insurance

The comparative statistics relating to the use of basket provisions in relation to W&I and non-W&I deals demonstrates that there is scope for sellers to increase the basket level significantly if W&I insurance applies. In particular, 36% of W&I insurance deals had a basket of more than 1% of the purchase price as compared to 22% for non-W&I insurance deals. In the absence of W&I insurance protection sellers are obtaining relatively greater levels of basket protection, certainly as compared with 2020, so that baskets of only up to 0.5% of the purchase price apply in 51% of non-W&I deals (compared to the overall 36%). The statistics continue to show the advantage for sellers where W&I insurance coverage applies.

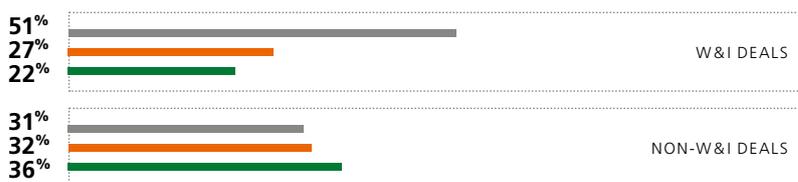
Time Trend



● 2011-2020 ● 2020 ● 2021
100% = all transactions with a basket clause

Basket Thresholds for 2021

W&I deals + non-W&I deals



● Up to 0.5% ● > 0.5% - 1% ● > 1%
100% = all evaluated transactions in the respective category

Basket sizes decreased with most at 1% of the purchase price or less

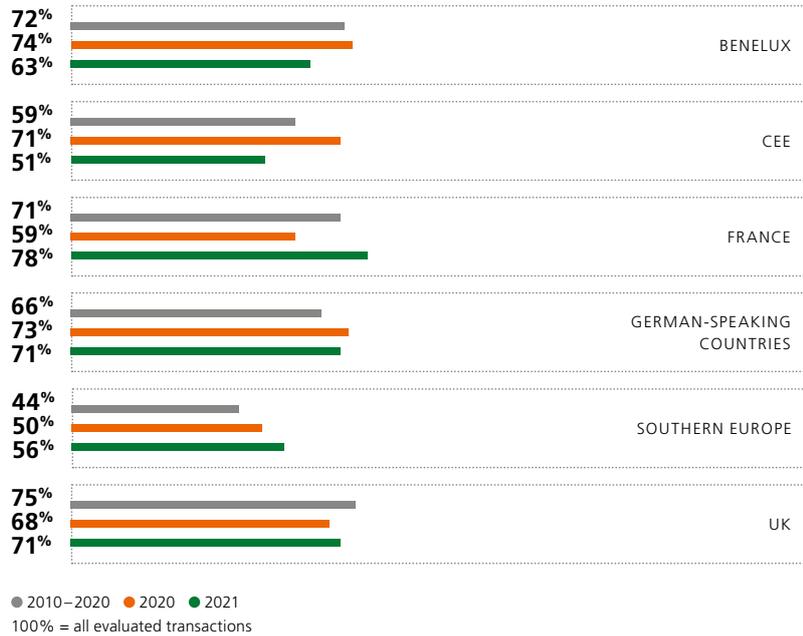
Basket levels increase significantly if W&I insurance applies

Regional Differences

There was a wider application of baskets across European transactions in 2021. France, the UK and the German-speaking countries lead the field with 78%, 71% and 71% application respectively. For France this represented a significant increase from 59% in 2020. There was a drop-off in application in respect of Benelux and CEE at 63% and 51% application from 74% and 71% respectively. The variation in the application of 'first dollar' baskets across the various jurisdiction remains marked, applying in an extraordinary 94% of UK transactions as compared with levels of 72% and 64% in France and the Southern European countries. However, those levels are an increase from 2020, which appears to indicate there is a greater convergence in the application of 'first dollar' baskets.

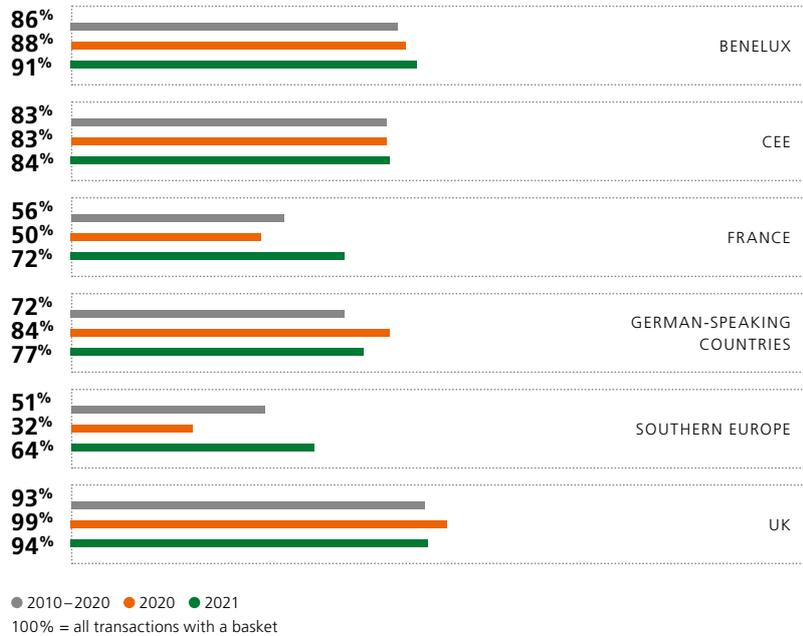
Time Trend Europe

Basket application



Time Trend Europe

First dollar



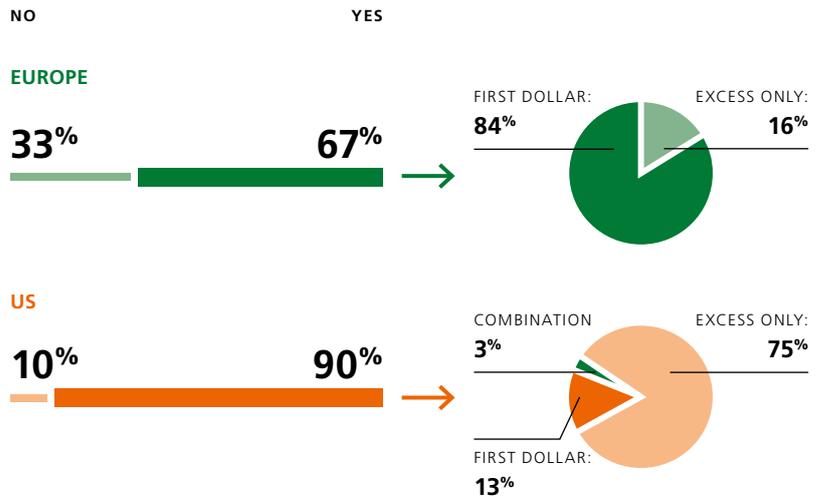
'First dollar' recovery in the UK

94% ➔

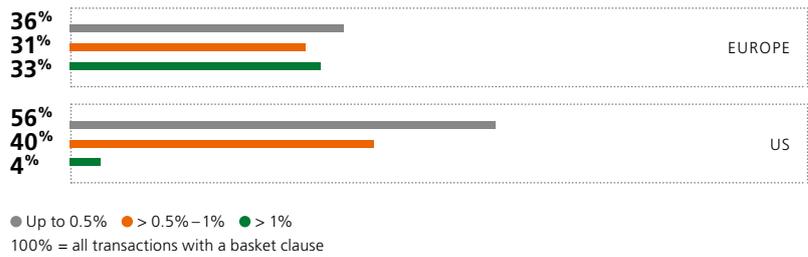
European/US Differences

We have previously noted that the US market applies a basket in nearly all transactions (90%). The US market uses 'excess only' baskets in 75% of transactions whereas such baskets rarely apply in the European market – just 16% of deals covered. There is also a disparity in the amount of the basket with just 4% of US transactions applying a basket of more than 1% of the purchase price as compared with 33% for European transactions.

Frequency of Baskets



Thresholds Europe/US



Baskets used in almost all US deals and mostly 'excess only' baskets applied



Liability caps

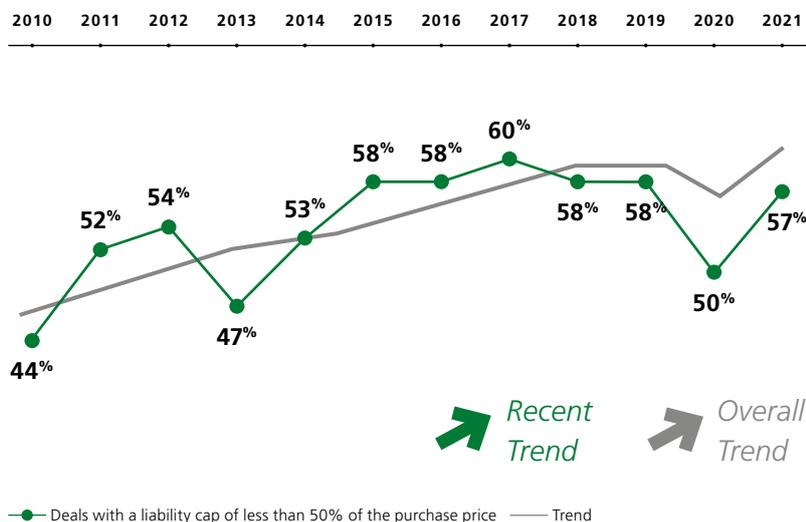
In most M&A transactions it is usually accepted that sellers expect that their liability in respect of warranty claims will not exceed a pre-agreed capped amount. This amount is often simply the purchase price so the buyer cannot recover more than it has paid. However, the liability cap might be hotly debated, and can vary significantly from deal to deal, particularly in larger deals. For deals with full W&I insurance cover the liability cap is often a nominal amount.

General Overview

In 2021 there was a big increase in the number of deals with liability caps of less than 50% of the purchase price. In 2020 there was a significant decrease in such deals so it seems that in 2021 there was a reversion to the liability caps prevailing before the pandemic. The proportion of deals with liability caps equal to the purchase price remained constant at 30% but those with a cap of less than 10% of the purchase price increased significantly to 22% from 16% in 2020. It seems likely that the greater use of W&I has resulted in sellers being able to command lower liability caps as buyers seek cover from the W&I insurance market. The amounts of liability caps are also subject to significant variation depending on deal size. For example, 46% of large deals (above EUR 100m) have a liability of less than 10% of the purchase price compared to 13% for small deals (below EUR 25m). 35% of small deals (below EUR 25m) have a liability cap of the purchase price as compared to 17% for large deals (above EUR 100m).

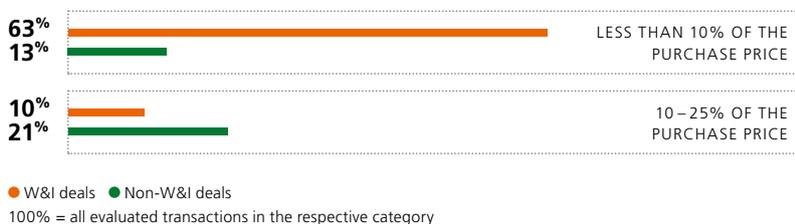
CMS Trend Index

Liability caps (less than 50% of purchase price)



Liability Caps for 2021

W&I deals + non-W&I deals



Liability cap less than 50% of purchase price

57% ➔

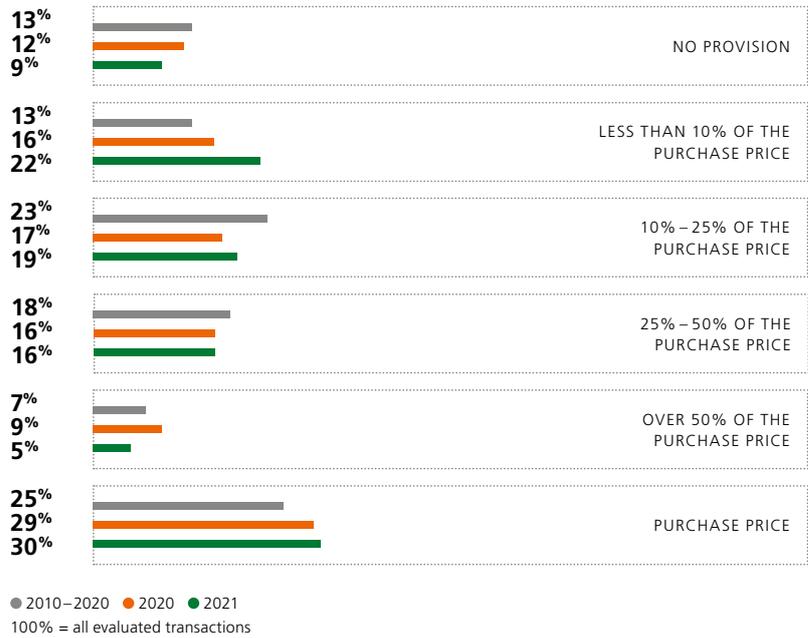
The number of deals with liability caps of less than 50% of the purchase price increased, back to the pre-pandemic level

This year's Study indicates that a significant proportion of deals (i.e. 22%) have a liability cap of less than 10% of the purchase price, which is a large increase on the level of 16% in 2020. The proportion of deals with liability caps equal to 10–25% and 25–50% of the purchase price remained broadly constant at 19% and 16% respectively. The proportion of deals with a liability cap equal to the purchase price also remained constant at 30%. Only 9% of the transactions do not have a liability cap at all.

Deals without liability caps

9%

Amount of Liability Cap

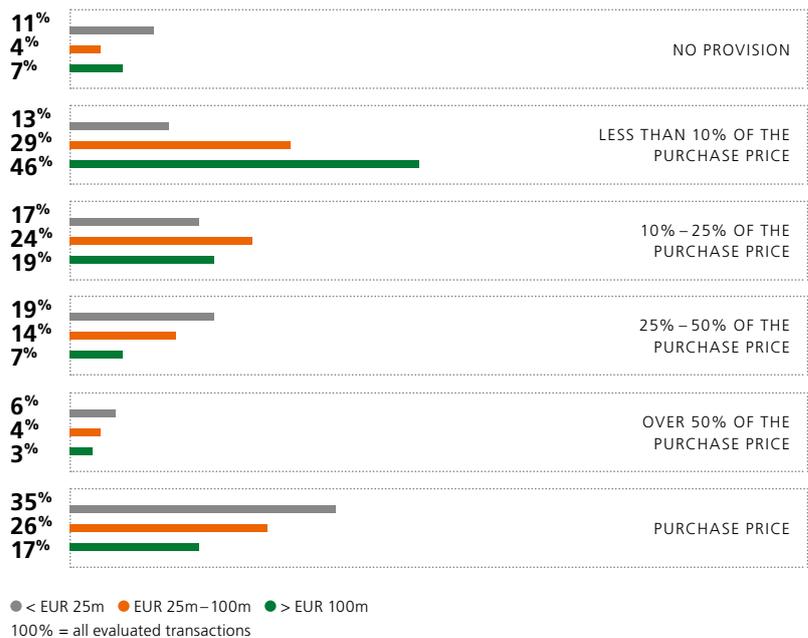


Analysis by Deal Size

The results of this year's Study indicate that the liability caps for larger transactions are decreasing and fewer of these transactions have caps equal to the purchase price. For 46% of large deals (i.e. greater than EUR 100m) and 29% of medium sized deals (i.e. between EUR 25m and EUR 100m) the liability cap is less than 10% of the purchase price whereas for small deals (i.e. less than EUR 25m) such a liability cap only applies in 13% of such deals. For small deals the purchase price is most likely to be the agreed liability cap and applies in 35% of those deals.

For small deals the purchase price is most likely to be the agreed liability cap

Amount of Liability Cap by Deal Size

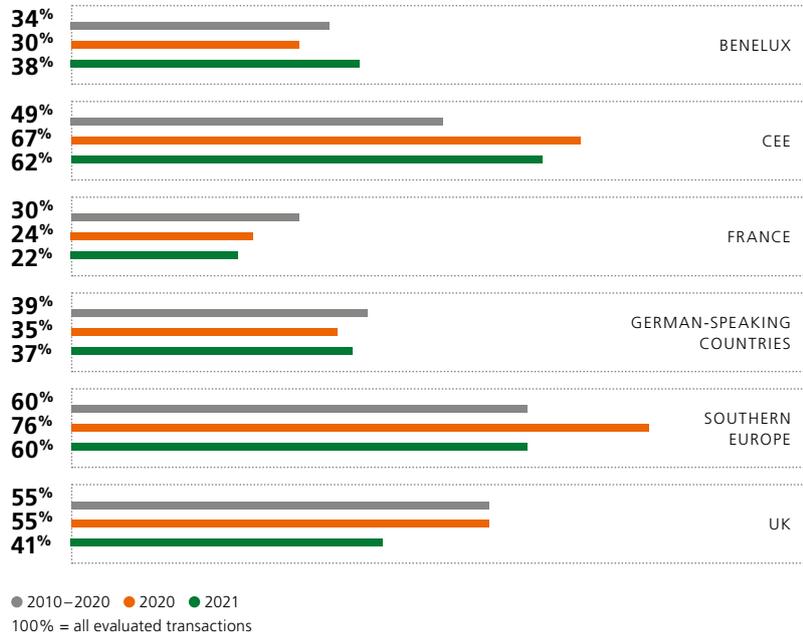


Specific Issues

Regional Differences

A liability cap of more than 50% of the purchase price applied in 38% of our European transactions. However, there are big variations between countries, with the range being from 22% to 62%. In 2021 there were also significant regional movements in respect of Benelux and the Southern European countries where liability caps applied to 38% and 60% of their transactions, representing an increase from 30% (for Benelux) and a decrease from 76% (for the Southern European countries). This contrasts with a big drop in the UK, where a liability cap of more than 50% of the purchase price only applied in 41% of transactions as compared to 55% in 2020.

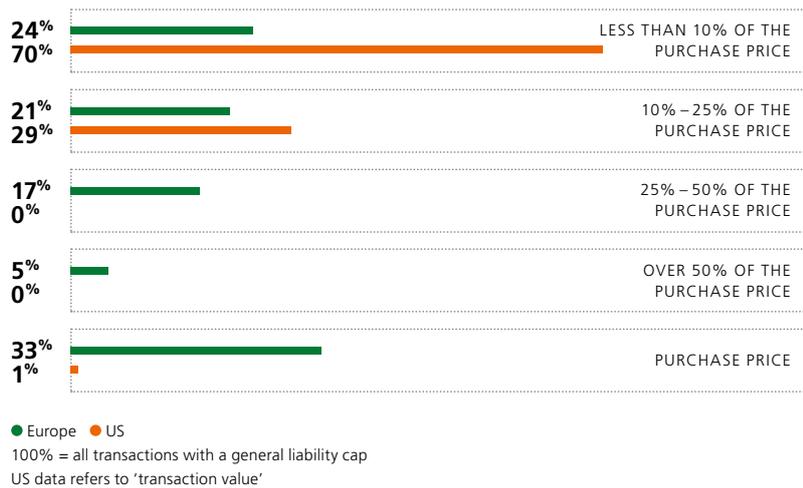
Time Trend Europe Liability Caps of more than 50%



European/US Differences

The US market has a more consistent and less varied range of liability caps in that the vast majority (99%) of deals there have a cap of 25% or less of the purchase price. Indeed a massive 70% of US deals have a cap of less than 10% of the purchase price. Although the difference narrowed in 2021 in our European sample, only 24% of European deals in 2021 had a cap of less than 10% of the purchase price and most European deals (i.e. 33%) had a liability cap equal to the purchase price, as compared with just 1% of US deals.

Liability Caps



Sector Differences

As indicated above 41% of all our European deals had caps of up to 25% of the purchase price and this average applied in most of the sectors covered. The exceptions were in the Hotels & Leisure and Real Estate & Construction sectors, for which 57% and 67% of such transactions had caps at this level and just 22% of deals in the Energy & Climate Change sector had a liability cap at this level. The variations year on year in respect of particular sectors are often quite significant, so we continue to assume that deal size and geography, rather than sector, are the major determining factors in setting a liability cap.

Frequency of Liability Caps up to 25%

SECTOR	2010 – 2020	2020	2021
BANKING & FINANCE	28%	0%	37%
HOTELS & LEISURE	42%	22%	57%
ENERGY & CLIMATE CHANGE	27%	33%	22%
CONSUMER PRODUCTS	38%	56%	41%
TECHNOLOGY, MEDIA & COMMUNICATIONS	34%	31%	34%
INFRASTRUCTURE & PROJECTS	20%	25%	50%
LIFE SCIENCES & HEALTHCARE	37%	38%	37%
REAL ESTATE	48%	40%	67%
INDUSTRY	41%	33%	36%
BUSINESS (OTHER SERVICES)	32%	36%	47%
CMS AVERAGE	36%	34%	41%

100% = all evaluated transactions of the respective sector





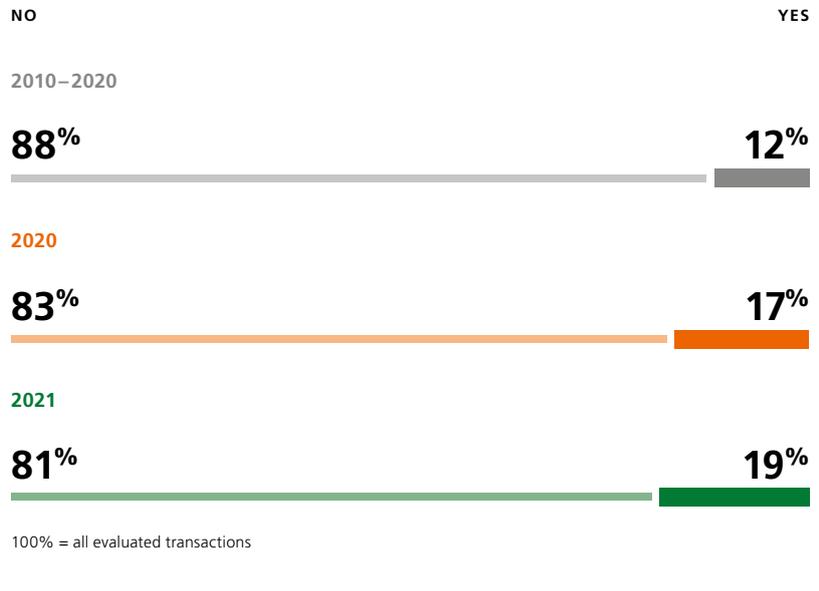
Warranty & Indemnity insurance

Where (i) there is no obvious warrantor to stand behind the warranties (e.g. private equity sellers) or (ii) there is an insufficient amount of coverage provided by the warrantors, W&I insurance offers an elegant solution.

Our data demonstrates that the drop-off in W&I insurance policies in 2020 was a one-off and 2021 was a buoyant year for the W&I insurance community, particularly on transactions with higher values and notably in the UK and US markets.

General Overview

Time Trend W&I Insurance



W&I insurance usage
19% ↗

The market this year

Brian Hendry, Head of Mergers & Acquisitions at W&I insurance broker Paragon International Insurance Brokers, notes that:

“Reflecting the general surge in activity in 2021, the M&A insurance market was incredibly active. Enquiry volumes across all sectors in UK, Europe, USA and AsiaPac increased many fold and globally the market received more than 13,000 enquiries resulting in demand for insurance products exceeding the budgeted expectations of brokers and insurers. Many insurers had material revisions to budgets and the need to seek additional capacity.

Although the costs for W&I cover remained reasonably stable in UK and Europe for the first half of the year, we saw a gradual increase in Q3 followed by a significant up-tick in Q4. A feature that had not previously been encountered was that deals, originally timed for November / December signing, had to be scheduled into the first weeks of 2022 as the W&I market didn’t have the “bandwidth” to complete their underwriting processes. New insurers are now regularly joining the market, with the majority of established insurers and brokers seeking to hire new talent and expand their teams. More than previous years there has been considerable external investments and acquisitions made into specialist M&A broking and underwriting firms.”

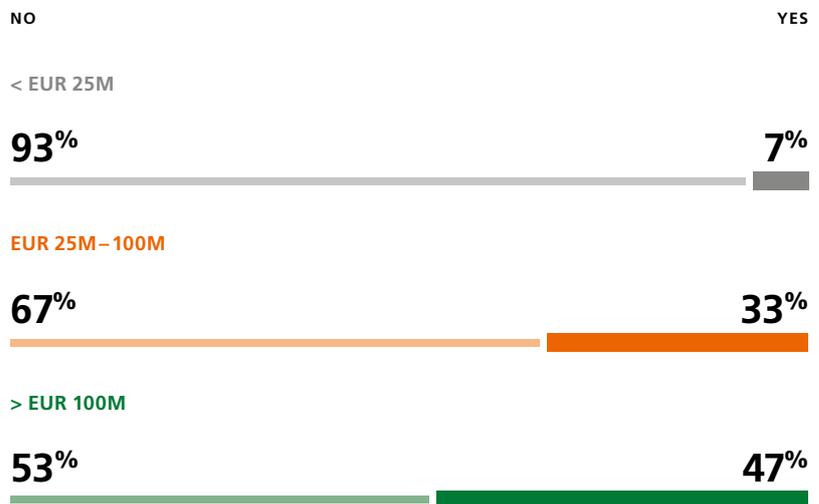
Analysis by Deal Size

2021 again showed the continuing trend that W&I insurance is most likely adopted on deals with larger values. W&I insurance was purchased on 47% of deals with a purchase price exceeding EUR 100m, broadly the same as 2020's figures. There was a 4% increase on usage to 33% on deals with values between EUR 25m and EUR 100m whilst W&I insurance remains relatively uncommon on the small deals (sub EUR 25m at 7%) where perhaps the cost of the premium is not merited.

W&I applies most for deals with larger values and was purchased on 47% of deals with a purchase price exceeding EUR 100m

W&I Insurance 2021

By purchase price (Europe-wide)



100% = all evaluated transactions



Specific Issues

Sector Differences

Whilst there is a consistent trend when comparing W&I insurance use against deal size, the same cannot necessarily be said when analysing the sector data. This year sees the unusual sight of Technology, Media & Communications being the sector which has adopted W&I insurance the most albeit it has been on the rise in this sector over the past three years. Whilst it remains, as expected, relatively commonplace in the Real Estate & Construction sector the data shows significant variances in other sectors but continues to be unpopular in the Infrastructure & Projects sectors.

Frequency of W&I Insurance

SECTOR	2011 – 2020	2020	2021
BANKING & FINANCE	2%	4%	4%
HOTELS & LEISURE	12%	10%	9%
ENERGY & CLIMATE CHANGE	12%	24%	11%
CONSUMER PRODUCTS	10%	7%	4%
TECHNOLOGY, MEDIA & COMMUNICATIONS	13%	16%	20%
INFRASTRUCTURE & PROJECTS	1%	0%	1%
LIFE SCIENCES & HEALTHCARE	4%	1%	13%
REAL ESTATE	25%	24%	16%
INDUSTRY	11%	9%	11%
BUSINESS (OTHER SERVICES)	8%	4%	11%
CMS AVERAGE	12%	17%	19%

100% = all evaluated transactions of the respective sector



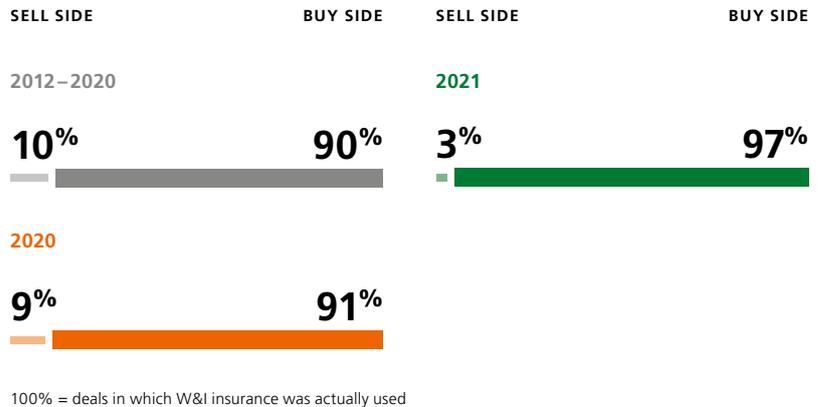
Type of Policy

More than ever before, the data for 2021 shows that if a W&I insurance policy is purchased it will almost always be a buy-side policy (i.e. the buyer will be the insured party). This was the case on 97% of the deals that involved W&I insurance (a 6% increase from 2020). Despite sell-side policies being rare, sellers still participate in the market and may actually agree to pay some or all of the premium payable for the relevant policy (e.g. by accepting a reduction in purchase price as a means of contribution). This year however saw a fall in the amount of policies paid for by sellers (down 5% to 15%).

A W&I insurance policy is almost always a 'buy-side' policy

W&I Insurance

By purchase price



W&I Insurance

Who pays the premium

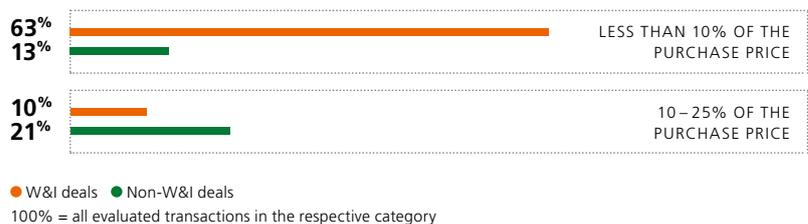


Liability Caps

Deals with W&I insurance are more likely to see the seller being able to agree a lower liability cap in its negotiation with the buyer. This may be a nominal amount with the buyer able then to purchase a W&I insurance policy either to top up its warranty coverage or, as is common, as its sole recourse. In 2021, 63% of deals (up 12%) involving W&I insurance had liability caps that were less than 10% of the purchase price compared to only 13% of non-W&I insured deals.

Liability Caps for 2021

W&I deals + non-W&I deals



Limitation Periods

Usually the length of any W&I insurance policy period will match the equivalent time limitation period for bringing warranty claims in the purchase agreement. However, it is possible to agree with the underwriter to purchase a different (usually longer) period. The data for 2021 (similar to 2019 and 2020) shows that a time limitation period of between 18 and 24 months is more common on W&I insurance deals than on deals without insurance. There was a modest increase in 2021 in longer limitation periods (more than 24 months) featuring on W&I insured deals (up 2% to 22%).

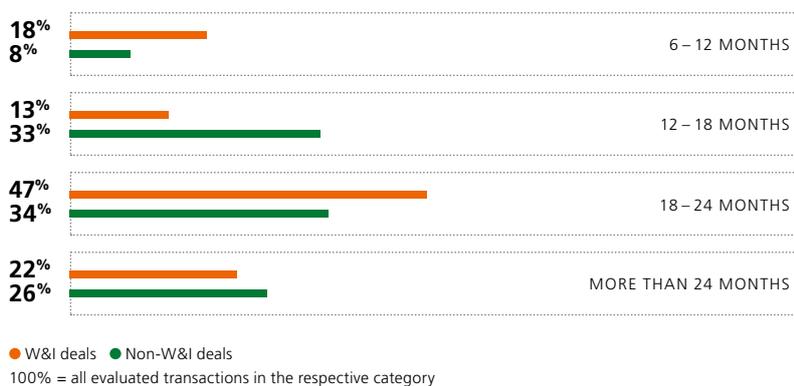
Frequency of Claims under W&I Insurance Policies

Clients sometimes ask how often there are warranty claims on M&A deals and particularly those where W&I insurance is in place. We can refer to the relatively recent reports from underwriters like AIG and Liberty which indicated that they receive claims notifications on between 15–20% of W&I insurance policies, although the reports do not go into as much detail as to the extent of paid claims materialising from those notifications.

In addition, Adrian Furlonge, partner of specialist M&A insurance broker HWF Partners, comments as follows on the frequency of claims whilst also noting a general hardening in the market:

Limitation Period for Warranty Claims for 2021

W&I deals + non-W&I deals



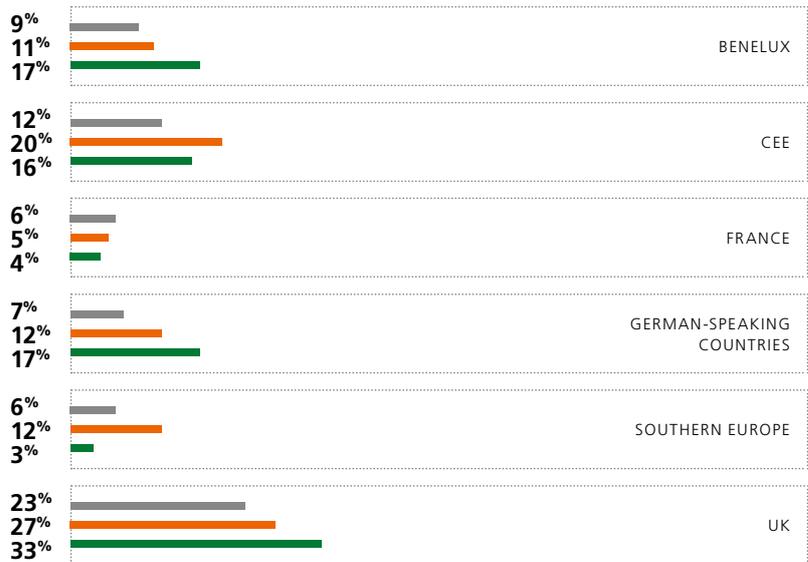
“Those who purchased a W&I insurance policy from Q4 2021 onwards will have noticed a change in the appetite, efficiency and pricing of insurers. There are a number of reasons for this: First, the capacity squeeze. Many insurers were unable to keep up with the sheer demand for the product from mid-2021 onwards. Some insurers had already reached their annual budgets by Q1 and were unable to source additional capital to deploy leading to them being far more selective and in some cases closing until 2022. Second, deal processes. With COVID-19 impacting ability to conduct face to face meetings and international travel, more corners have been cut than ever on due diligence. This, together with processes being run seven days a week in extremely tight timelines leads nicely onto the third issue: Claims activity and management. Given the increase in the use of the product together with the manner of deal doing changing, the market has seen more notifications during 2020/1 than any other period with hundreds of £m being paid out. This has included claims in traditionally “safe” sectors such as property and renewable energy as well as an increase in claims in risk areas such as material contracts, IP and data protection / cyber. This is leading to all insurers forecasting 2022 to be a bumper claims year. As such, there has been a market-wide price increase to ensure continued profitability and longevity of the product as well as greater scrutiny being paid to certain sectors and areas of risk.”

Regional Differences

Regional disparity in the popularity of W&I insurance is demonstrated again in 2021. The UK remains the market most comfortable with W&I insurance and experienced a 6% increase in usage to 33% of deals (10% higher than the average over the last decade). Each of Benelux and the German-speaking countries saw a rise in popularity whilst there were falls in W&I insurance's use in CEE, France and Southern European countries. However, nowhere was W&I insurance more popular than in the US as the ABA Study indicates that RWI insurance (as it is known in the US) was purchased on more than 60% of deals.

Adrian Furlonge commented on the W&I insurance market in different territories in Europe:

Time Trend Europe



● 2010-2020 ● 2020 ● 2021
100% = all evaluated transactions

“The last two years have seen Europe-wide expansion on the broker and underwriter side. HWF itself has opened offices in Paris and Warsaw to supplement its existing presence and many insurers and brokers have done the same with a particular push into Southern Europe/Iberia and the CEE. In places such as Germany, Iberia and the Nordics, there is now limited need to approach the London market to obtain quotes given the underwriting expertise on the ground locally. European clients have certainly benefited from this and it has definitely resulted in more deals coming to market than ever before. That said we have seen certain London market insurers seeking to benefit from having greater international focus allowing them to offer broader coverage and better pricing out of London than might be achieved locally. This has meant that there has been an element of forum shopping, particularly outside of the core mid-market space. Clients should be wary of this to an extent because, while a London insurer may deliver, the importance of local expertise should not be overlooked.”



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 choosing shorter limitation periods than applies in the relevant statute. This is favourable to sellers because buyers have less time to bring claims. In contrast to previous years, the former 'seller-friendly' trend of shorter periods has shifted towards longer periods in 2021.

General Overview

In 2021 (as in 2020) limitation periods tended to be longer. Limitation periods of more than 24 months are almost as popular as the high points reported in the earlier years of the Study and were seen in 25% of deals in 2021 (which is also above the 11-year average of 22% for the period from 2010 to 2020). The first years of the Study saw more than one quarter of all deals with long limitation periods of more than 24 months (2010 to 2012: 27%, 2013: 26%), followed by a drop in 2014 to 15%. The trend began to rise again but there was a substantial dip in 2019 (19% from 24% in 2018).

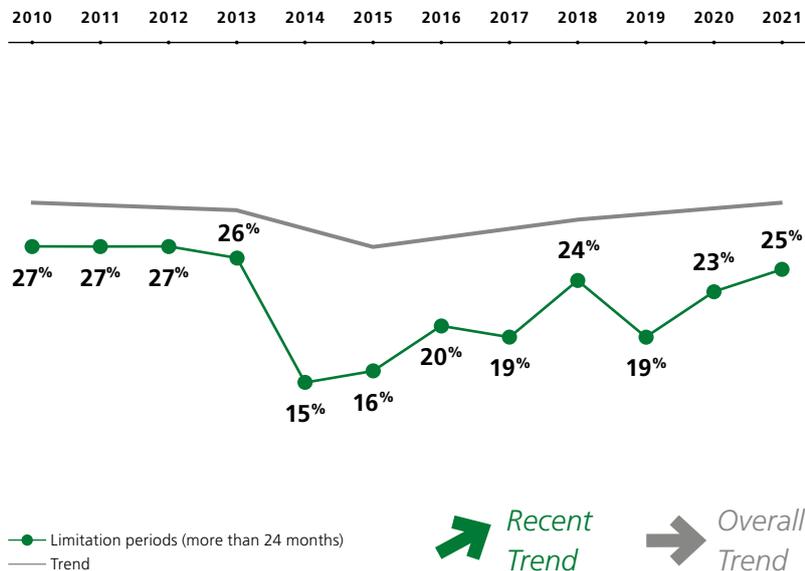
Limitation periods tend to be longer

In contrast to the rise of longer limitation periods, the use of shorter limitation periods slightly decreased. The use of the shortest periods (from six to 12 months) fell by 1% (from 11% in 2020 to 10% in 2021) and the same applies to limitation periods in the 12 to 18 months range (2021: 29%, 2020: 30%). As an overall comment, the movements from shorter to longer periods are relatively slight but the trend towards shorter periods has reversed, which in the current environment of a hot M&A market is somewhat surprising.

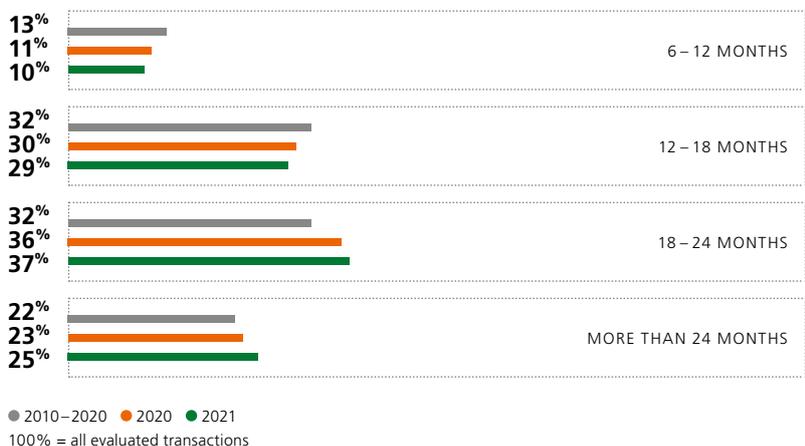
Limitation periods > 24 months

25% ➔

CMS Trend Index



Time Trend



Specific Issues

Regional Differences

We observed an opposing development while looking at the different European regions. In almost all evaluated regions we saw a decrease in deals with shorter limitation periods for warranty claims (below 12 months). Specifically:

In the German-speaking countries there was a slight increase of longer limitation periods (more than 24 months) from 14% in 2020 to 17% in 2021, but also a rise of short limitation periods (six to 12 months) in those countries (2020: 8%; 2021: 13%) and a huge drop in the use of 18 to 24 months periods (2020: 43%; 2021: 32%).

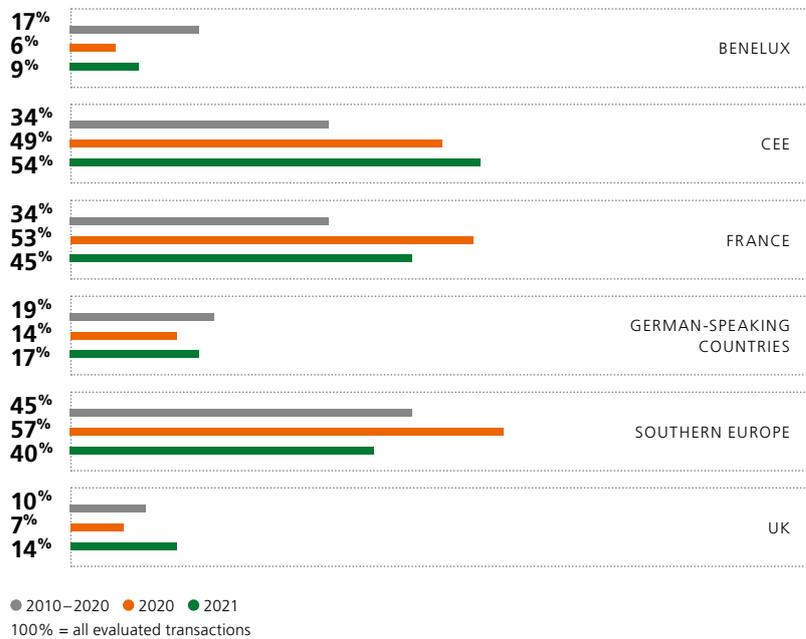
In France, as in previous years, parties agree on longer limitation periods for warranty claims. 80% of the French deals contained limitation periods of more than 18 months in 2021 in contrast to 73% in 2020. However, this is driven by a vast increase of the usage of limitation periods from 18 to 24 months (35% in 2021, 20% in 2020).

In Southern European countries, 80% of the deals (2020: 76%) had longer limitation periods (more than 18 months), which represents a common trend. Correspondingly, there were few deals with shorter limitation periods (six to 12 months), namely 6% in 2021 (2020: 5%).

In the UK, CEE and Benelux, there has been an increase in deals with longer limitation periods (i.e. more than 24 months) and a corresponding decrease in the number of deals with shorter limitation periods (six to 12 months) for warranty claims.

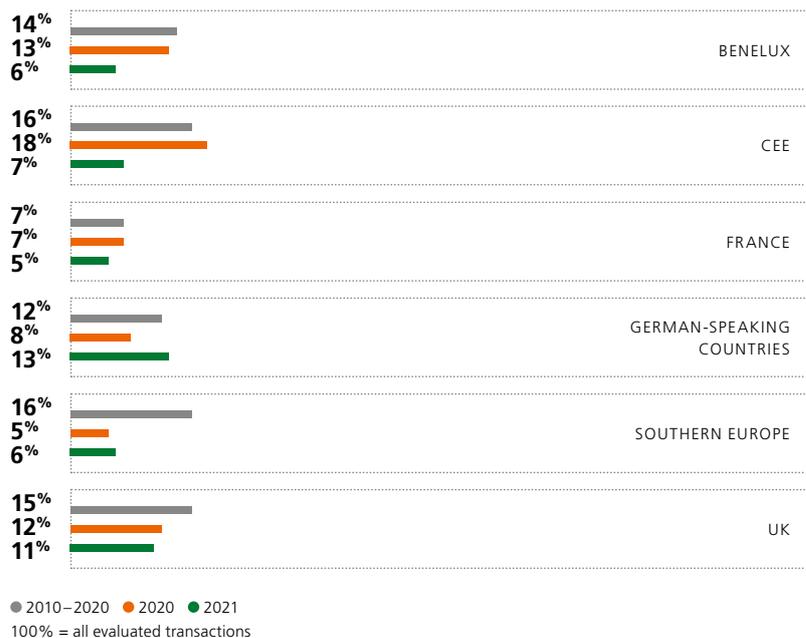
Time Trend Europe

More than 24 months



Time Trend Europe

Six to 12 months



Sector Differences

Sector analysis demonstrates that, in 2021, longer limitation periods (i.e. those exceeding 24 months) were most likely in the Energy & Climate Change and Life Sciences sectors (39% and 36% of deals recorded in those sectors, respectively).

The Hotels & Leisure sector, which saw longer limitation periods (i.e. those exceeding 24 months) in 2020 (37%), tended to use shorter limitation periods in 2021 as the usage of longer limitation periods dropped (from 37% to 24%).

The Banking & Finance sector saw the biggest rise in longer limitation periods (i.e. those exceeding 24 months) as these were used in 27% of deals (2020: 7%).

Limitation Periods (more than 24 months)

SECTOR	2010 – 2020	2020	2021
BANKING & FINANCE	17%	7%	27%
HOTELS & LEISURE	26%	37%	24%
ENERGY & CLIMATE CHANGE	21%	26%	39%
CONSUMER PRODUCTS	25%	24%	24%
TECHNOLOGY, MEDIA & COMMUNICATIONS	18%	20%	19%
INFRASTRUCTURE & PROJECTS	15%	0%	0%
LIFE SCIENCES & HEALTHCARE	23%	26%	36%
REAL ESTATE	26%	22%	14%
INDUSTRY	19%	24%	31%
BUSINESS (OTHER SERVICES)	25%	16%	13%
CMS AVERAGE	22%	23%	25%

100% = all evaluated transactions of the respective sector

Longest limitation periods in the sectors for Energy & Climate Change and Life Sciences

Analysis by Deal Size

In contrast to previous years, deal size seems not to have been the driving factor when choosing limitation periods for warranty claims. Nearly one third of all deals contained limitation periods between 18 and 24 months irrespective of deal size (38% of deals below EUR 25m, 34% of deals between EUR 25m and EUR 100m and 34% of deals above EUR 100m).

Time Trend

By purchase price less than EUR 25m



● 2010 – 2020 ● 2020 ● 2021
100% = all evaluated transactions

For all deal sizes the duration of limitation periods increased. In almost two-thirds of deals (irrespective of size) limitation periods of more than 18 months were agreed.

Limitation periods are less 'buyer-friendly' in transactions with a value above EUR 100m as one quarter of deals contained short limitation periods (six to 12 months). Correspondingly, only 22% of deals with a value of more than EUR 100m contained limitation periods exceeding 24 months in 2021.

In contrast smaller deals with a value lower than EUR 25m had longer limitation periods, as two-thirds of deals with a longer limitation period (more than 18 months) increased from 63% in 2020 to 66% in 2021.

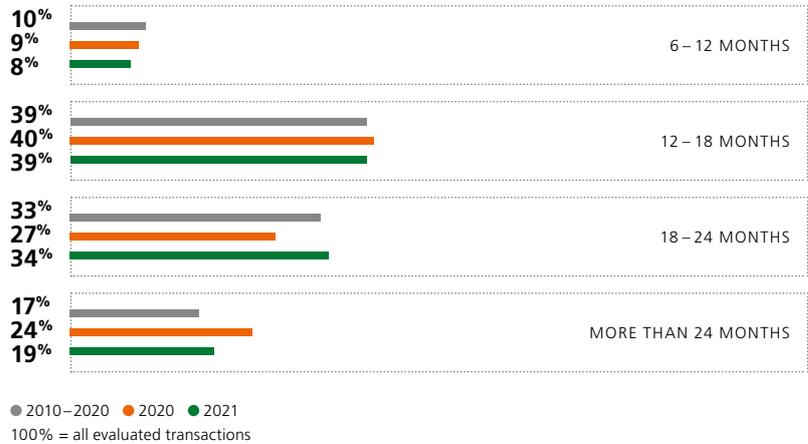
Limitation periods < 18 months

39% ↘

Limitation periods increased irrespective of deal size

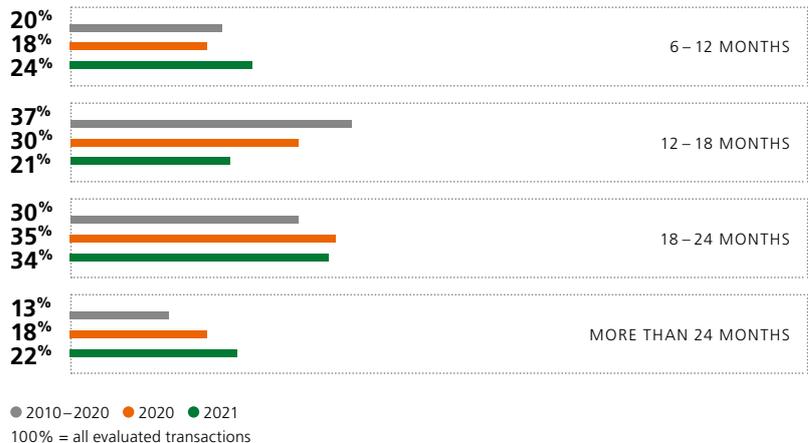
Time Trend

By purchase price EUR 25m – 100m



Time Trend

By purchase price more than EUR 100m





Security for warranty claims

M&A deals may include a form of security for warranty claims where the buyer is concerned about the seller's ability to satisfy any liability to meet a claim. The type and the value of the security depends on many factors, such as the likelihood of a claim occurring, the strength of the seller's covenant and the cost to obtain a particular type of security.

General Overview

28% of deals contained security for warranty claims in 2021 (down 1% when compared to 2020). The 'seller-friendly' trend of recent years continued to permit sellers to avoid having to provide security, a trend which may have been encouraged by the greater use of W&I insurance, meaning that buyers require less direct recourse to the seller. The use of escrow accounts has also decreased sharply to 43% of deals (compared with the average of 57% for the period 2010 to 2020). Where the parties agreed to use security for warranty claims, we noted a 'buyer-friendly' trend regarding the specific forms of security used, e.g. purchase price retention.

Time Trend

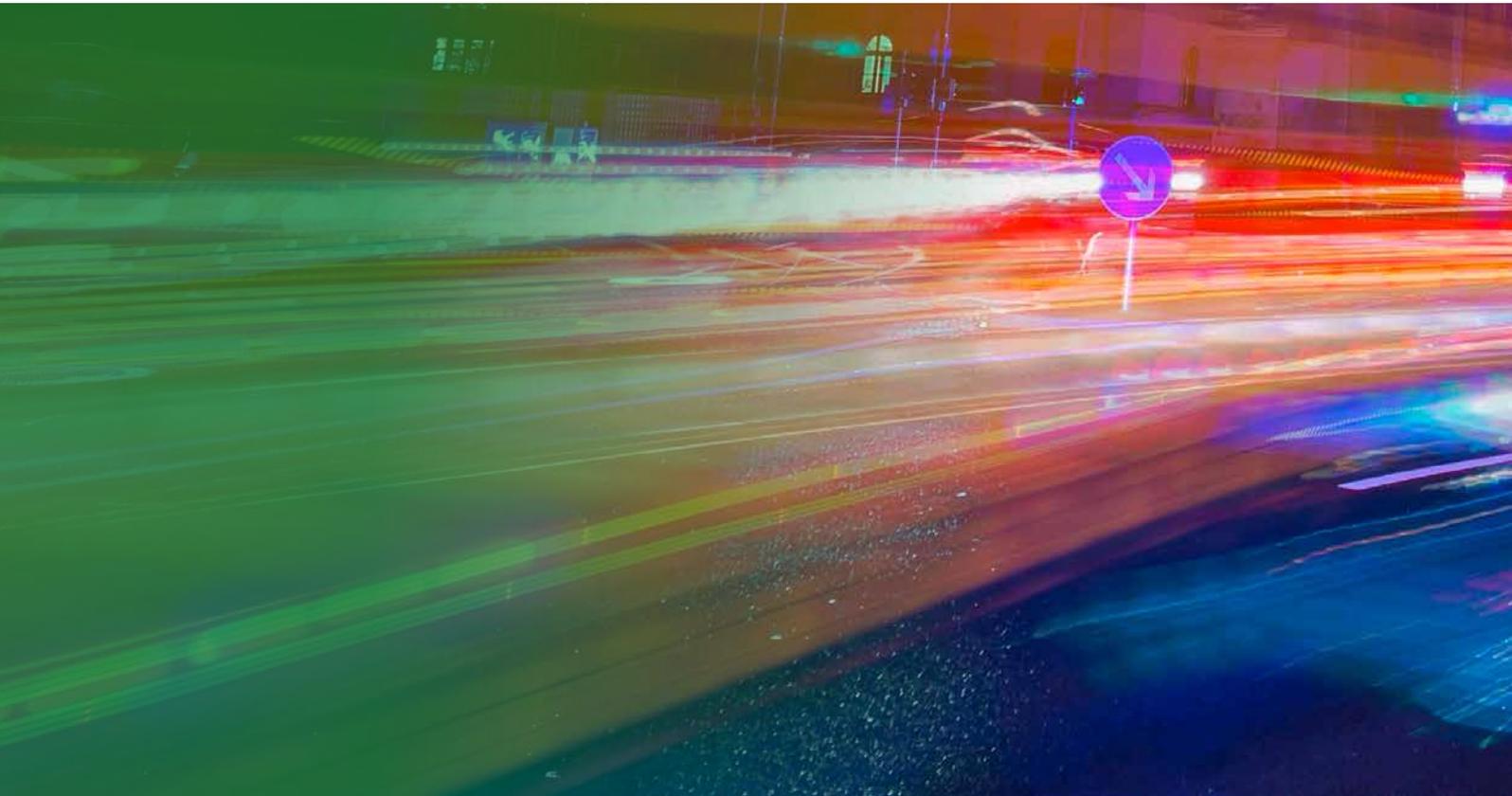


100% = all evaluated transactions

Sellers still able to avoid giving security

Frequency of security

28% →



Specific Issues

Type of Security

In past years of the Study, granting security for warranty claims by means of an escrow account was the most popular form of security (43%). However, this has shifted towards the more 'buyer-friendly' type of security of a purchase price retention. A retention was used in 41% of the deals with a security, which marks a big increase compared to 2020 (32%) and the 11-year average (2010 to 2020: 29%). Similarly, the use of escrows dropped to 43% as compared to 57% in the 11-year average and 48% in 2020. As granting a bank guarantee has continued its loss of popularity in 2021 (10%) when compared with 2020 (13%), this was also the case for other forms of security for warranty claims (12% of deals in 2021).

Time Trend

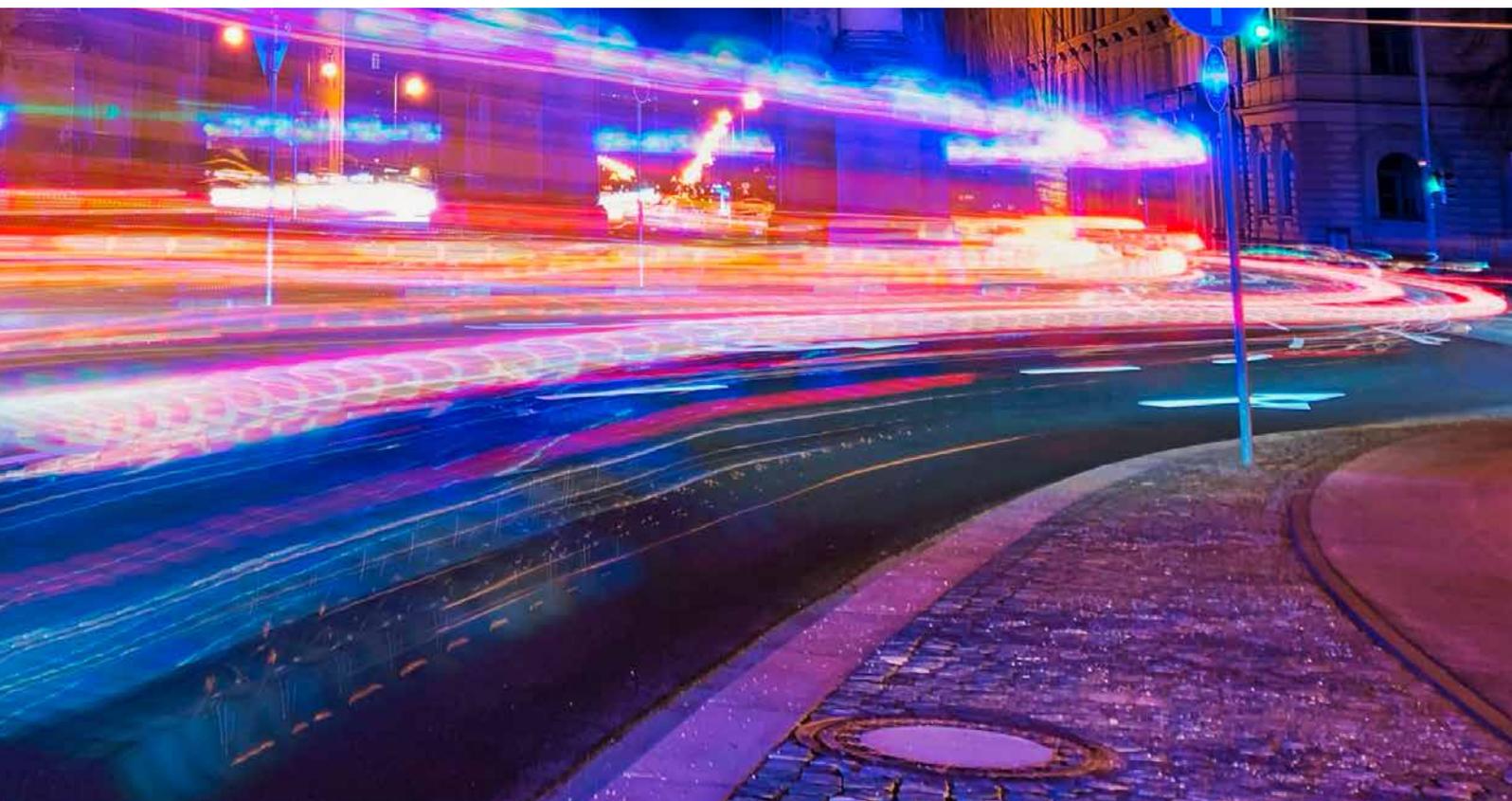


● 2010-2020 ● 2020 ● 2021
100% = transactions with safeguarding mechanism – more than one type of security possible

The use of escrow accounts as security has dropped significantly

Retention of purchase price

41% ➔

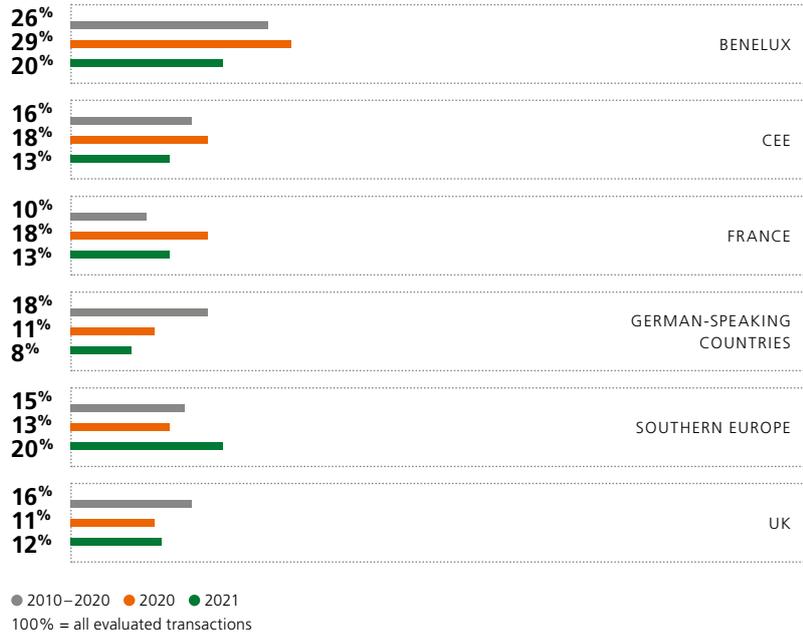


Regional Differences

The use of escrow accounts is especially popular in Southern European countries and Benelux, applying to 47% of deals with a security for warranty claims. However, this is a much lower figure when compared with the figure for Benelux in 2020 (71%). Whilst the use of escrow accounts slightly increased in the German-speaking countries, we recorded the opposite trend in France and CEE in 2021, where the use of escrow accounts dropped from 57% in 2020 to 27% in 2021 and from 61% in 2020 to 52% in 2021 respectively. Interestingly, CEE and the German-speaking countries faced the biggest increase in the use of retention of purchase price as the form of security (CEE: up 21% from 22% in 2020 to 43% and German-speaking countries up 18% from 35% in 2020 to 53% of deals with a security for warranty claims in 2021). A purchase price retention is gaining popularity in Southern European countries (up 15% to 37%) and the UK (up 5% to 50%) as well.

Time Trend Europe

Use of escrow accounts



Retention of a part of the purchase price is almost as popular as the use of escrow accounts



Analysis by Deal Size

Parties agree on security for warranty claims more often if the purchase price is below EUR 100m (29% in 2021). For large deals, security for warranty claims was agreed only in 22% of the deals in 2021.

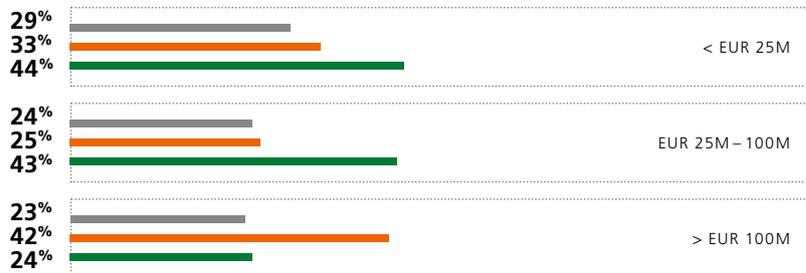
We saw that purchase price retention is more common (43% and 44%) in deals below EUR 100m.

Escrow accounts are much preferred in large deals, being used in 53% of EUR 100m-plus deals where a security for warranty claims was agreed and even more in medium sized deals (57%).

Bank guarantees are more commonly used in small deals (14% for deals with a value below EUR 25m, 8% for deals with a value between EUR 25m and EUR 100m-plus, 0% for EUR 100m plus deals).

Retention of part of the purchase price

By purchase price 2010–2021



● 2010–2020 ● 2020 ● 2021

100% = transactions with safeguarding mechanism – more than one type of security possible

Escrow accountts

By purchase price 2010–2021



● 2010–2020 ● 2020 ● 2021

100% = transactions with safeguarding mechanism – more than one type of security possible



MAC clause

Material Adverse Change clauses (MAC clauses) allocate the risk of fundamental changes occurring between signing and completion. MAC clauses entitle the buyer to terminate the agreement if a specific event materialises before completion. 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.

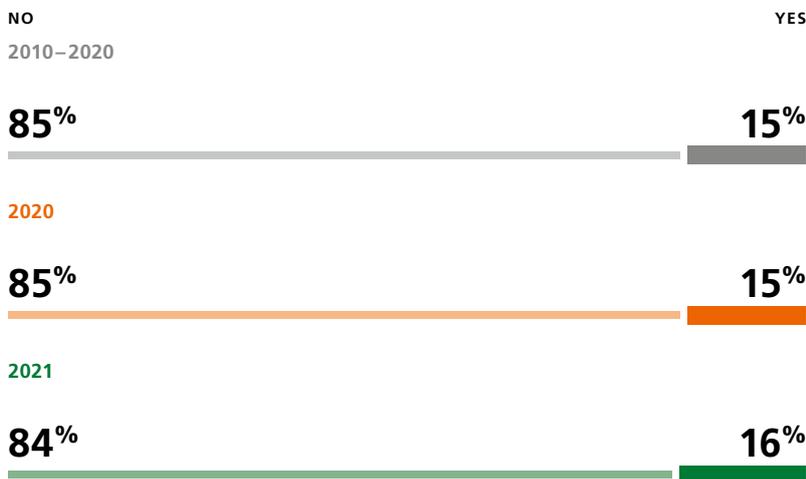
General Overview

In 2021, MAC clauses were used in 16% of the deals. This is a slight increase both when compared with 2020 (15%) and with the 11-year average (15%). This may indicate that sellers have been more successful in resisting MAC clauses because of their strong commercial position. However, the slight increase might reflect uncertainties due to the economic environment applying as a result of the COVID-19 pandemic.

There are often carve-outs from the MAC clause, although it remains challenging for buyers to negotiate general carve-outs. Whilst exemptions in the event of force majeure (15%) and on the basis of sector-specific economic developments (19%) have slightly lost significance in 2021 in contrast to previous years, other types of exemptions (33%), most likely to be COVID-19 related, and exemptions on the basis of overall economic developments (26%) have significantly regained popularity.

Time Trend

MAC CLAUSES



100% = all evaluated transactions



Exemptions from Material Adverse Change

The frequency of Back-Door-MAC clauses in a transaction (i.e. a right of the buyer to rescind or terminate the SPA in the event that warranties given as of signing are not true and accurate after signing) has remained relatively stable in 2021, with 20% of the deals including such clause when compared with 21% in 2020 and the 11-year average of 21% for 2010 to 2020.



● 2010–2020 ● 2020 ● 2021

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

Specific Issues

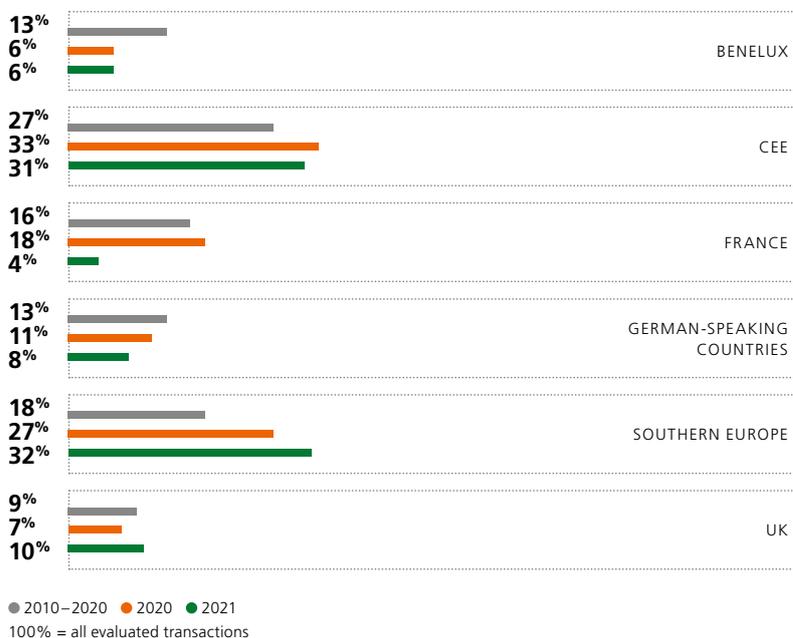
Regional Differences

The stark regional inconsistencies in the development of using MAC clauses continue to apply.

As compared to 2020, MAC clause usage in 2021 decreased notably in France (from 18% to 4%) and slightly in German-speaking countries (from 11% to 8%). MAC clause usage remained nearly stable in Benelux (6%) and in the UK (from 7% to 10%).

In comparison, in CEE and Southern European countries MAC clauses were used in almost one third of all 2021 deals (31% and 32% respectively). However, the vast increase in usage in Southern European countries might be a pandemic-related occurrence as this contrasts with the 11-year average of only 18% of deals. In CEE the usage dropped slightly (from 33% in 2020) and is now again nearer the 11-year average of 27%.

Time Trend Europe



Southern Europe is experiencing a continuing increase in MAC clause usage in the past two years

Sector Differences

In 2021, MAC clauses were most frequently used in the Life Sciences sector (25%). The frequency of MAC clauses in the Hotels & Leisure sector dropped significantly from 30% in 2020 to only 6% in 2021. A similar trend of decreasing MAC clause usage can be observed especially in the Consumer Products sector (minus 3%), Industry sector (minus 3%) and Real Estate & Construction sector (minus 7%).

The Technology, Media & Communications sector (plus 9%) and the Life Sciences sector (plus 8%) instead saw a bigger increase in MAC clause usage.

Frequency of MAC Clauses

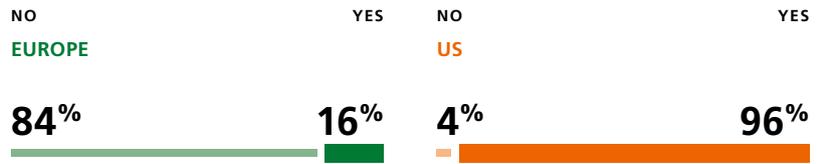
SECTOR	2010-2020	2020	2021
BANKING & FINANCE	20%	6%	10%
HOTELS & LEISURE	15%	30%	6%
ENERGY & CLIMATE CHANGE	14%	14%	20%
CONSUMER PRODUCTS	13%	16%	13%
TECHNOLOGY, MEDIA & COMMUNICATIONS	13%	9%	18%
INFRASTRUCTURE & PROJECTS	10%	25%	13%
LIFE SCIENCES & HEALTHCARE	17%	17%	25%
REAL ESTATE	15%	20%	13%
INDUSTRY	16%	17%	14%
BUSINESS (OTHER SERVICES)	14%	14%	11%
CMS AVERAGE	15%	15%	16%

100% = all evaluated transactions of the respective sector

European/US Differences

In contrast to Europe, where only 16% of deals included MAC clauses in 2021, there were MAC clauses in 96% of US deals according to the most recent US statistics for 2020 and Q1 in 2021. This remarkable disparity is, on the one hand, explicable by sellers' higher success in demanding deal certainty on controlled auctions in Europe and, on the other hand, by the greater number of transactions that sign and close simultaneously in certain European jurisdictions.

MAC Clauses Europe/US 2021



100% = all evaluated transactions

MAC clause frequency US

96%

Disparity between Europe (16%) and the US (96%) remains



Analysis by Deal Size

The bigger the deal the more often a MAC clause was used in 2021. Whilst in small deals we noticed only a small increase from 13% in 2020 to 14% in 2021, the recent upward trend for medium sized deals stopped (a fall from 22% in 2020 to 18% in 2021). For large deals we observed a notable increase from 13% in 2020 to 20% in 2021. Small deals less commonly include a MAC clause, presumably due to the lower financial risk of fundamental changes post-signing, as contrasted to such risks in medium sized and large deals. The sudden drop of MAC clause usage in large deals in 2020 was a unique event as the figure in 2021 (20%) is even above the long-term average for 2010 to 2020 (18%).

MAC clause usage more common in large deals

MAC Clauses 2010–2021

By purchase price

< EUR 25M

NO YES
2010–2020



2020



2021



EUR 25M–100M

NO YES
2010–2020



2020



2021



> EUR 100M

NO YES
2010–2020



2020



2021



100% = all evaluated transactions



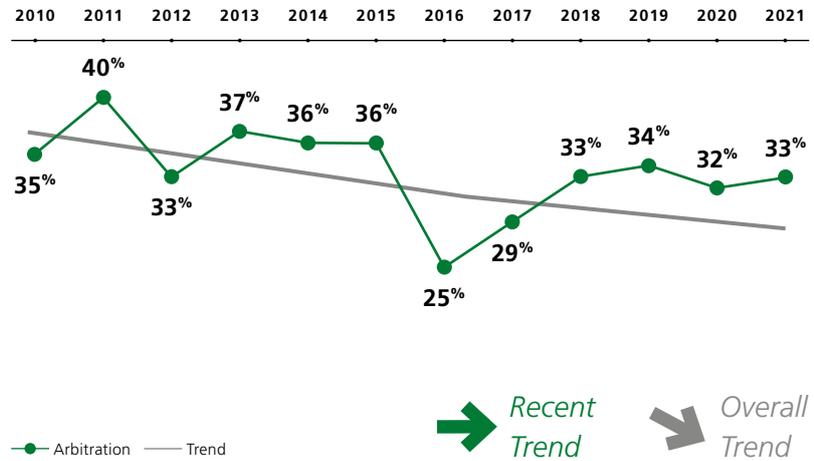
Arbitration

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 avoid a public process. There are perceived downsides, such as the relatively high costs of arbitrations administered by well-known arbitration institutions and the concern that potential efficiencies are not actually achieved in practice. However, since the enforcement of foreign judgments 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

In 2021, arbitration was used as the dispute resolution mechanism in 33% of deals. This marks a slight decrease compared to 2020 (32%), following a steady increase in recent previous years (2016: 25%; 2017: 29%; 2018: 33%). The current popularity of arbitration as a dispute resolution mechanism is consistent with its long-term popularity over the course of the previous 11 years (2010 to 2020), where the use of arbitration averages 33%. The overall trend shows that arbitration is less popular in certain regions (UK, France and Benelux) than others (CEE, German-speaking and Southern European countries). In the previous 11 years, the popularity of arbitration clauses has remained relatively stable within each categorised region, except for France in 2021.

CMS Trend Index



Arbitration clause ratio 2021

33% →

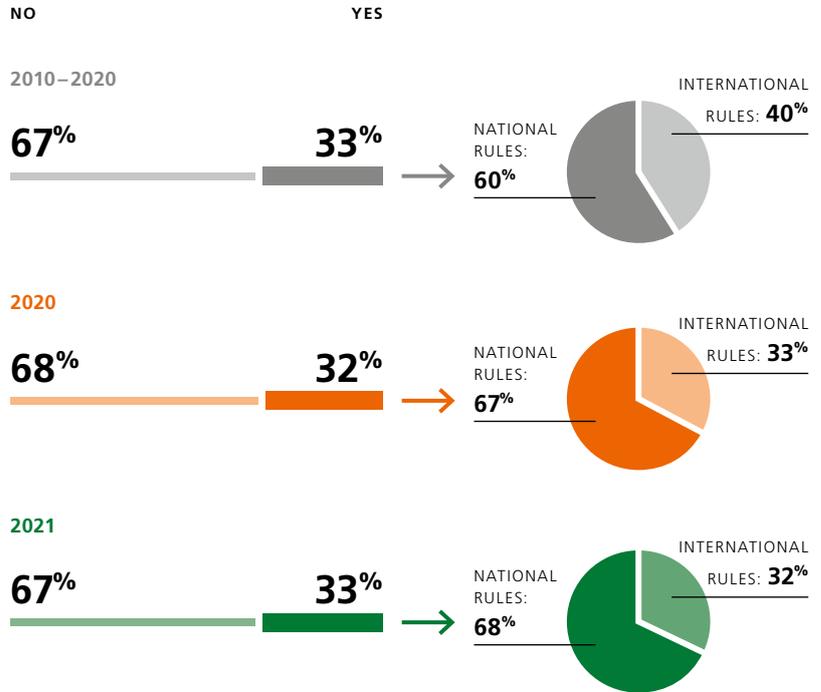


In 2021, the use of national rules to govern arbitration (68%) has extended its popularity over the use of international rules when compared with the 11-year average of 60% (2010 to 2020). This might be a result of the pandemic and the stronger focus on national interests seems to have set a new trend.

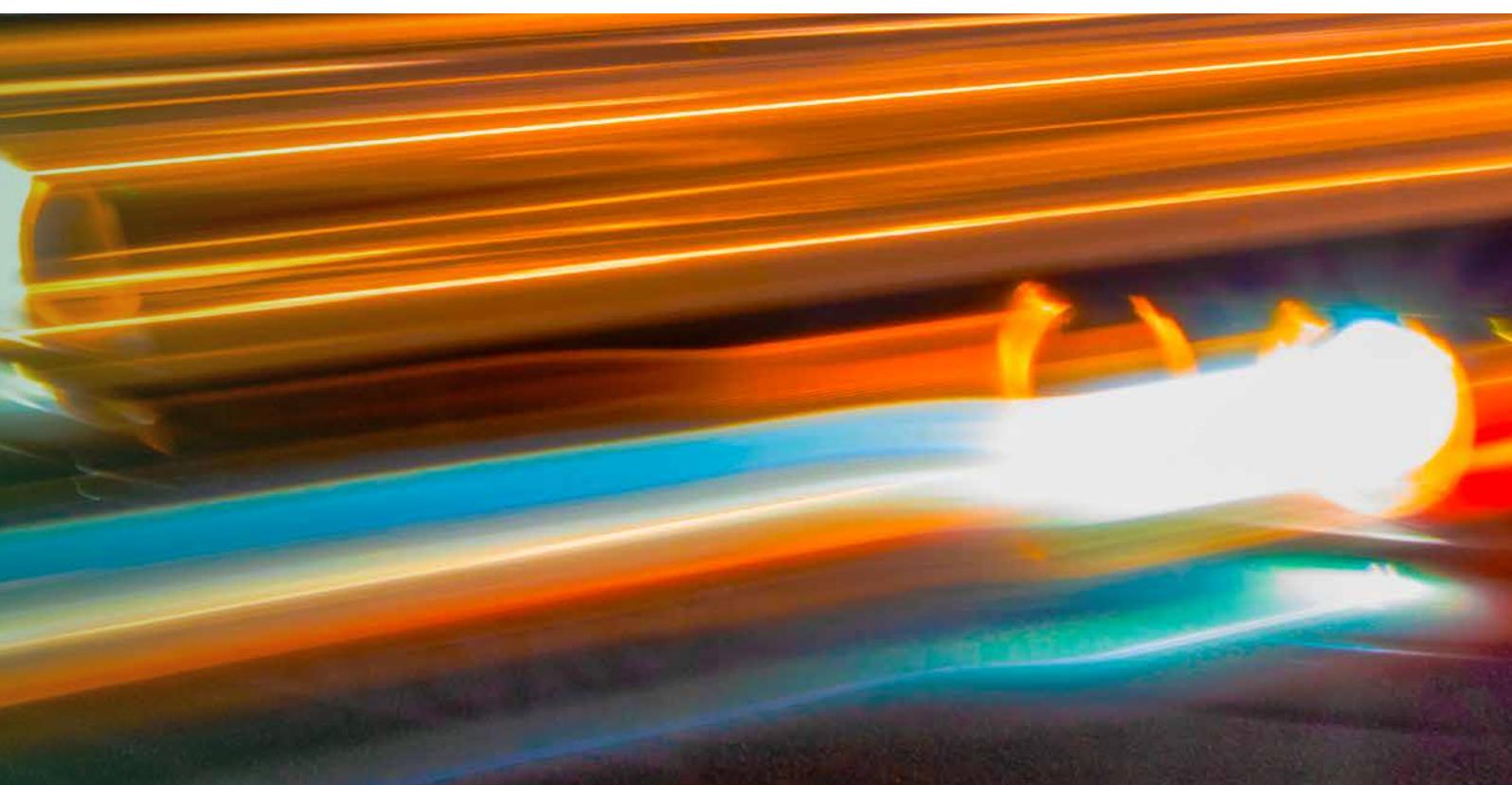
National rules of Arbitration remain popular

National rules
68% ➔

Time Trend



100% = all evaluated transactions



Specific Issues

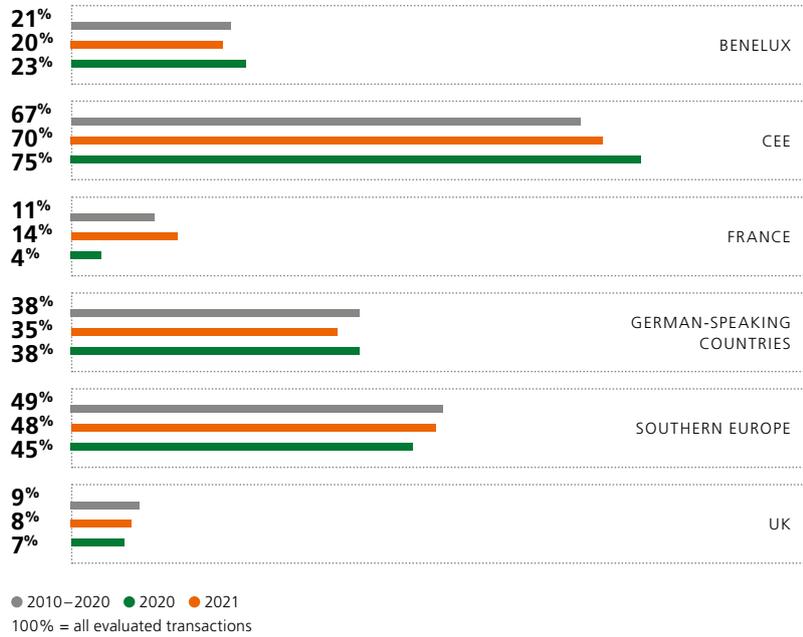
Regional Differences

In 2021, arbitration clauses remained relatively uncommon in the UK (7%, 2020: 8%, 2010 to 2020: 9%) and were hardly used in France (4%).

In comparison to 2020, arbitration is again slightly more popular in Benelux, featuring on 23% of deals in 2021 (20% in 2020). We saw an opposing development in Southern European countries, where an arbitration clause was included in 45% of deals in 2021 in contrast to 48% in 2020.

On the other hand, arbitration has remained a popular dispute resolution mechanism in CEE, where three-quarters of deals had an arbitration clause (compared with 70% in 2020) and German-speaking countries (38% in 2021 compared with 35% in 2020).

Time Trend Europe



Arbitration still most commonly used in CEE

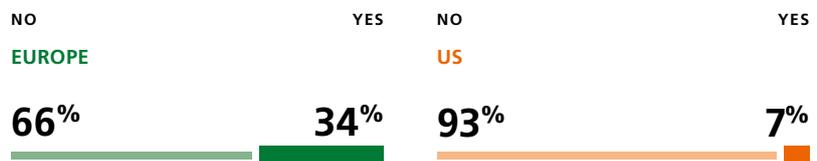
75%

Arbitration uncommon in France and in the UK

European/US Differences

Compared to the US (7%), the use of arbitration is much more popular in Europe (34%)

Arbitration Clauses Europe/US



100% = all evaluated transactions

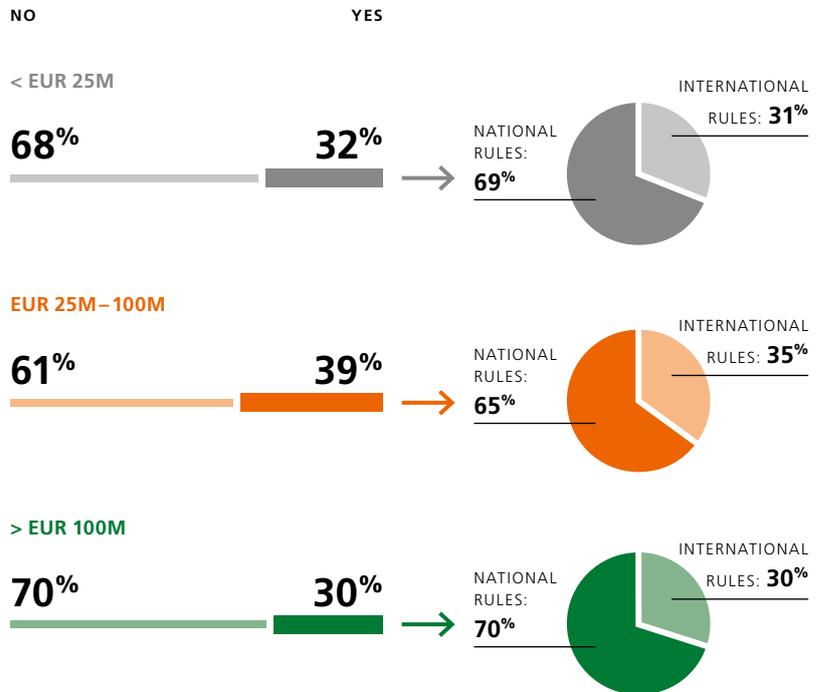
Analysis by Deal Size

In contrast to previous years of the Study, the transaction value was not a determining factor for the use of arbitration as the dispute resolution mechanism. In 2021, 32% of the small deals and 30% of the large deals contained an arbitration clause, whereas 39% of the medium sized deals (EUR 25m to EUR 100m) used an arbitration clause.

The application of national rules is frequently chosen for all deal sizes (70% of EUR 100m plus deals; 65% of deals with a value between EUR 25m and EUR 100m and 69% of deals below EUR 25m).

National rules are chosen in almost three-quarters of large deals with an arbitration clause

Use of Arbitration By Purchase Price 2021



100% = all evaluated transactions with an arbitration clause



Tax

The rationale behind a tax indemnification provision is that the buyer wants to be held harmless for pre-completion tax risks. Tax covenants 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.

General Overview

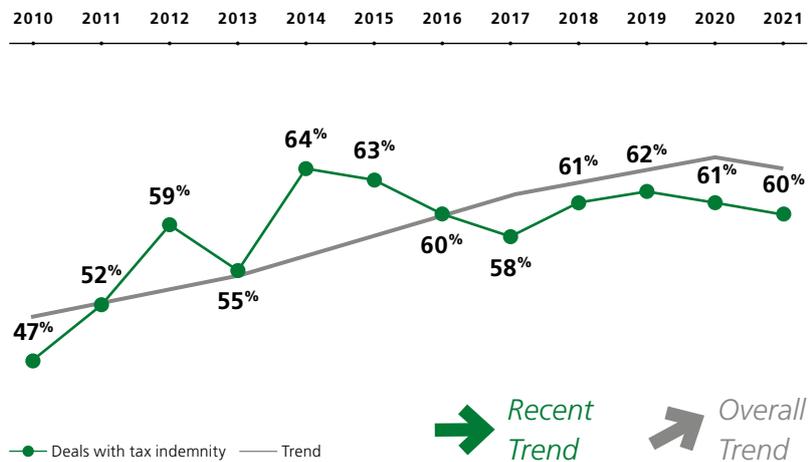
Tax indemnities were agreed in 60% of the deals in 2021. This seems to reflect a levelling off in the application of such indemnifications over the past years and reflects a slight decrease from the high of 64% in 2014. However, this is nearly in line compared with the 11-year average (2010 to 2020: 59%).

Tax indemnity 2021

60% →

CMS Trend Index

Tax indemnity agreed



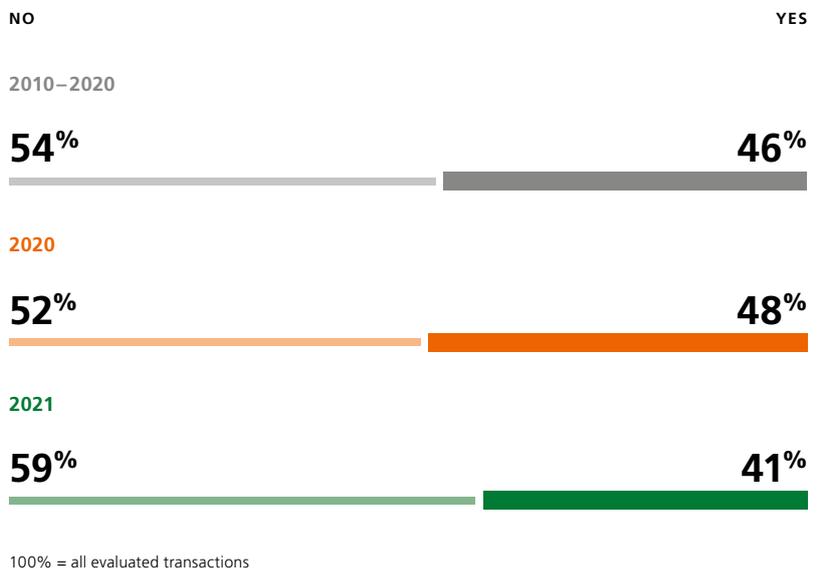
In 2021, only 41% of deals contained a clause granting the seller the right to participate in a future tax audit. This reflects a bigger decrease when compared with the previous year (2020: 48%) and seems to have set a new trend. Participation rights lost popularity over the years and 2021 marks a new low level, even when compared with the 11-year average (2010 to 2020: 46%).

Sellers less often able to negotiate a participation right in future tax audits

Seller's participation right

41% ↘

Participation Right in Future Tax Audit

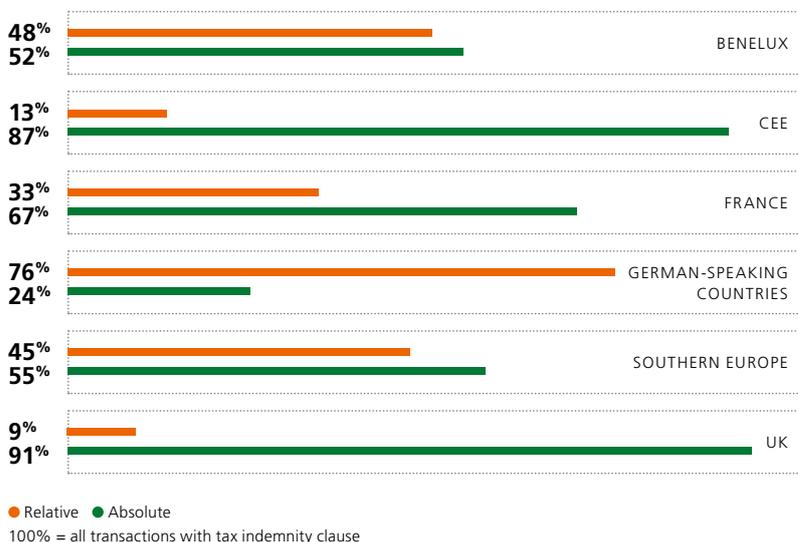


Specific Issues

Regional Differences

The strong regional differences in the use of absolute and relative limitation periods remain. While relative limitation periods continue to prevail in German-speaking countries (2021: 76%, 2020: 73%), the opposite trend has been detected in the UK, France and CEE in recent years. Absolute limitation periods are still the norm in the UK (2021: 91%, 2020: 88%) and France (2021: 67%, 2020: 71%) and again the norm in CEE (2021: 87%, 2020: 67%, 2019: 59%, 2018: 91%). The use of either absolute or relative limitation periods tends to be almost universal within most regions, except in Benelux (2021: 52% absolute, 48% relative limitation periods), and Southern European countries (2021: 55% absolute, 45% relative).

Absolute and Relative Limitation Period 2021



Type of Limitation Period

Parties who agree on an absolute limitation period tend to choose a period of more than five years after closing (2021: 46%, 2020: 41%). If the parties agree on a relative limitation period for tax indemnification, the vast majority choose a period of up to 12 months after the decision of the tax authority (2021: 32%, 2020: 40%).

Duration of Limitation Period



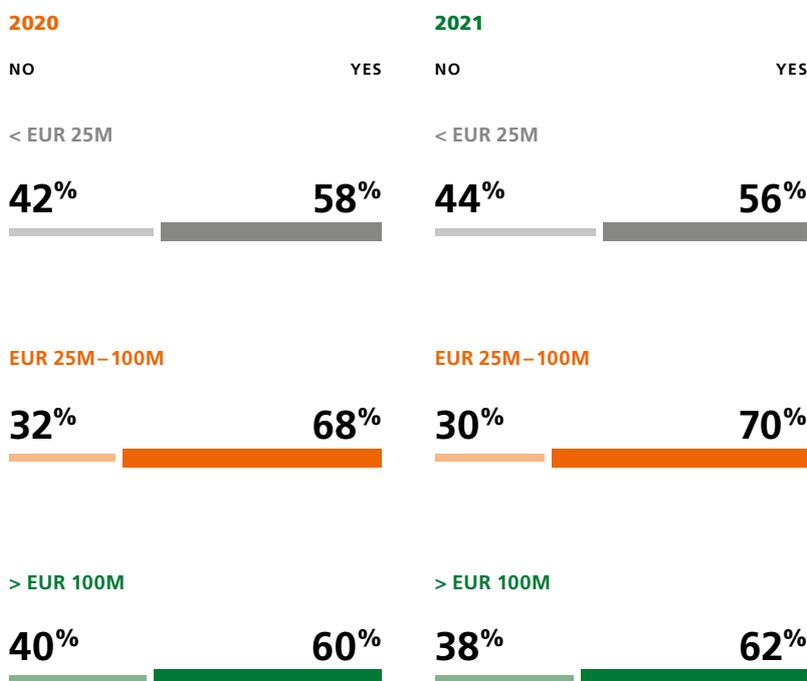
Analysis by Deal Size

In 2021, the parties agreed on a tax indemnity in more deals than on a participation right in a future tax audit. As in the previous years, tax indemnities were mainly agreed in medium sized deals (2021: 70%, 2019: 68%). In large deals (EUR 100m plus), tax indemnities were agreed slightly more often in 2021 (62%) when compared with 2020 (60%).

Our deal size analysis demonstrates that in large deals sellers in one third of all deals preserved a participation right in proceedings started by a tax authority, which is a vast decrease compared to previous years (2021: 38%, 2020: 55%, 2019: 51%). In contrast, we noted that the use of participation rights for medium sized deals (between EUR 25m and EUR 100m) remained stable (2021: 43%, 2020: 44%). In 2021, the seller's right to participate in proceedings was agreed on in 42% of small deals (below EUR 25m).

Tax Indemnity Agreed

By purchase price



100% = all evaluated transactions

Tax indemnity

70% of deals
EUR 25m–100m



62% of deals
> EUR 100m



Tax indemnities still more common in medium sized transactions

Global reach, local knowledge



Our latest CMS Corporate / M&A headline deals

Ametek

CMS advised Ametek, a NYSE listed and leading global manufacturer of electronic instruments and electro-mechanical devices, on its USD 230m acquisition of Magnetrol.

Biogroup

CMS advised Biogroup on the acquisition of a majority stake in Cerba and Analiza laboratories.

BluJay Solutions

CMS advised E2open Parent Holdings on its USD 1.7bn acquisition of BluJay Solutions.

Daimler Truck

CMS advised Daimler Truck on its joint venture with Traton and Volvo to create and operate a high-performance European public charging network for long-haul electric trucks and coaches with an initial investment of EUR 500m – the largest in heavy truck charging infrastructure in Europe to date.

FC AC Pisa 1909

CMS advised New York-based corporate-financier Alex Knaster on the acquisition of a 75% stake in A.C. Calcio Pisa 1909 S.r.l., the owner of Tuscan-based football club AC Pisa 1909.

Banco Sabadell

CMS advised Banco Sabadell on its EUR 1bn agreement with IBM to transform its infrastructure and delve further into digitalisation and the use of big data.

Blue Prism Group

CMS advised Blue Prism Group on the recommended offer made by funds managed by US private equity firm Vista Equity Partners.

Bugatti Rimac Joint Venture

CMS advised Volkswagen and Porsche on its Bugatti Rimac Joint Venture.

Eaton Corporation plc

CMS advised Eaton Corporation plc on the EMEA aspects across 22 jurisdictions of the divestiture of its USD 3bn Global Hydraulics Business to Danfoss A/S.

Geneva International Motor Show

CMS advised Geneva International Motor Show on the creation of a new Qatar Geneva International Motor Show in partnership with Qatar Tourism.

Hitecvision

CMS advised Norwegian private equity fund Hitecvision in a USD 1.35bn deal to acquire the majority of Exxon's (Esso) UK offshore business, one of the largest UK oil and gas transactions in 2021.

Macquarie Capital

CMS advised Macquarie Capital, as the main investor, on the acquisition of a majority stake in the fibre optic network owned by MásMóvil.

Rohlik Group

CMS advised a group of investors, led by Partech and including EBRD, Quadrille Capital and J&T Bank, on a EUR 190m fundraising for Rohlik Group (Rohlik), one of Europe's leading online grocery businesses.

SSE plc

CMS advised SEE plc on its disposal of 33.3% of Scotia Gas Networks Limited for GBP 1.225bn to a consortium comprising existing SGN shareholder Ontario Teachers' Pension Plan Board and Brookfield Super-Core Infrastructure Partners.

Turn / River Capital

CMS advised growth equity firm Turn/River Capital on its EUR 315m strategic investment in Redwood Software, a leading provider of cloud-based business and IT process automation solutions.

Worldline

CMS advised Worldline on its asset divestments in Austria, Belgium and Luxembourg.

InPost

CMS advised InPost and its majority shareholder private equity fund Advent International on InPost's listing on the Euronext Amsterdam Stock Exchange.

Punch Pubs

CMS advised Punch Pubs' management team on the GBP 900m acquisition of the company, which operates over 1,300 pubs across the UK.

SK Capital Partners

CMS advised SK Capital Partners, in partnership with Heubach Group, on the acquisition of Clariant's Pigments Business. The transaction values Clariant Pigments at just over USD 1bn.

Stadtwerke München

CMS advised Stadtwerke München and Bayerngas on the sale of Norwegian and UK gas and oil fields by Spirit Energy to Norway's Sval and Equinor.

West Ham United FC

CMS advised a Czech investment group owned by businessmen Daniel Křetínský and Patrik Tkáč on the acquisition of a significant minority stake in London premier league football club West Ham United.

WOW TECH GROUP

CMS advised WOW TECH GROUP on its >EUR 1bn business combination with Lovehoney Group.

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 provided they 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, Russia, Slovakia, Slovenia, 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. The Norway deals are covered in the overall numbers.

Transactions included in the Study cover the following sectors:

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

Some comparative data from the US was derived from the "2020 and Q1 2021 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. Due to rounding, some totals may not correspond with the sum of the separate figures.

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