

press release

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2011 study highlights return to more seller-friendly market

European legal and tax services provider CMS has launched the *CMS European M&A Study 2011*, which analyses exclusive data compiled from more than 1,000 of its own M&A deals since 2007, including some 300 deals in 2010 alone. The Study shows a clear shift back toward sellers, following last year's significant swing toward buyers.

"During 2010, we saw a definite increase in the overall pace of M&A transactions, which is continuing into early 2011," said Thomas Meyding, Head of the CMS Corporate Group. "The shift of contractual risks back to buyers is unlikely to reach the levels of 2007, before the financial crisis, but there are certainly swings back to a sellers' market, as more investors are keen to do business."

The Study reports on key trends from 2010, including purchase price adjustments, locked box mechanisms, earn-outs, *de minimis* and basket provisions, liability caps and limitation periods. The Study also tracks trends over

the four-year period 2007-2010. Some of the key findings include:

- A more marked reduction in purchase price adjustments, down a further 13% points in 2010 from 2009, and a much greater use in Continental Europe of locked box mechanisms, which depend on thorough financial due diligence by the buyer and a stable working capital position;
- Earn-out periods became shorter, as demonstrated by 65% of such earn-outs being payable within 24 months compared with just 51% in 2009, indicating that sellers are banking on a quicker return;
- A 7% increase in 2010 from 2009 on deals featuring a repetition of all warranties on closing;
- A slight decrease in the number of deals with *de minimis* provisions; more deals had basket threshold provisions and still more deals featured recovery on an 'excess only' basis, indicating perhaps a gradual movement towards US deal norms;
- The percentage of transactions where the liability cap exceeded 50% of the purchase price has declined when measured against the peak of the last two quarters of 2009;
- The proportion of deals with general warranty limitation periods exceeding 24 months has generally flatlined at around 27% since its peak in the second quarter of 2009, and declined notably in the last quarter of 2010;
- A decline in the use of arbitration as the dispute resolution mechanism with just 32% of 2010 deals featuring an arbitration clause as against 40% in 2009.

While these observations seem to signal an overall trend toward seller-friendly provisions in Europe generally, there are significant regional differences highlighted by the Study.

- "In the UK, sellers were more successful at off-loading risk and limiting their liability during 2010 than they were in 2009," said Martin

Mendelssohn, a CMS corporate partner in London, "We expect to see more aggressive liability caps and shorter limitation periods during 2011. There continues to be a significant focus on working capital adjustments in UK deals and, in this regard among others, the UK has more in common with US deal practice than with the rest of Europe. The return of financial players to M&A activity quickened the pace of deals in 2010 and made the market more competitive. We expect this trend to continue through 2011 and to pave the way for more seller-friendly M&A deal making."

- In German-speaking countries, there was a notable increase of liability caps and decrease in liability caps of more than 50% of the purchase price, which is a return to the average of the three-year period between 2007-2009. Escrow accounts were more frequently used as a security for warranty claims and cartel clearances were the most likely pre-condition to closing.
- In France, 2010 M&A activity witnessed two periods: the first semester was a "wait & see" mode followed by a much more proactive second semester. French M&A shows outstanding particularities that distinguish France from the other European regions: (i) one third of the deals used earn-outs, more than any other region; (ii) every recorded deal had a liability cap, with French deals having the highest proportion of low liability caps (almost 50% had a liability limitation of up to 25% of the purchase price); (iii) France provides for the highest number of deals subject to buyer's financing condition.
- In southern Europe, the number of earn-out deals decreased considerably. Deals were the least likely within Europe to have a de minimis and basket provisions, and escrow accounts remained rare as a mechanism for securing warranty claims.

- In Benelux, general warranty limitation periods became lengthier with 50% of deals having a general warranty limitation period exceeding 24 months. Buyer financing conditions were extremely rare (only 4%) and material adverse change (MAC) clauses, clauses offering a back door way of exiting a deal should something go wrong pre-closing, decreased significantly.
- In central and eastern Europe (CEE), earn-out deals were rare (only 8%) and non-compete clauses are much rarer when compared to elsewhere in Europe. Arbitration is also the main dispute resolution process – 76% compared with the European norm of 33% in 2010.

The Study also highlights significant cultural and regulatory differences between Europe and the United States. Chiefly, the comparison shows material adverse change (MAC) clauses are used in 80% of deals in the US compared with just 16% of deals in Europe. Basket thresholds for warranty claims are much more prevalent in the US, and the basis of recovery differs ('excess only' being more popular in the US). Working capital adjustments continue to be by far the most frequently used criteria for purchase price adjustments in the US, and basket thresholds tend to be lower in the US with 89% being less than 1% of the purchase price compared with 49% in Europe.

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NOTES TO EDITORS

CMS aims to be the best European provider of legal and tax services. Clients benefit from the expertise of more than 770 partners and 2800 lawyers based in 53 offices in 28 jurisdictions. CMS firms posted a combined turnover of EUR 739m in 2010.

The CMS nine member firms are: *CMS Adonnino Ascoli & Cavasola Scamoni (Italy); CMS Albiñana & Suárez de Lezo (Spain); CMS Bureau Francis Lefebvre (France); CMS Cameron McKenna LLP (UK); CMS DeBacker (Belgium); CMS Derks Star Busmann (Netherlands); CMS von Erlach Henrici Ltd. (Switzerland); CMS Hasche Sigle (Germany); and CMS Reich-Rohrwig Hainz (Austria).*

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