4th European M&A Study demonstrates that 2011 was a seller's year

In a review of 1,350 deals done between 2007-2011, CMS' fourth annual M&A Study shows that, in terms of risk allocation between seller and buyer, 2011 was definitely a seller's year.

Thomas Meyding, Head of CMS Corporate Group, comments, "The good news for sellers is that the trend is moving in their direction. The fact that there are a few more buyers looking to do deals, particularly private equity houses with funds to invest, means that sellers were able to be more robust in their negotiations.

"For example, our deal analysis shows that there has been a steady reinstatement of pre-2008 standards with certain seller-friendly provisions such as lower liability caps, shorter warranty limitation periods and reasonably generous de minimis and basket provisions. In addition, the greater spread of locked box deals and growing acceptance of warranty and indemnity insurance provide more protection against downside risk than was the case even pre-2008."

However, sellers did not have it all their own way and a number of buyer-friendly trends are also noticeable. Meyding continues, "2011 also saw a significant rise in securing non-compete covenants from sellers and a greater concern about obtaining security from the seller against warranty claims. However, buyers are definitely looking more to price their risk and concentrate on thorough due diligence rather than drive hard bargains on deal issues such as seller liability limitations."

Other findings of the CMS European M&A Study 2012 are:

- Compared to the US, there remains little appetite overall for earn-out deals in Europe (only 14% in 2011) apart from deals in the TMT sector. Earn-out clauses quite often give rise to difficult negotiations and subsequent disputes. In Europe we more often see purchase price gaps being bridged by vendor loans or option arrangements.

- It is good news for sellers that general liability caps are lower than in previous years, with the majority of deals now having a liability cap of less than half the purchase price. It is interesting to note that caps in the US tend to be much lower. Buyers are more willing to agree a lower cap because their risk appetite has increased and they are undertaking more thorough due diligence prior to signing.

- There is a growing recognition of warranty and indemnity insurance as the solution for the warranty gap where the seller refuses to give warranties – for example in the case of financial sellers. Warranty indemnity insurance is often used to compensate for a lack of adequate warranty protection under the Sale & Purchase Agreement (SPA).

- Buyers were more cautious in 2011, with a higher proportion (42% compared with 37% in 2010) obtaining some form of security – whether it be the use of an escrow account, retention or bank guarantee. This is strong illustration of the fact that in mergers & acquisitions, “cash is king”.

- Sellers were still able to resist material adverse change (MAC) clauses. Only 16% of deals in Europe contained one – a significant contrast to the US where the overwhelming majority (93%) of deals have MAC clauses. One possible explanation of this difference is that the fact that many European jurisdictions already provide the right to request an adjustment of the SPA or to walk away.