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M&A Trend Analysis

Fourth Edition

2024

Foreword

We are delighted to publish the fourth edition of our M&A trend analysis.

This publication analyses data from a broad sample of M&A transactions on which Fladgate advised during 2022 and 2023.

Our analysis, which spans 22 data points, highlights how some deal terms have remained consistent, whereas other terms have evolved over the last couple of years.

As well as analysing those data points, we have included a series of forward-looking articles on a range of M&A related trends and themes.

This publication will be of interest to anyone engaged in or considering M&A activity, including funds, HNWs, entrepreneurs and corporates, as well as intermediaries including corporate finance advisers and reporting accountants.

If you would like to discuss this publication further, please do get in touch with us or your usual Fladgate contact.

David Robinson
Head of Corporate
drobinson@fladgate.com
+44 (0)7729 032028

Anthony Shatz
Partner, Corporate
ashatz@fladgate.com
+44 (0)7855 516365

Fladgate is top ranked in the legal directories for M&A deals up to £100 million.

01 Sectors

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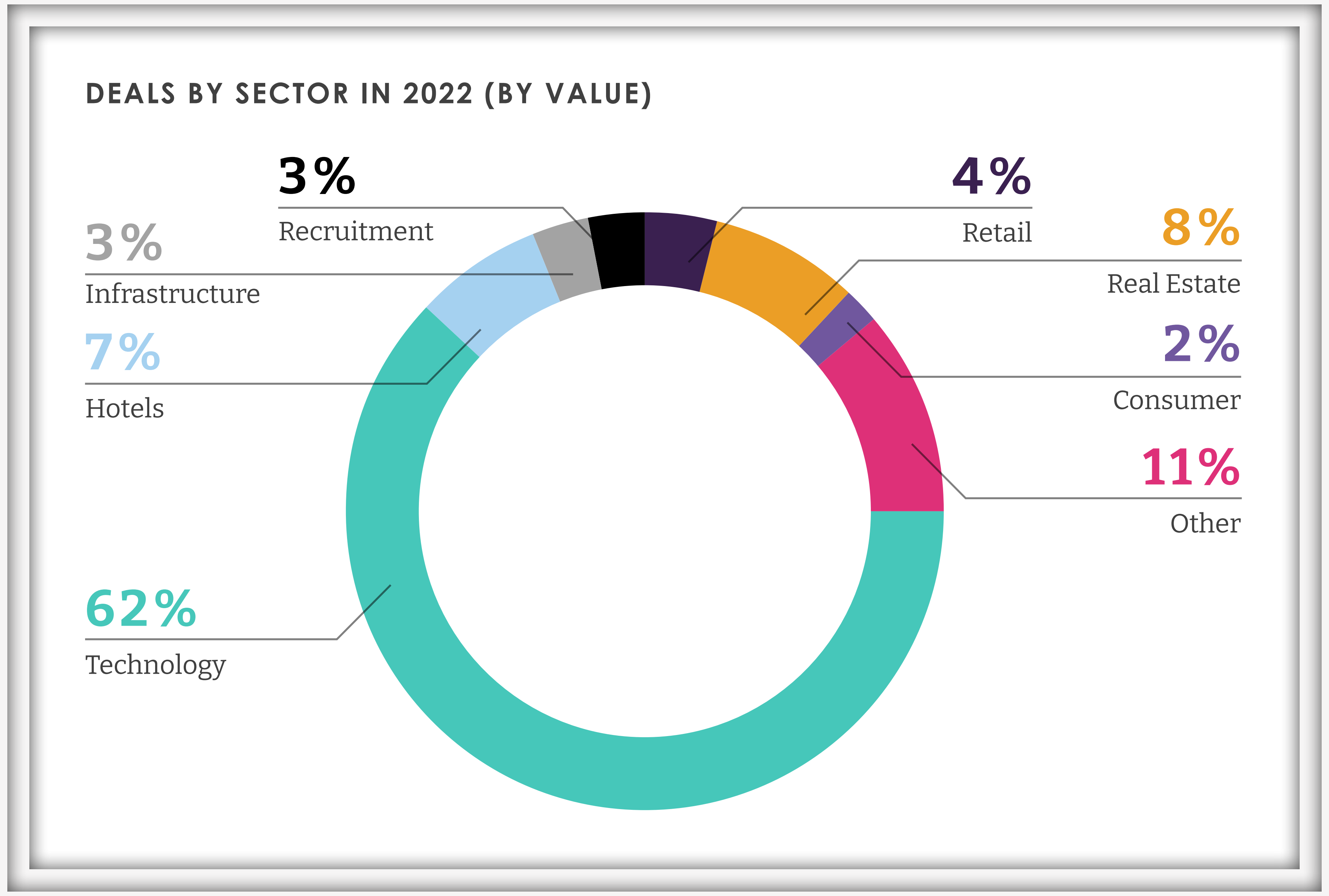
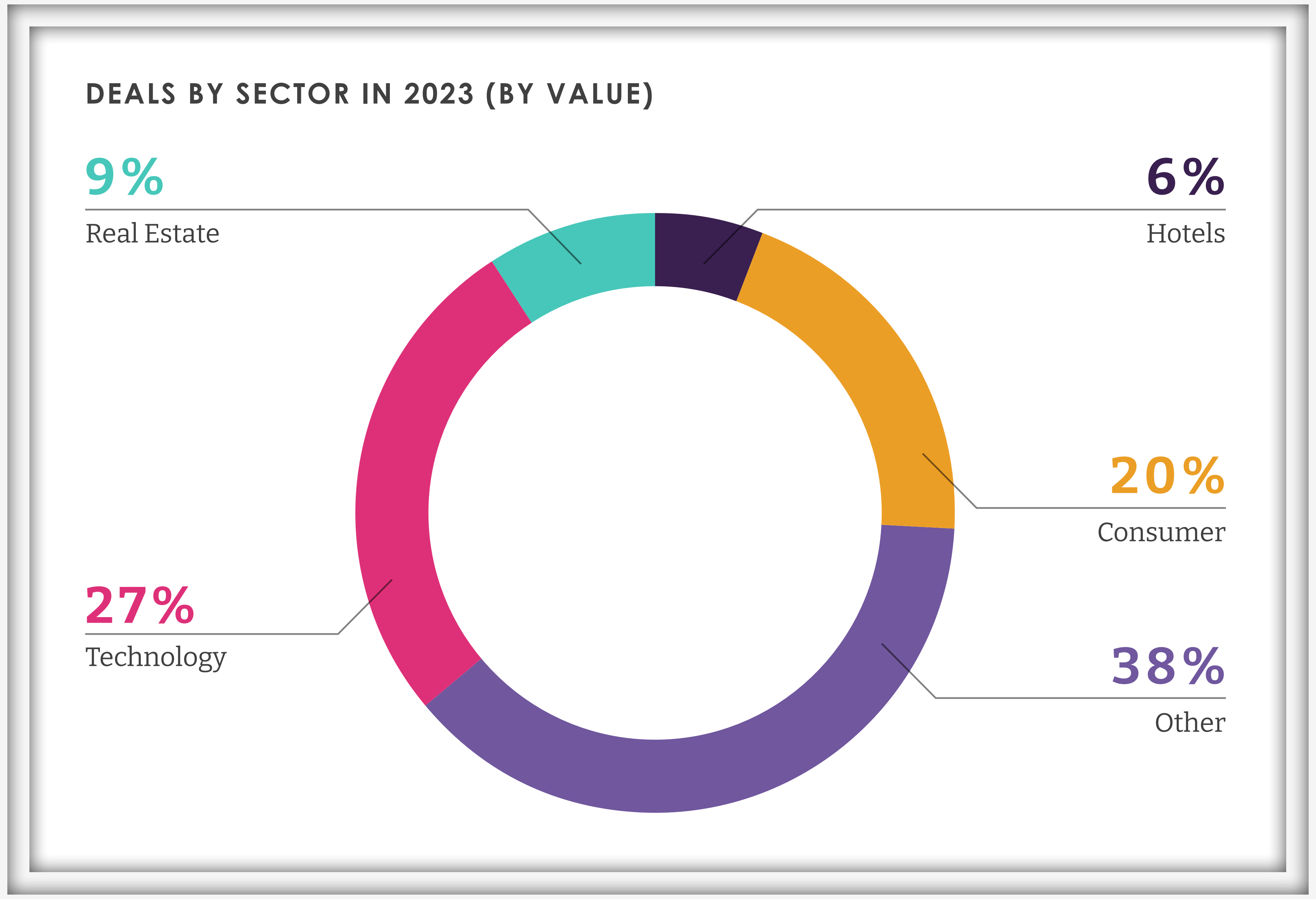
The deals analysed for this publication broke down into the following sectors.

The technology sector represented the majority of deals by value in 2022 (62%), and a significant proportion of deals by value in 2023 (27%).

Although the team has been advising on a broad range of deals across multiple sectors, technology deals have accounted for the largest proportion of deals by value in both years. This suggests that technology companies continue to attract high valuations relative to other sectors.





02 Buyside vs Sellside

In both 2022 and 2023, we acted for a similar percentage of sellers and buyers (by percentage of deals). This balanced practice gives us the ability to negotiate effectively on behalf of all our clients.

2022 (BY NUMBER OF DEALS)

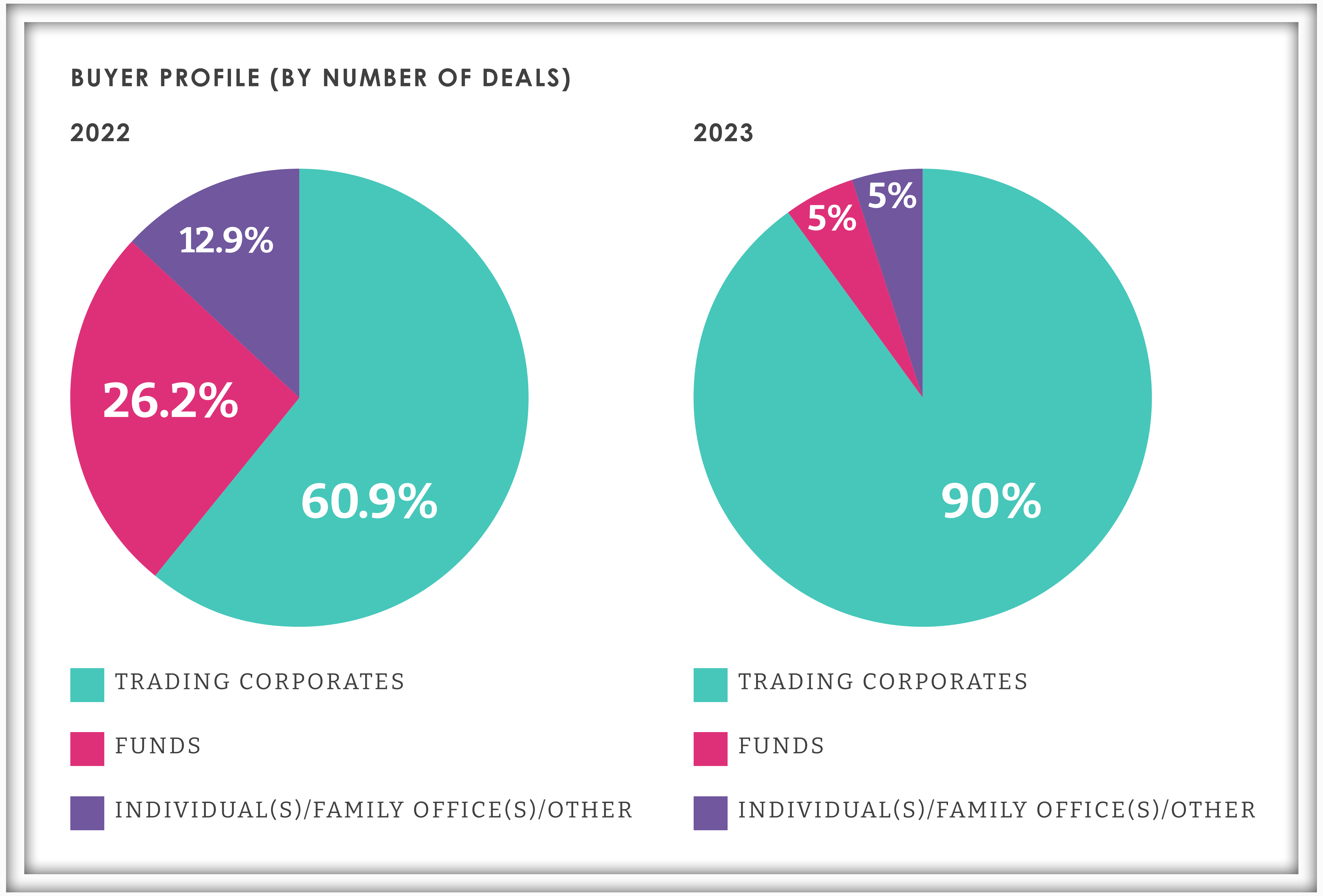
Sell side	Buy side
52.2%	47.8%

2023 (BY NUMBER OF DEALS)

Sell side	Buy side
50%	50%

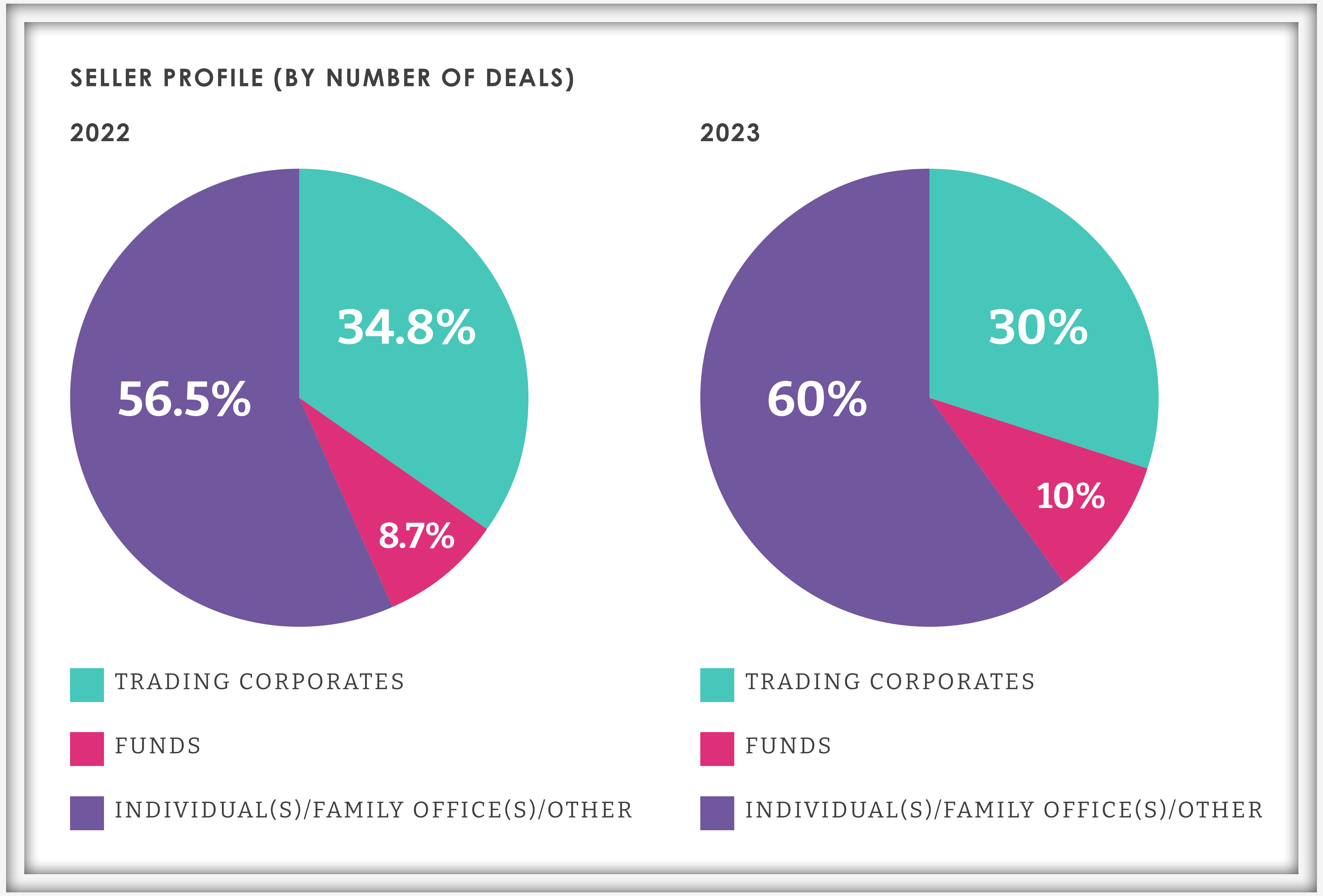
03 Buyer Profile

Trading corporates accounted for the majority of deals across both 2022 and 2023, in particular 2023. This might be attributable to funds and family offices transacting less in a high interest rate environment, relative to corporates undertaking strategic M&A.



04 Seller Profile

On the sell-side, individuals and family offices accounted for the majority of deals in both 2022 and 2023. This might be because those types of market participant were seeking to generate additional liquidity in the context of more challenging markets.



NSIA Two Years On

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The UK National Security and Investment Act (NSIA) is now a relevant consideration for any transaction involving a UK business, especially those in sensitive sectors.

Enacted to safeguard 'national security' interests, the NSIA introduces a robust regime for screening investments and acquisitions by foreign entities. Notably, it empowers the UK Government to scrutinize transactions in various sectors, such as defence, critical infrastructure, advanced technology and dual-use goods (among others), and to impose conditions on transactions, block deals altogether, or require parties to take specific actions to mitigate security concerns.

One of the key impacts of the NSIA on UK transactions is the requirement for mandatory notification for transactions within the 17 business sectors that have been identified as requiring Government oversight. This means that parties involved in transactions falling within the scope of the NSIA must notify the UK Government, allowing for it to carry out an assessment of any potential security implications. Failure to comply with notification requirements can lead to significant penalties.

Overall, the NSIA has had a material impact on many types of UK transactions (including over internal group reorganisations), reshaping the regulatory landscape to prioritize national security considerations. Compliance with the NSIA requirements has become a crucial aspect of conducting transactions involving UK businesses, influencing deal structures, timelines and outcomes, and becoming an important element of any transactional due diligence (alongside any other relevant regulatory issues or concerns).

That said, the proportion of transactions in which the UK Government has decided to take specific action to mitigate identified national security concerns remains very low (less than 2% of those notified to it).

Accordingly, it is very much a manageable risk area for those involved in transactions, provided the necessary steps are taken to identify any relevant impacts at the outset of the deal timetable.

Alex Haffner
Partner, Commercial, Competition & Regulatory
ahaffner@fladgate.com
+44 (0)7779 663731

05 Time to Closing

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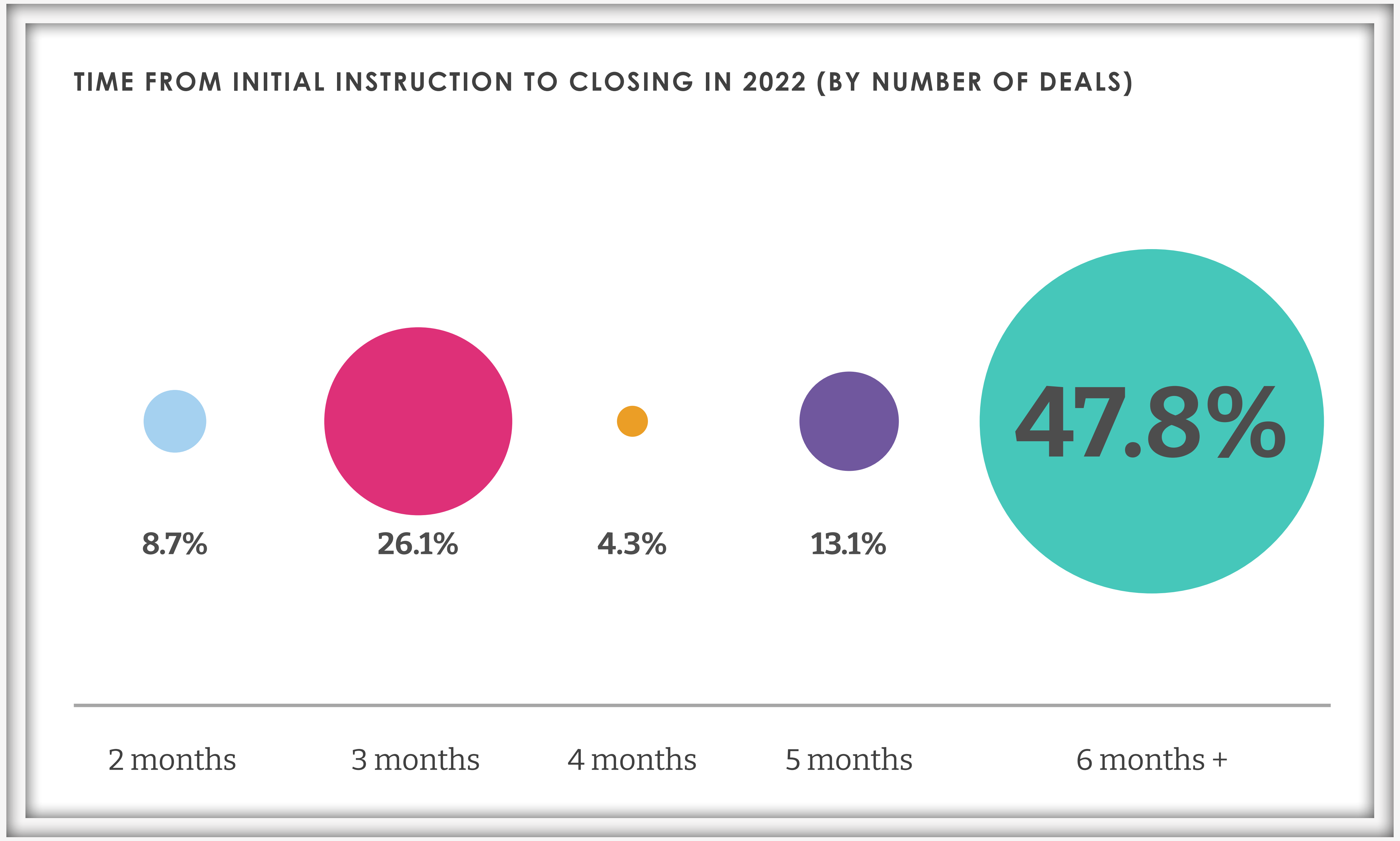
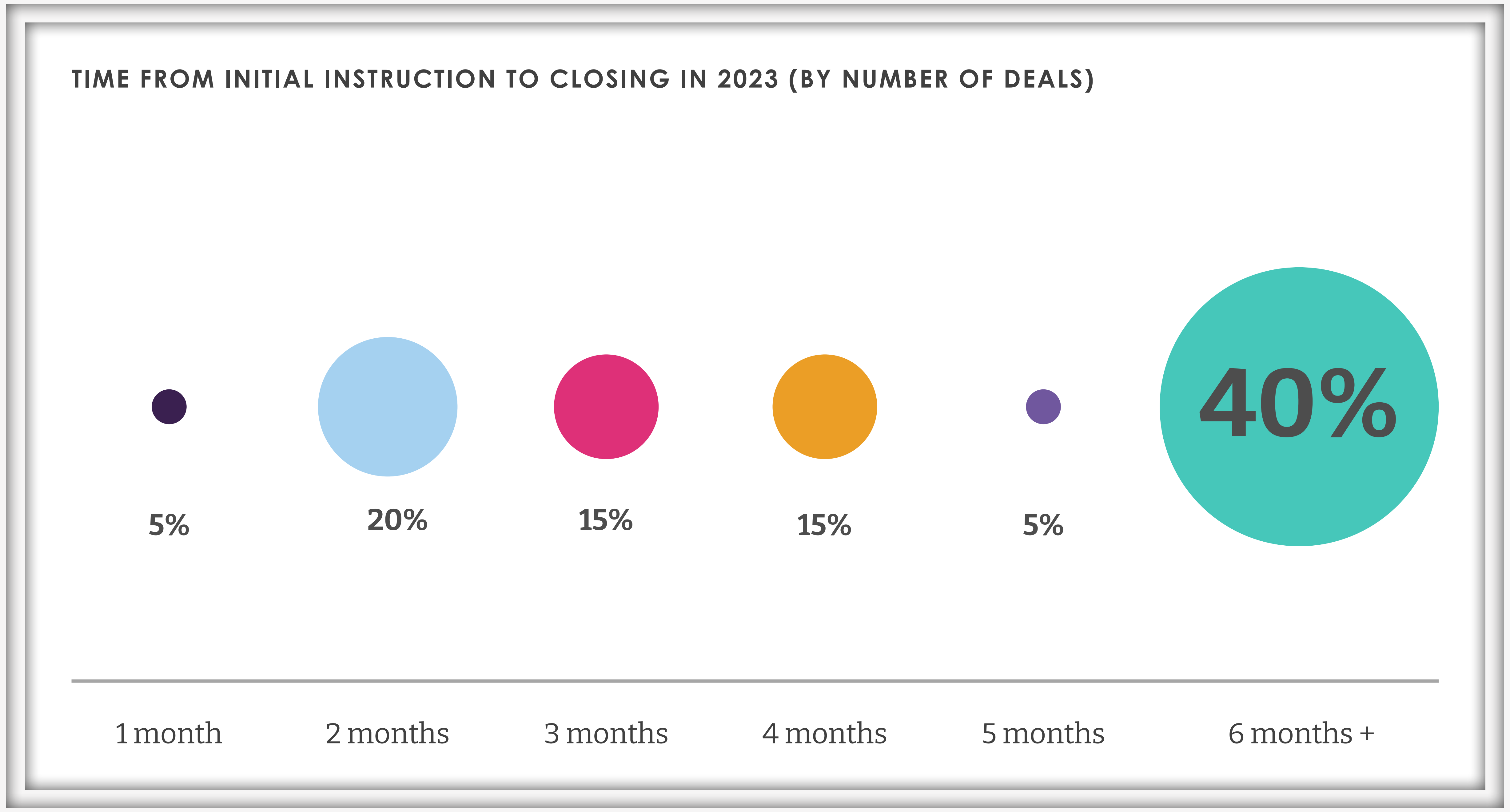
The percentage of transactions that took six months or more to close held relatively steady from 47.8% in 2022 to 40% in 2023. This evidences a year on year trend of deals taking longer to close, which we have identified in prior M&A trackers. This could be because deal terms are becoming more complex, gaps in pricing expectations having to be bridged by deferred consideration or earnouts, financing becoming less available and/or more deals being subject to closing conditions.





06 Share vs Asset Transactions

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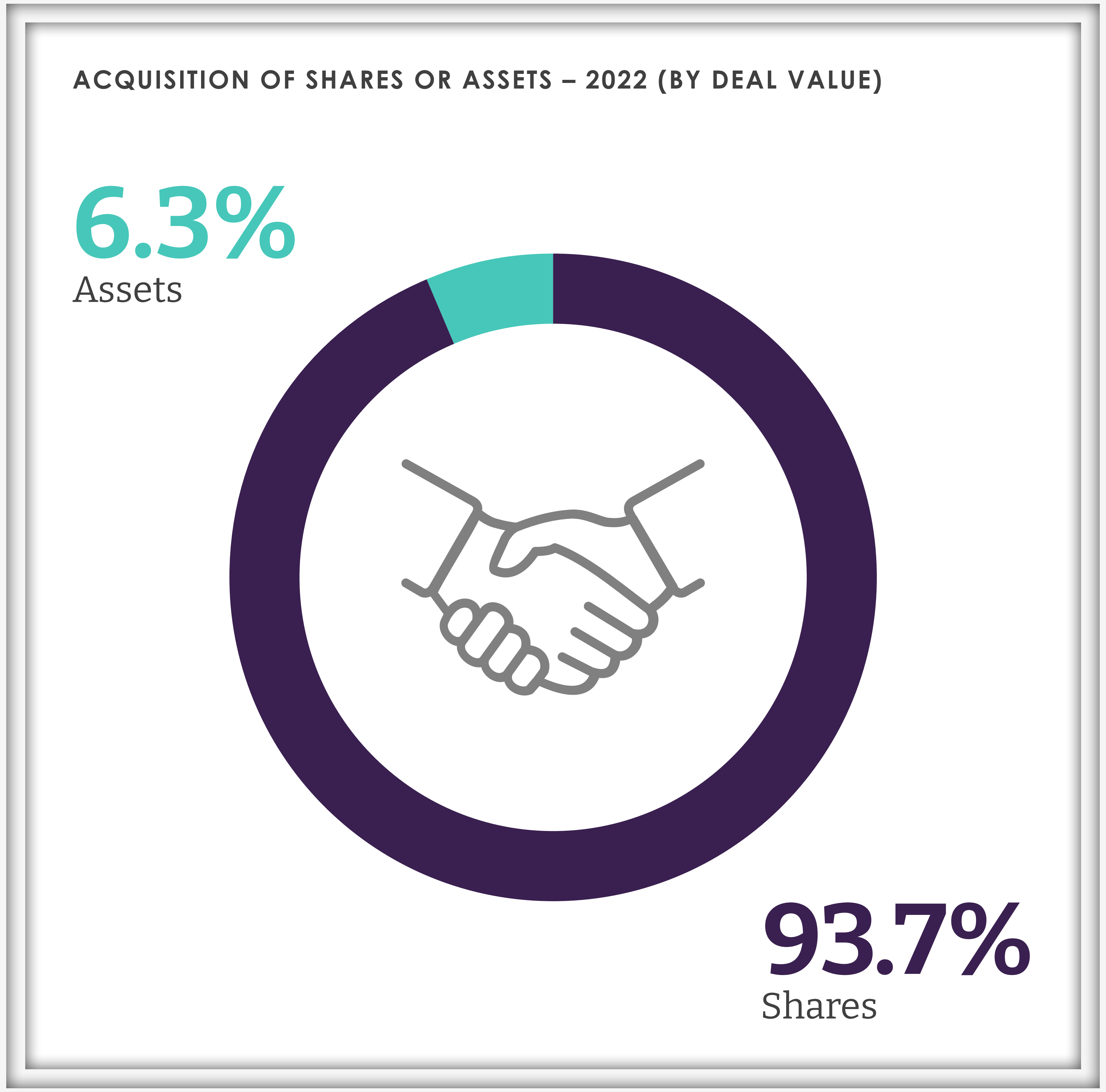
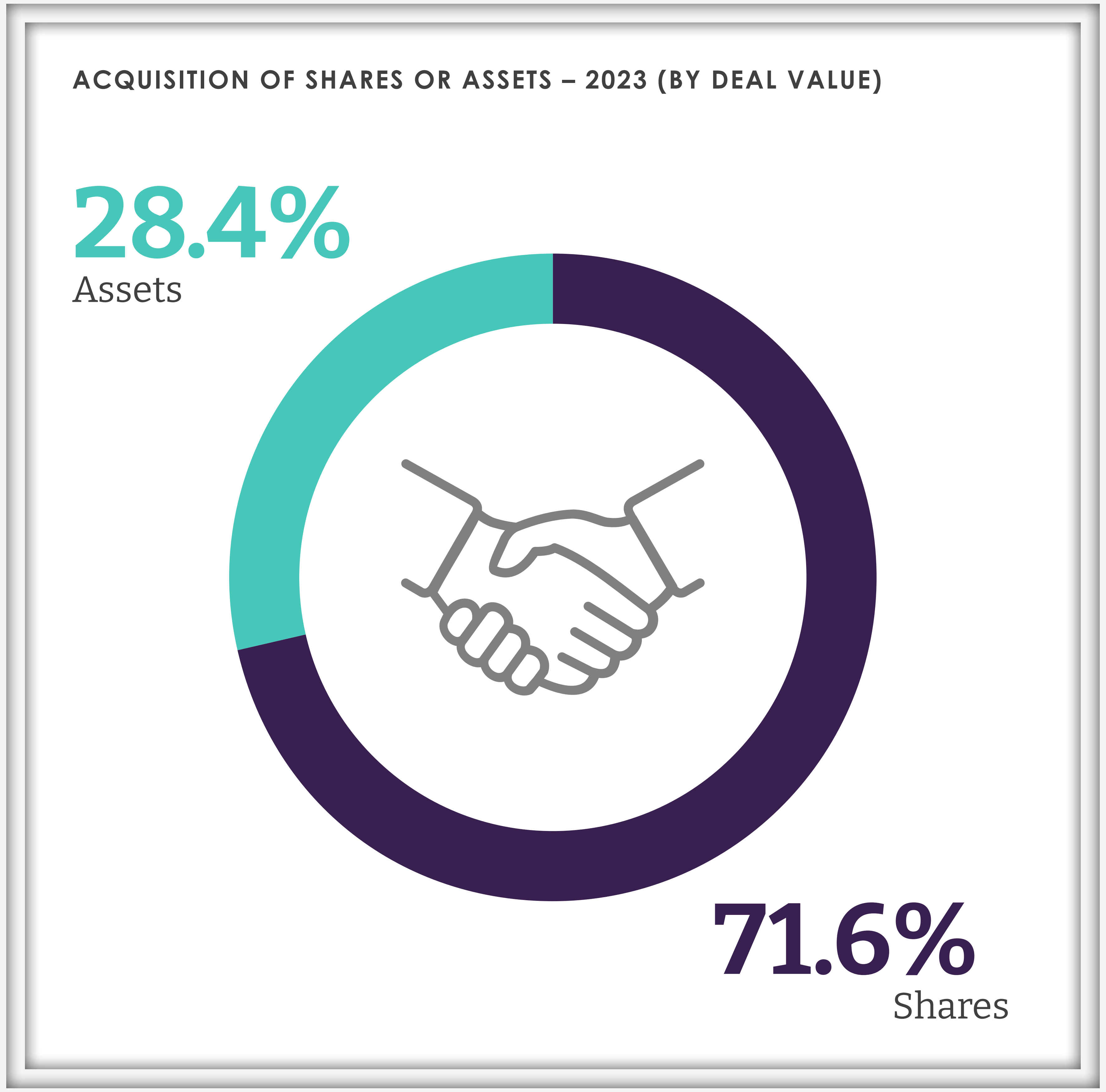
By value, the percentage of transactions structured as an acquisition of assets as opposed to an acquisition of shares increased from 6.3% in 2022 to 28.4% in 2023.

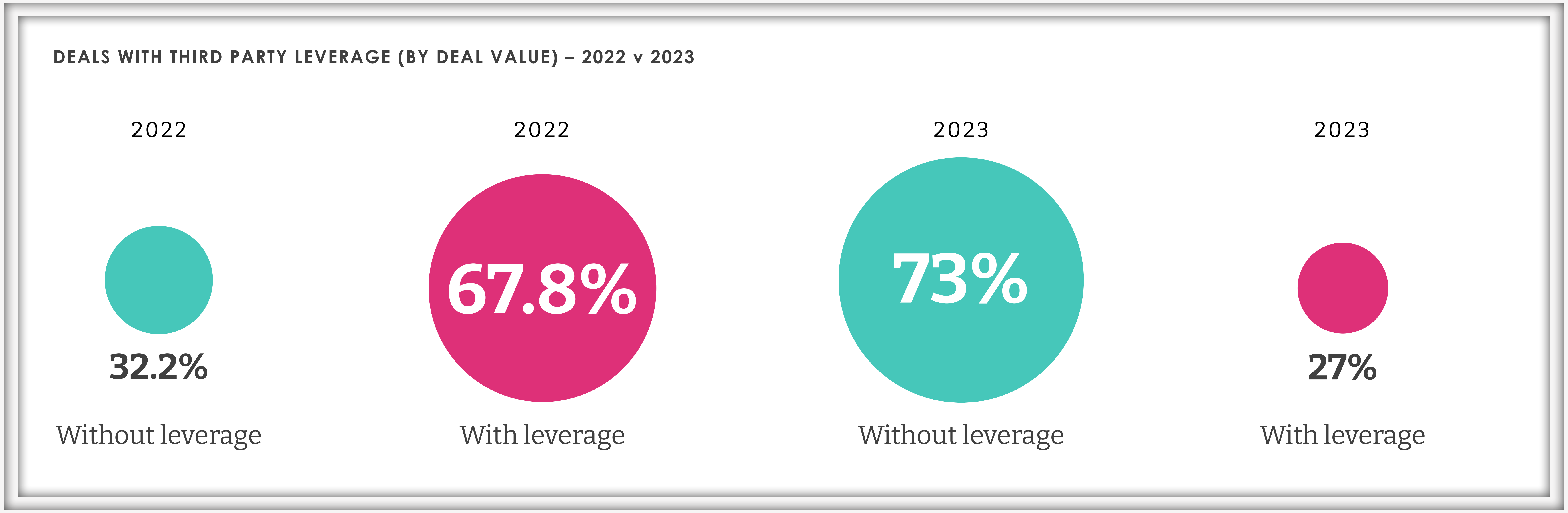
This increase might be attributed to buyers wanting to structure transactions so as to exclude certain target liabilities, or for other deal-specific or tax structuring reasons.





07 Use of Leverage

In 2022, 67.8% of deals by value used third party leverage. By 2023, this had fallen to 27%. This is evidence of debt financing becoming harder to utilise effectively in an M&A context, given the higher interest rate environment that has taken hold over the last year or so.



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Trends in M&A Debt Financing

M&A activity and related debt issuances were down markedly year on year in 2023 as high inflation, weaker asset valuations and rising interest rates throughout global markets rendered the cost of borrowing and capital more unattractive. However, there is cautious optimism that activity will increase in 2024 as rates first stabilise and then start to fall, and the pent-up demand both for newly raised funds to deploy "dry powder" investor capital and for older funds to exit their private equity portfolios will probably drive PE sponsors back to the negotiating table.

As traditional bank financing has been less attractive during this period of rising interest rates, private credit has increasingly stepped in to fund leveraged buyouts as its offering of c.10% yield on senior secured positions suddenly doesn't look so expensive. Leveraged loan origination desks at the large investment banks have noticed the success of private credit and may look to replicate the private credit model through enhancing their own private credit capabilities.

Against this backdrop, "covenant-lite" facilities, which had become an increasingly prominent tool in leveraged financings, are being used by some lenders to try to incentivise borrowers and sponsors to take on leveraged debt, despite the current higher borrowing costs, and given the increased flexibility they provide for portfolio companies. However, more conservative lenders are conversely moving away from these sorts of facilities as they look to increase underwriting standards given the more difficult macro-economic environment.

2024 will see a number of significant elections around the globe, including in both the UK and the US. These elections could act as a hindrance to a swifter rebound in M&A activity, as PE firms will want to understand implications for the political, legal and regulatory framework that the results of those elections will have on transactional markets.

Ed Fuller
Partner, Debt Finance
efuller@fladgate.com
+44 (0)7980 738549

08 Geographic Location of Buyers

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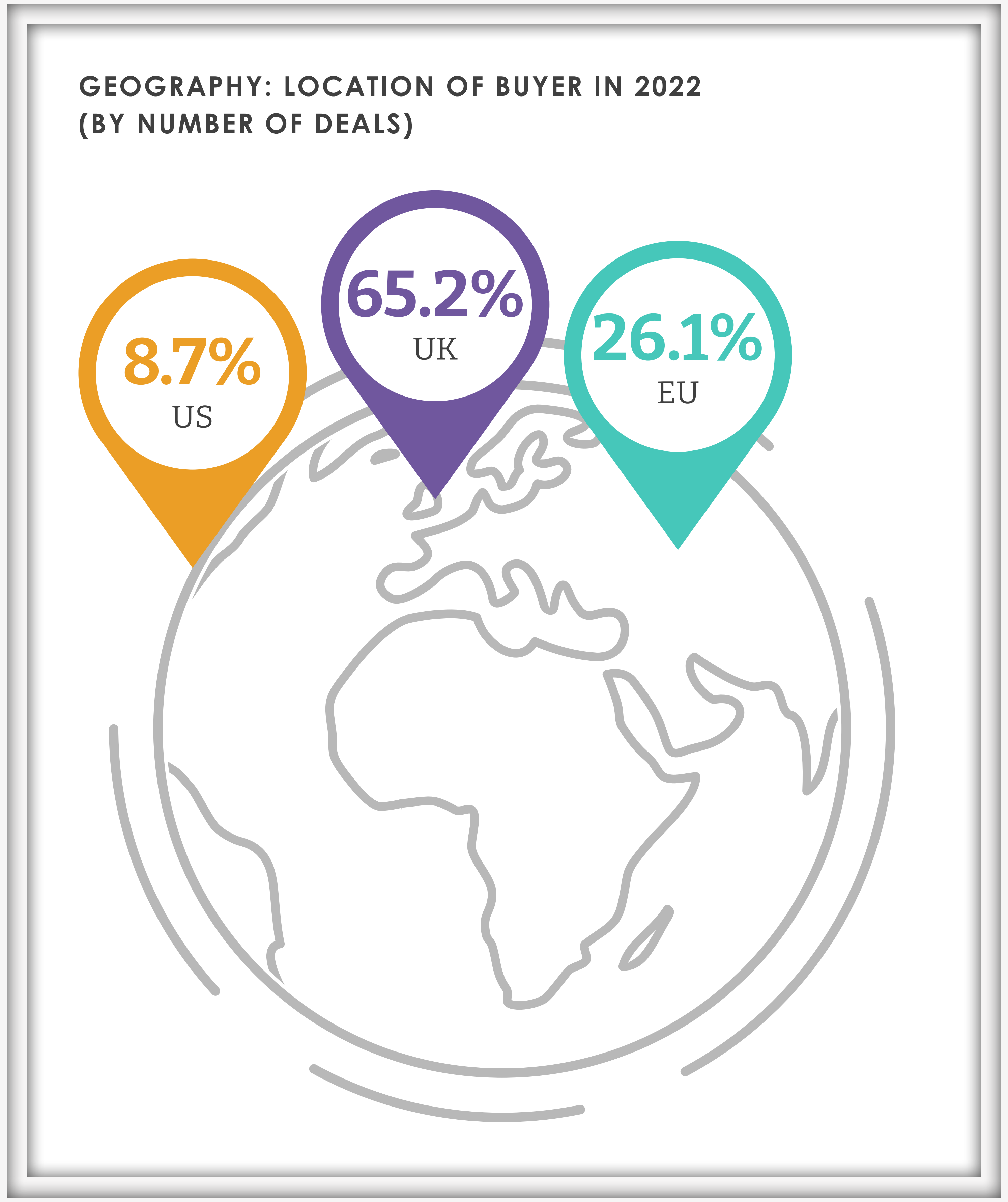
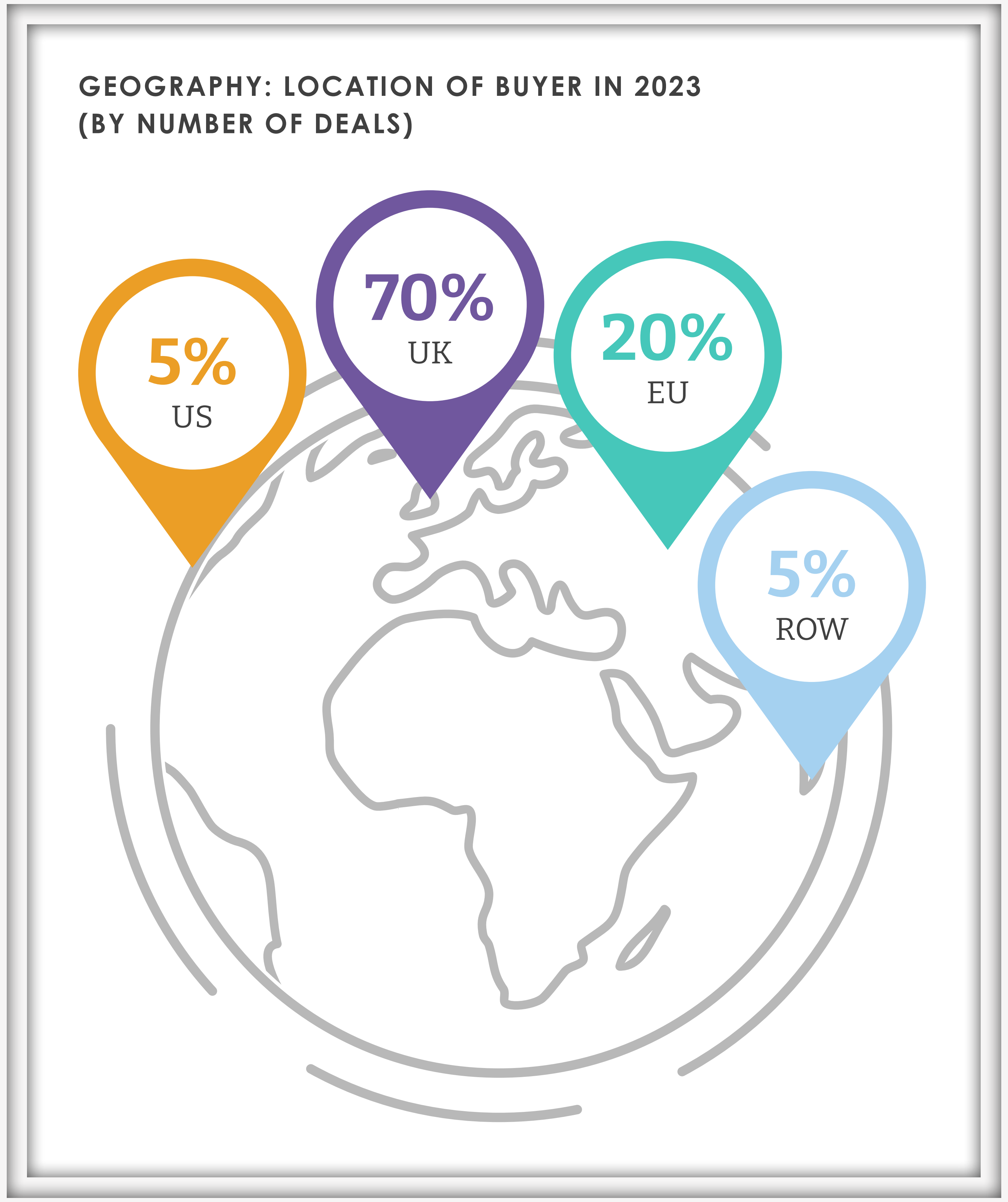
By number of deals, the UK accounted for the majority of buyers across both 2022 and 2023. However, when analysed in terms of deal value, US buyers accounted for 61.8% of deals value, US buyers accounted for 61.8% of deals in 2022 and 26.5% of deals in 2023. Although this proportion reduced from 2022 to 2023, it demonstrates how US-domiciled buyers continue to feature significantly in the UK M&A market, which we believe in part is due to how the US economy has substantially out-performed the UK and European economies for at least the last few years.





09 Consideration Structures

Over recent years, the market has been seeing an increase in the use of vendor loan notes and share consideration to bridge the gap between buyer and seller pricing expectations. Interestingly, these techniques were less prominent in 2023 deals relative to 2022, perhaps because sellers' pricing expectations have been falling, thereby narrowing the pricing expectation gap and therefore the need for such techniques to be deployed in transactions. However, please also see data points 11 and 12 in relation to earnouts and deferred consideration respectively, both of which have increased in that time period.

PERCENTAGE OF DEALS BY VALUE WHICH FEATURED LOAN NOTE CONSIDERATION

2022	2023
68.7%	19.1%

PERCENTAGE OF DEALS BY VALUE WHICH FEATURED SHARE CONSIDERATION

2022	2023
69.7%	23%

The Evolution of Distressed M&A

In 2024, we expect to see increased use of both administration and restructuring plans in M&A, rather than relying on solvent restructurings post-acquisition. Administration is well suited to addressing operational costs and structural business issues, and restructuring plans can be used to address capital structure issues as well.

Pre-packaged administrations have been a common exit from a distressed business for the company's secured creditors. However, a pre-pack administration usually follows an accelerated M&A process run by the prospective administrators. We think acquisitive PE houses will seek out distressed targets, put in secured debt at the opco level and then use administration as a proactive tool to accelerate the target's restructuring post-acquisition. The ability to reduce operating costs like head office costs and unwanted leases (as in the Body Shop example) makes this an attractive option and an effective use of a legitimate restructuring tool, although it carries the potential for reputational risk for both the buyer and the target.

We expect Restructuring Plans, introduced in the UK in 2020, will also start to be used to complete the acquisition of targets. These plans were modelled on the Companies Act scheme of arrangement which is often used to implement a public company takeover, but are specifically designed for use with a company facing financial difficulties. The advantage over using a conventional scheme of arrangement is that the Restructuring Plan is ready-made to cram down one or more classes of dissenting creditors or members.

The capital structure can be significantly amended, with changes to maturity dates and other terms imposed on creditors, provided that the relevant tests are met and the plan is fair. Because of the significant amount of work required to document and agree such a Restructuring Plan, this will work only where the buyer and the target co-operate prior to the acquisition. However, the very nature of the Restructuring Plan regime is that having a dissenting group of creditors who object to the restructuring of their position on acquisition is not fatal to the Restructuring Plan's success. We think this will also carry a lower level of reputational risk for both the buyer and the target's board than using an administration process shortly after acquisition.

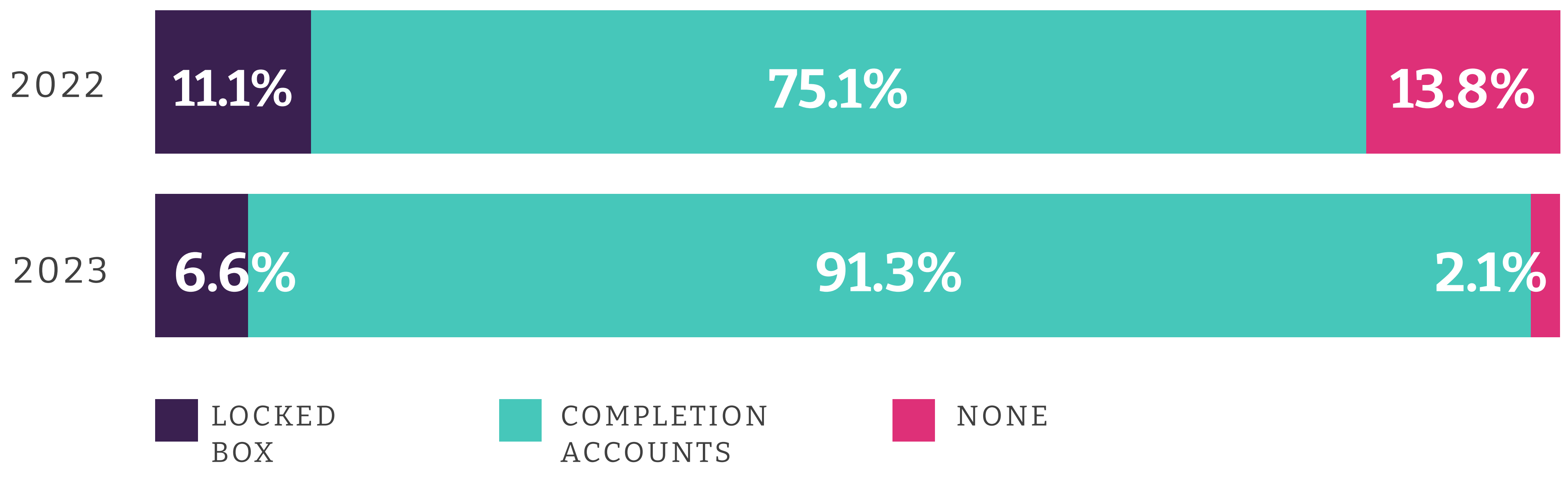
Overall, we expect a higher volume of distressed M&A deals in the mid-market in 2024 and into 2025 because Covid-era government support has come to an end, and also a result of many businesses coming to the end of their debt financing terms.

Georgia Quenby
Partner, Finance & Restructuring
gquenby@fladgate.com
+44 (0)7817 058613

10 Price Adjustment Mechanisms

In both 2022 and 2023, completion accounts mechanisms featured much more heavily than locked box mechanisms, which continues a trend we have been seeing from prior years. This may be because trading corporates (as opposed to private equity) have accounted for the majority of buyers on this sample of transactions (see data point 3 for further details).

PRICE ADJUSTMENT MECHANISMS – 2022 v 2023 (BY NUMBER OF DEALS)



11 Earnouts

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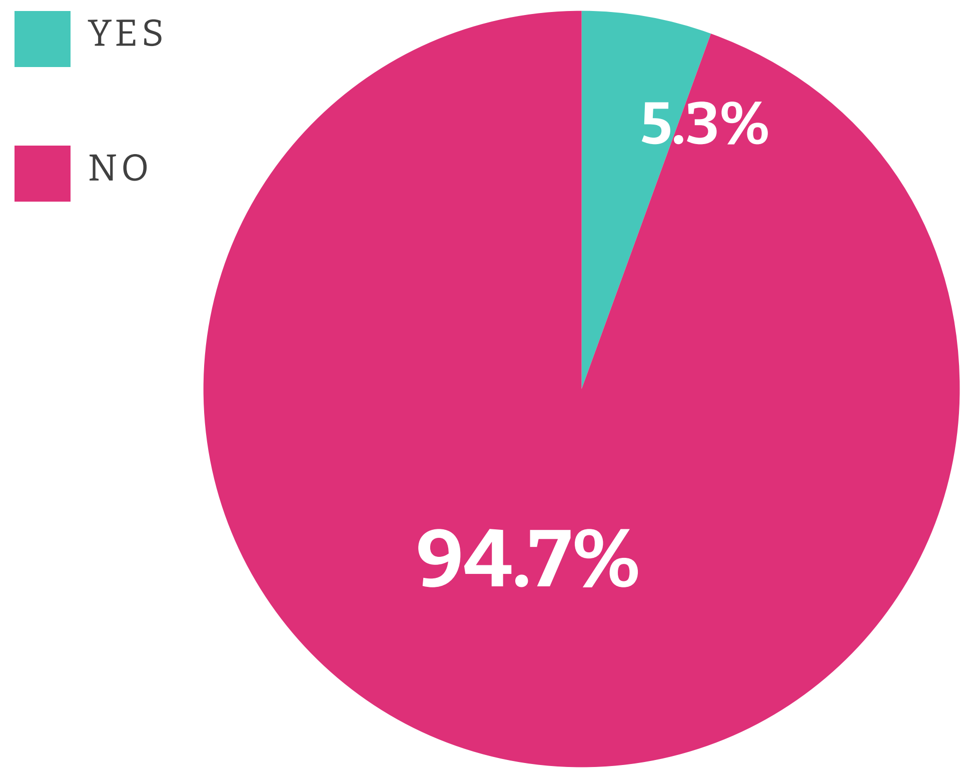
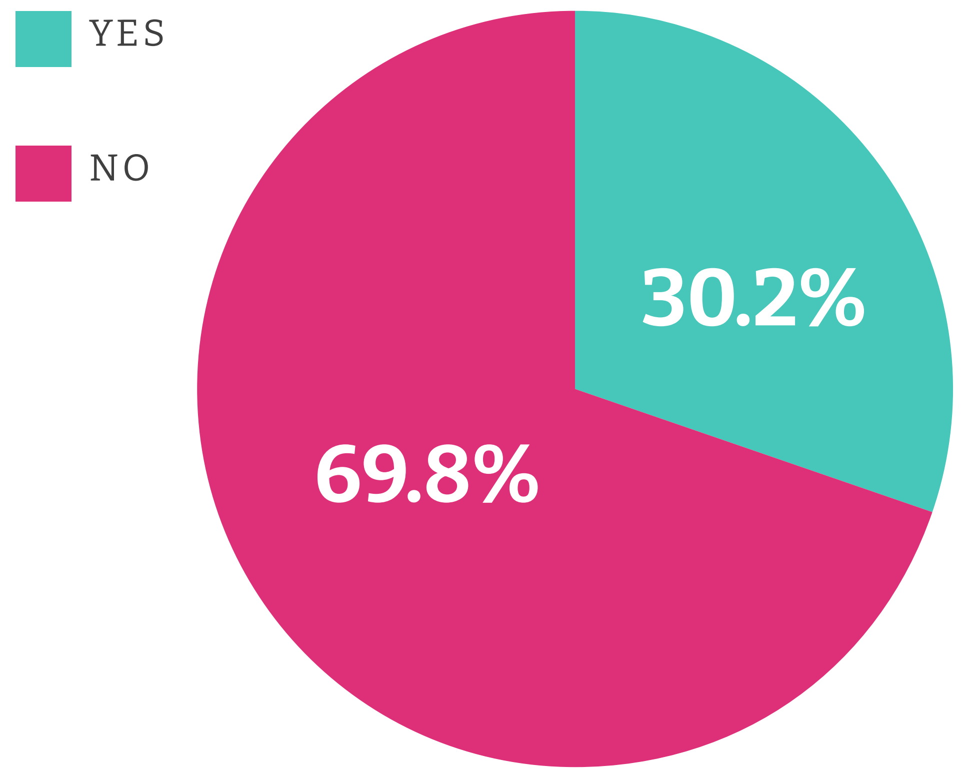
By value, there was a significant increase in deals that featured an earnout, from 5.3% in 2022 to 30.2% in 2023, which would suggest earnouts are being used more frequently to bridge the pricing expectation gap between buyers and sellers.

2022 – EARNOUT (BY DEAL VALUE)



2023 – EARNOUT (BY DEAL VALUE)



In 2023, we saw an increased incidence of shorter duration earnouts, which is an interesting trend.

EARNOUT DURATION – 2022 (BY VALUE)

84.6%
UP TO THREE YEARS

15.4%
THREE YEARS OR MORE

EARNOUT DURATION – 2023 (BY VALUE)

97.4%
UP TO THREE YEARS

2.6%
THREE YEARS OR MORE

12 Deferred Consideration

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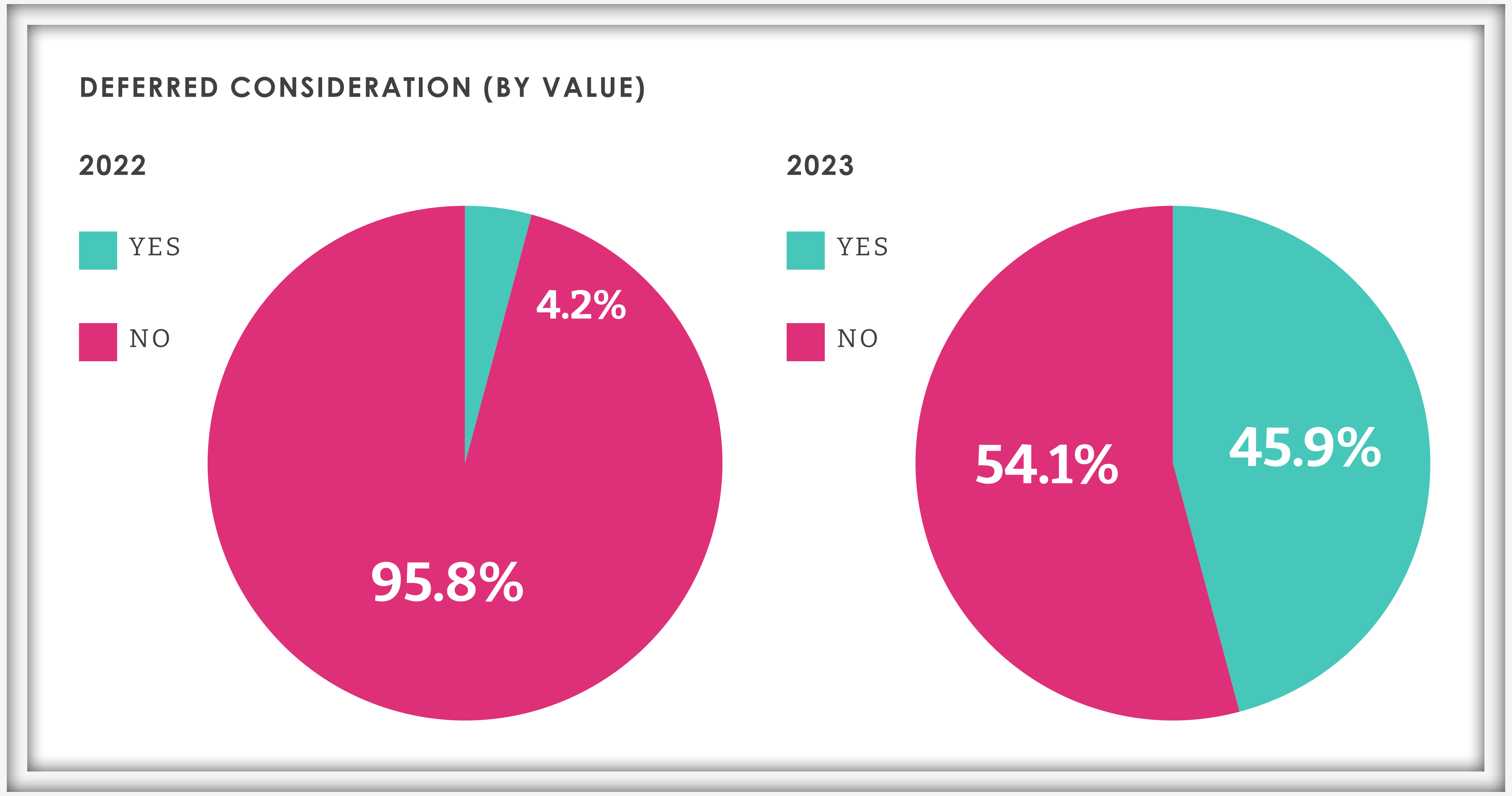
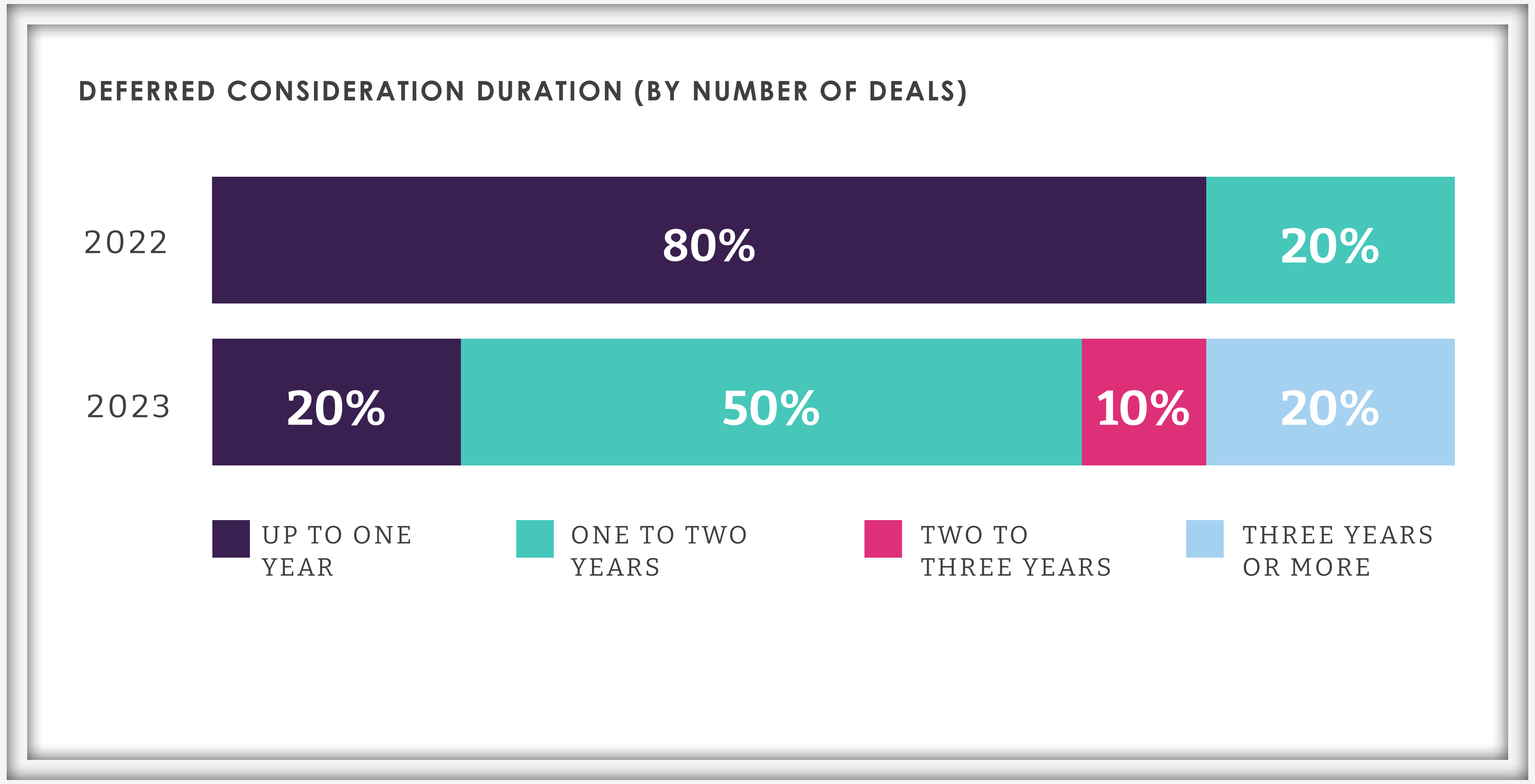
Similar to the trend we have been seeing with earnouts, deferred consideration mechanisms featured more in 2023 than 2022, particularly when analysed by value, increasing from only 4.2% of deals in 2022 to 45.9% of deals in 2023. In terms of duration over which any such deferred consideration is payable, the picture was much more mixed in 2023 relative to 2022.





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Public M&A

Three Predicted Trends for 2024

More takeover activity, particularly on AIM: We are seeing a significant uptick in the amount of takeover activity in relation to mid and small cap listed companies in the UK, particularly AIM listed companies. The second half of 2023 saw 33 firm offer announcements of which 24 were for AIM listed companies (in contrast there were eight firm offers announced for AIM listed companies in the same period in 2022). Many more takeover offers are being considered by bidders and targets which are yet to come into the public eye; we expect this is a trend that will continue through 2024.

AIM listed companies are widely considered to be undervalued and many directors are struggling to access the funds their companies need, and so are considering the merits of continuing to be listed. The result is that AIM has become the centre of UK takeover activity. A number of factors have deterred megadeal public takeovers over the last couple of years (there were only four firm offers of over £1 billion in 2023) – in particular, geopolitical instability, high interest rates, increased costs of debt, persistent inflation and intensifying regulatory scrutiny. However, with at least three deals over £1 billion already having been announced this year, there is now cautious optimism that larger public takeovers are making a comeback too.

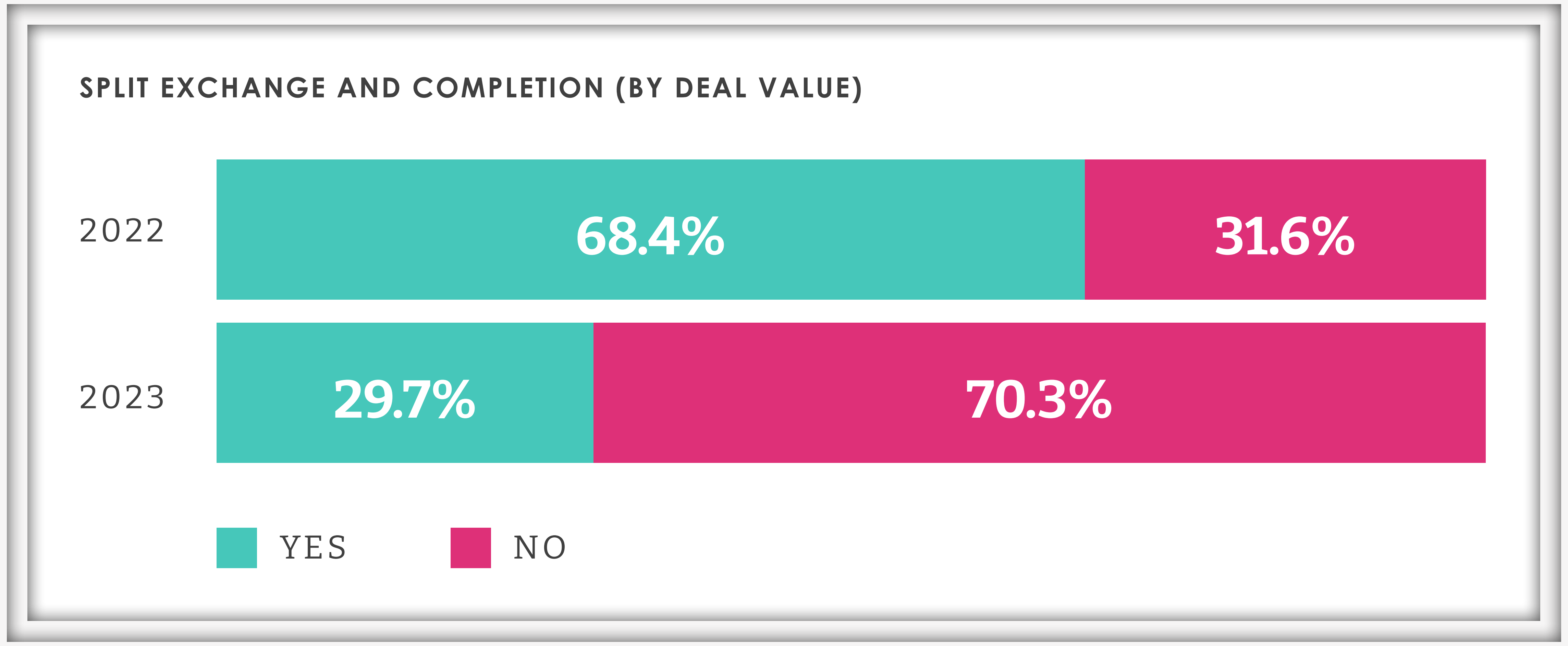
More PE bidders: We are seeing increased levels of interest in takeovers from private equity, particularly smaller private equity houses. 63% of firm offers announced during 2023 came from private equity or other fund-backed entities and these numbers are expected to continue into 2024. Private equity has traditionally been more wary of public deals and the limited due diligence, increased regulation and media attention associated with them. However, with private equity continuing to sit on high levels of dry powder, UK share prices taking time to rebound and interest rates beginning to stabilise, we expect to see more public to private transactions through 2024.

More overseas bidders: Overseas bidders are taking advantage of the weak pound and favourable exchange rates, and are increasingly making more offers for UK PLC. 66% of all firm offers for UK AIM listed companies came from non-UK incorporated bidders in 2023, whereas overseas bidders only made 45% of the firm offers in 2022. Takeovers by overseas bidders have recently involved some UK household names: Hotel Chocolat was acquired by the US multinational Mars Inc; Lookers by the Canadian Alpha Auto Group; OntheMarket by the US real estate platform CoStar Group; and Fulham Shore (owner of Franco Manca and The Real Greek) by the Japanese restaurant holding company TORIDOLL Holdings. As the UK continues to experience weak growth and with an impending general election, we think this is a trend that will continue this year.

Tessa Trevelyan Thomas
Partner, Corporate and Public M&A
ttrevelyanthomas@fladgate.com
+44 (0)7811 608879

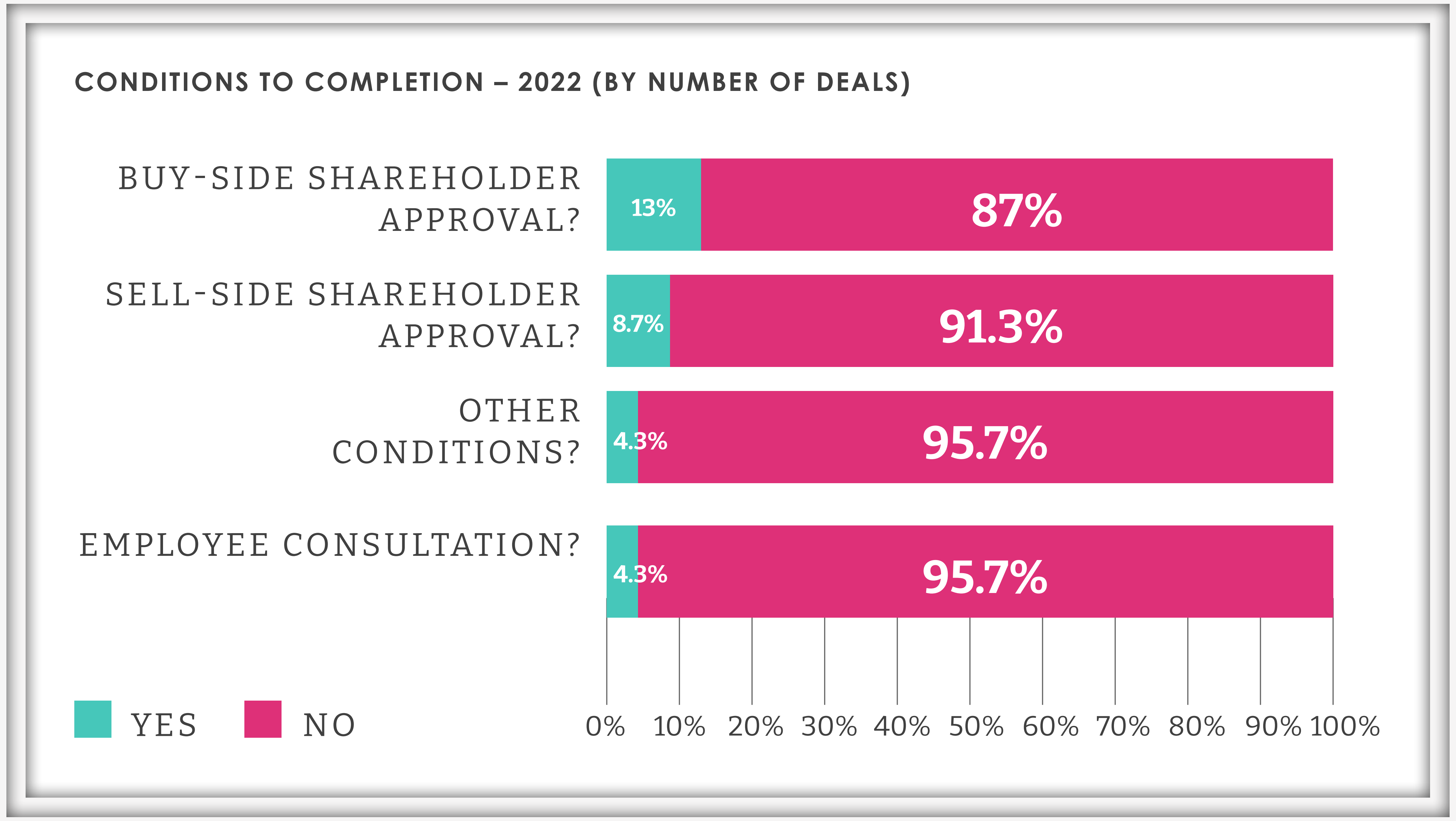
13 Split Exchange and Completion

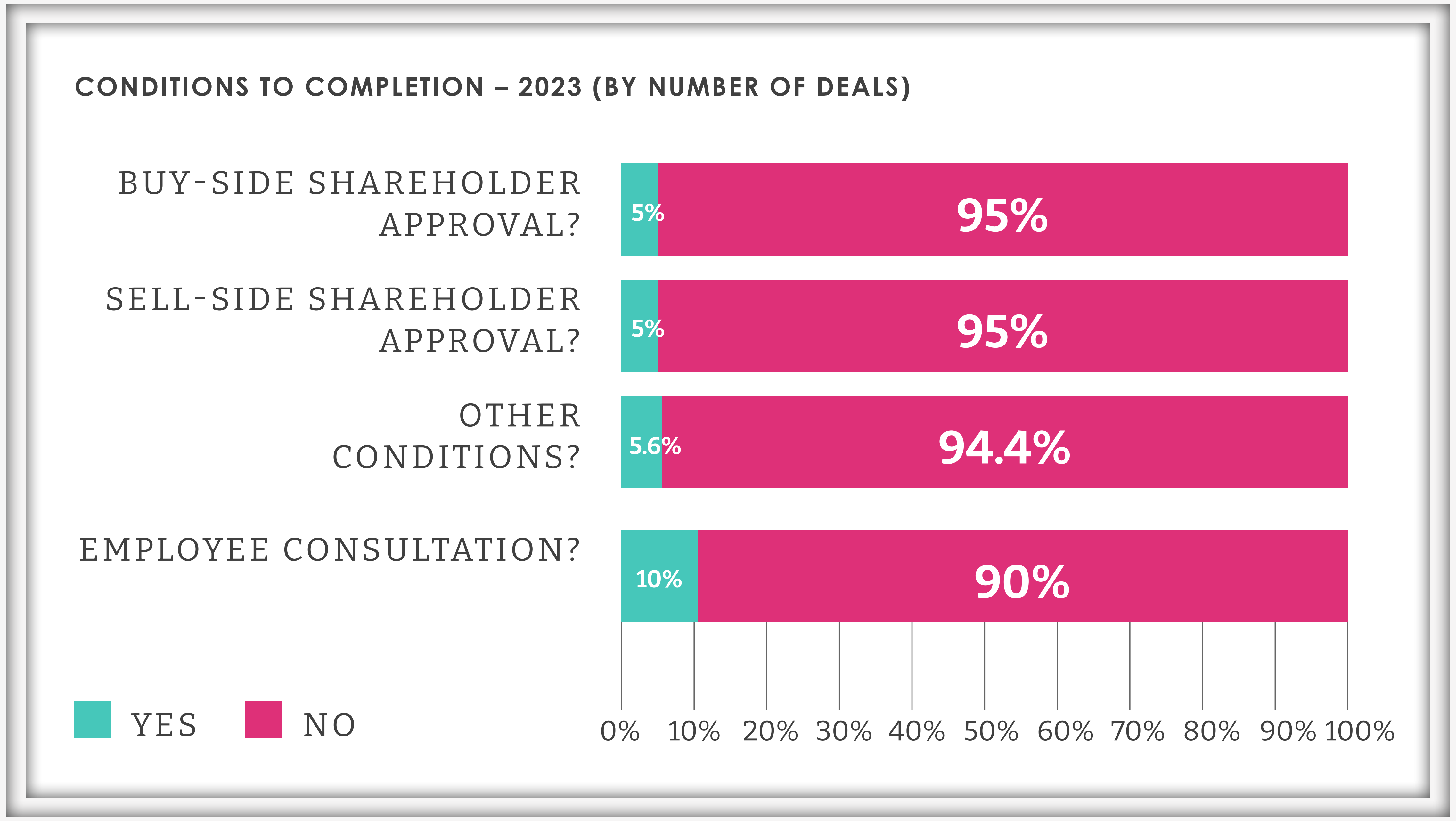
By value, 68.4% of transactions in 2022 featured a split exchange and completion. This proportion fell to 29.7% in 2023, which suggests more deals have been signing and closing simultaneously. The data point on the next page analyses in more detail those deals which featured conditions to closing.



14 Conditions to Completion

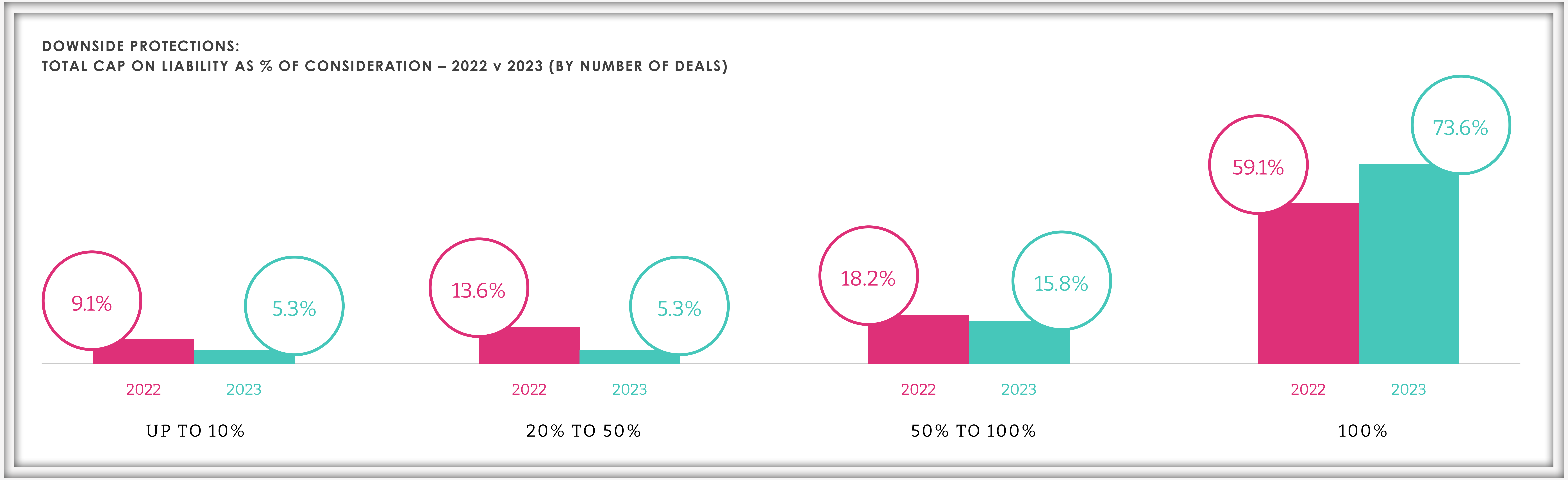
Conditions to closing will be different for each transaction, and will be a function of the terms of each deal and specific legal requirements.





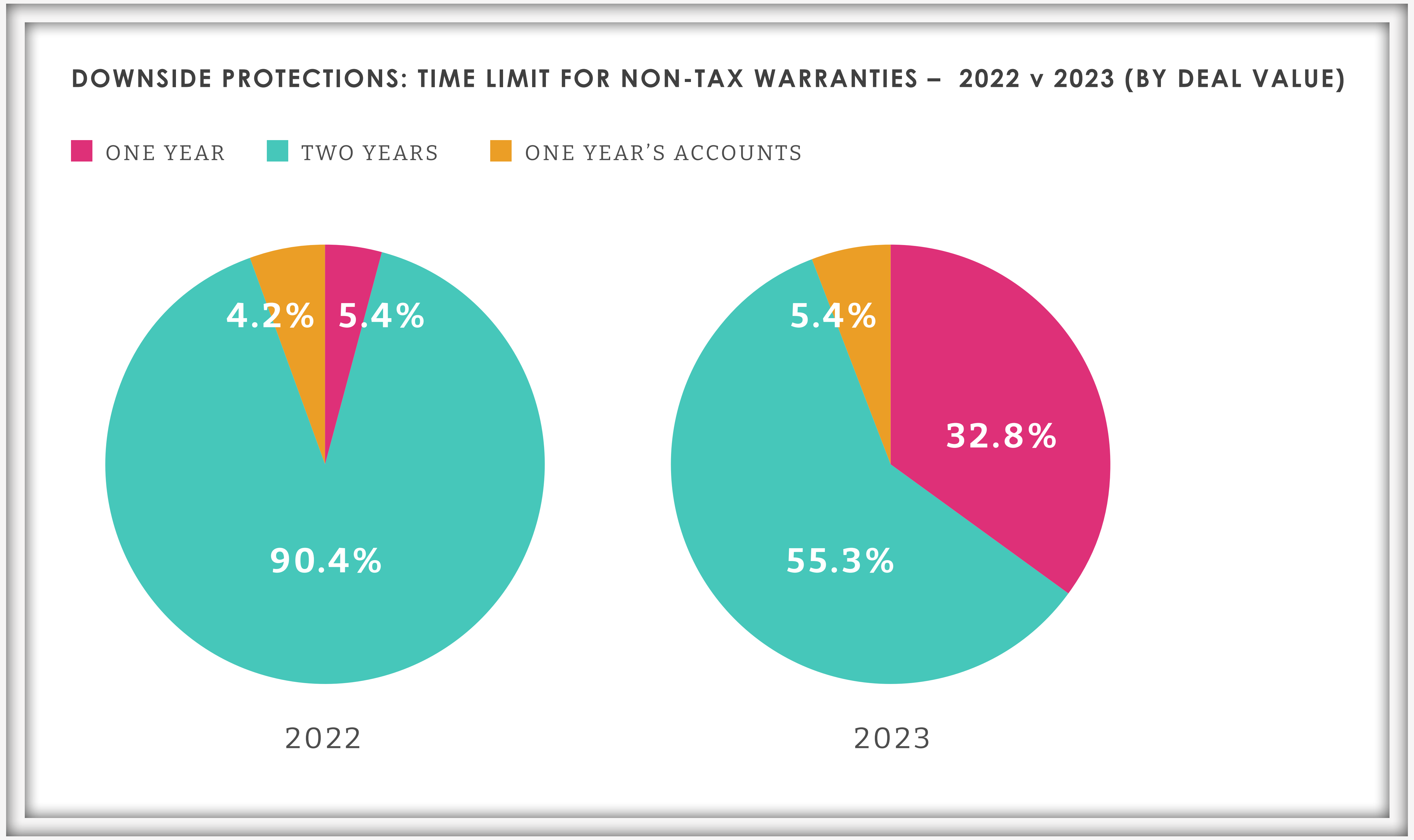
15 Liability Caps for Warranty Claims

In both 2022 and 2023, the majority of deals featured a liability cap set at 100%, increasing from 59.1% of deals in 2022 to 73.6% of deals in 2023. For a number of years, we had seen such liability caps being set at a lower level. This shift evidences buyers getting the upper hand on this point of negotiation.



16 Time Limits for Warranty Claims

In 2022 and 2023, the majority of deals (by value) featured a two-year time limit for non-tax warranty claims. This is consistent with previous years, although interestingly more deals featured a one-year time limit in 2022 than 2023.



The Rise of the AQSE Market

The Aquis Stock Exchange (AQSE) operates markets designed for entrepreneurial growth companies seeking access to growth capital. Over the past few years, it has increasingly been seen as a viable alternative to a listing on the London Stock Exchange's AIM market or on the LSE's Main Market via admission to the Standard segment of the FCA's Official List (commonly known as a "Standard listing").

AQSE operates two primary markets: a Main Market and a Growth Market. The AQSE Main Market is a Regulated Market for securities admitted to the Official List, and as such is best suited to larger companies which are able to comply with the more demanding requirements of the Official List and associated corporate governance standards, navigate the listing process and prepare the necessary listing documentation.

The Growth Market is for "unlisted" securities. The market is divided into two segments – Apex for larger, more established companies and Access for smaller companies at an earlier stage in their development. Access-listed companies may, in due course, graduate to the Apex segment which imposes more onerous eligibility criteria.

Driven by, amongst other things:

a) a perception that the attendant costs and complexity of an AIM listing are suitable only for larger and better-resourced companies; and
b) recent and upcoming changes to the requirements for a Standard listing, such as:
   i) an increase in the minimum market capitalisation to £30 million; and
   ii) the anticipated merger, in H2 2024, of the Standard and Premium listing segments which will add to the listing requirements by, for example, requiring the appointment of a sponsor to advise on the listing,

growth companies have increasingly been attracted to listing on the AQSE Growth Market, typically via the Access segment.

Paul Airley
Partner, Capital Markets
pairley@fladgate.com
+44 (0)7506 927724

The Rise of the AQSE Market Continued

Benefits of an IPO onto the AQSE Growth Market for a growth business include:

a) Access to new capital, from both retail and institutional investors (including the ability to raise additional capital via follow-on financings once listed);
b) Providing shareholders with a clear valuation and visible share price at all times;
c) Use of share options to incentivise and retain key staff;
d) Founders are able to retain majority control, with a minimum 10% "free float" to be made available to new investors;
e) Enhanced profile and visibility as a result of the public quotation;
f) Certain tax advantages which accrue to AQSE Growth Market companies, including potential eligibility for EIS, VCT and SEIS investments and certain CGT exemptions on disposal of shares, as well as share trading being free of stamp duty;
g) The willingness of AQSE to support the listing of businesses in "frontier", emerging sectors and new technologies; and
h) In contrast to the listing process on other markets, the ability of the company and its financial adviser to enter into a dialogue directly with the AQSE to assist in the listing process.

The recent statistics show increasing traction for AQSE Access segment IPOs as well as the ongoing benefits of listing, as follows:

a) 16 IPOs in 2023, including nine IPOs in Q4 of which four came in December;
b) Strong pipeline of listing candidates in 2024;
c) Increased liquidity in stocks compared to the same periods in 2023; Q1 2024 saw two record trading months on AQSE, with value trading up 30% against Q1 2023; and
d) The number of compelling AQSE success stories continue to grow and, despite very tough conditions, companies are able to reach milestones and raise money. For example, Q1 2024 saw Equipmake Holdings (*electric drivetrains*), EDX Medical (*medical diagnostics*) and All Things Considered (*music industry*) all complete institutionally-backed fundraises.

Paul Airley
Partner, Capital Markets
pairley@fladgate.com
+44 (0)7506 927724

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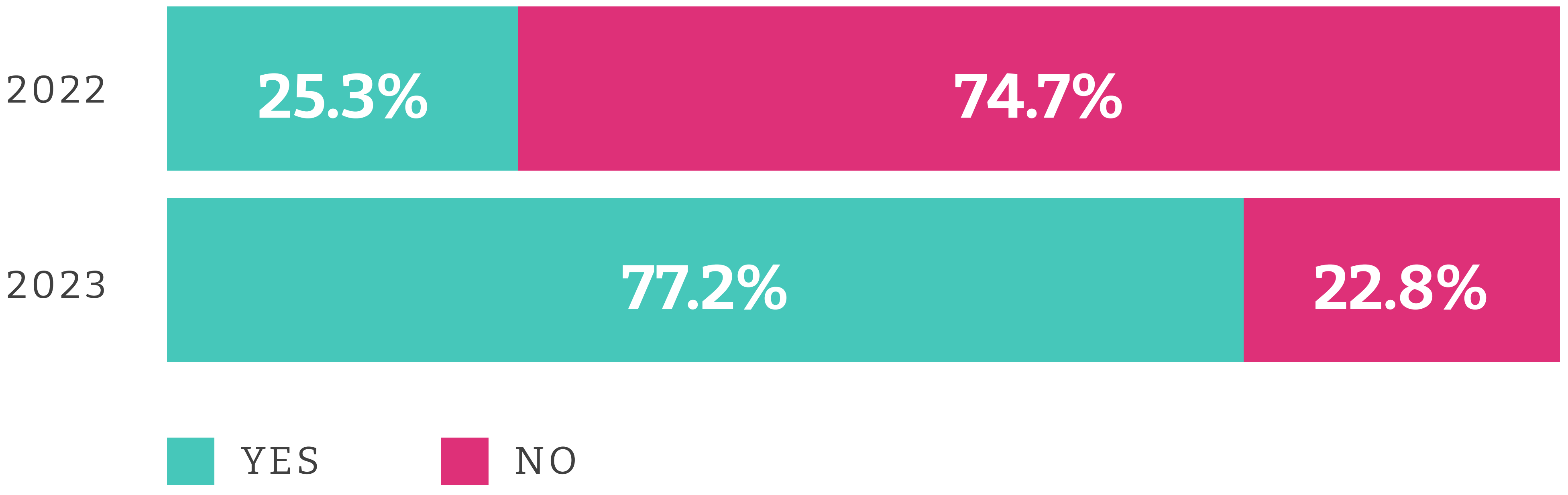
17 Non-Tax Indemnities

By value, there was a material increase in deals featuring non-tax related indemnities from the seller in 2023 compared to 2022, increasing from 25.3% to 77.2%.

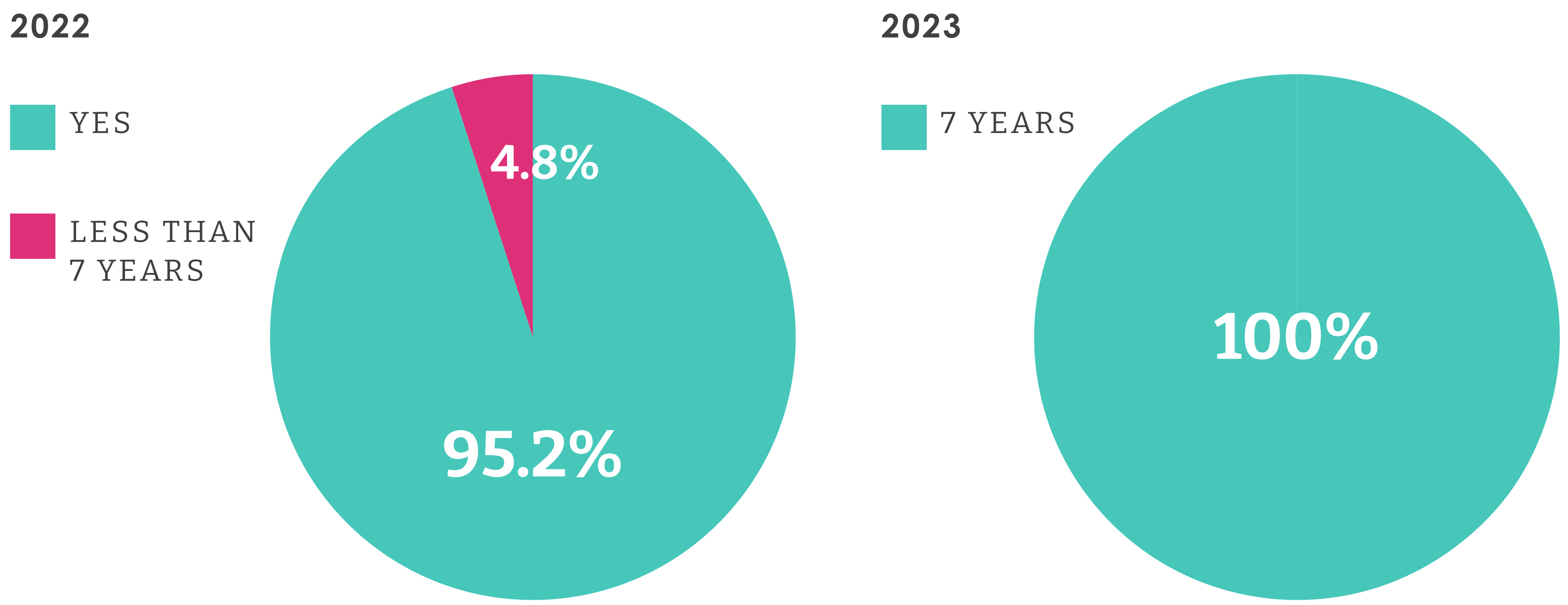
DOWNSIDE PROTECTIONS: NON-TAX INDEMNITIES FROM THE SELLER – 2022 v 2023 (BY DEAL VALUE)



18 Tax Claims

Across 2022 and 2023, the most prevalent time limitation period for tax claims (and also tax warranty claims) is seven years, which is consistent with prior years.

TIME LIMIT FOR CLAIMS UNDER TAX DEED (BY NUMBER OF DEALS)



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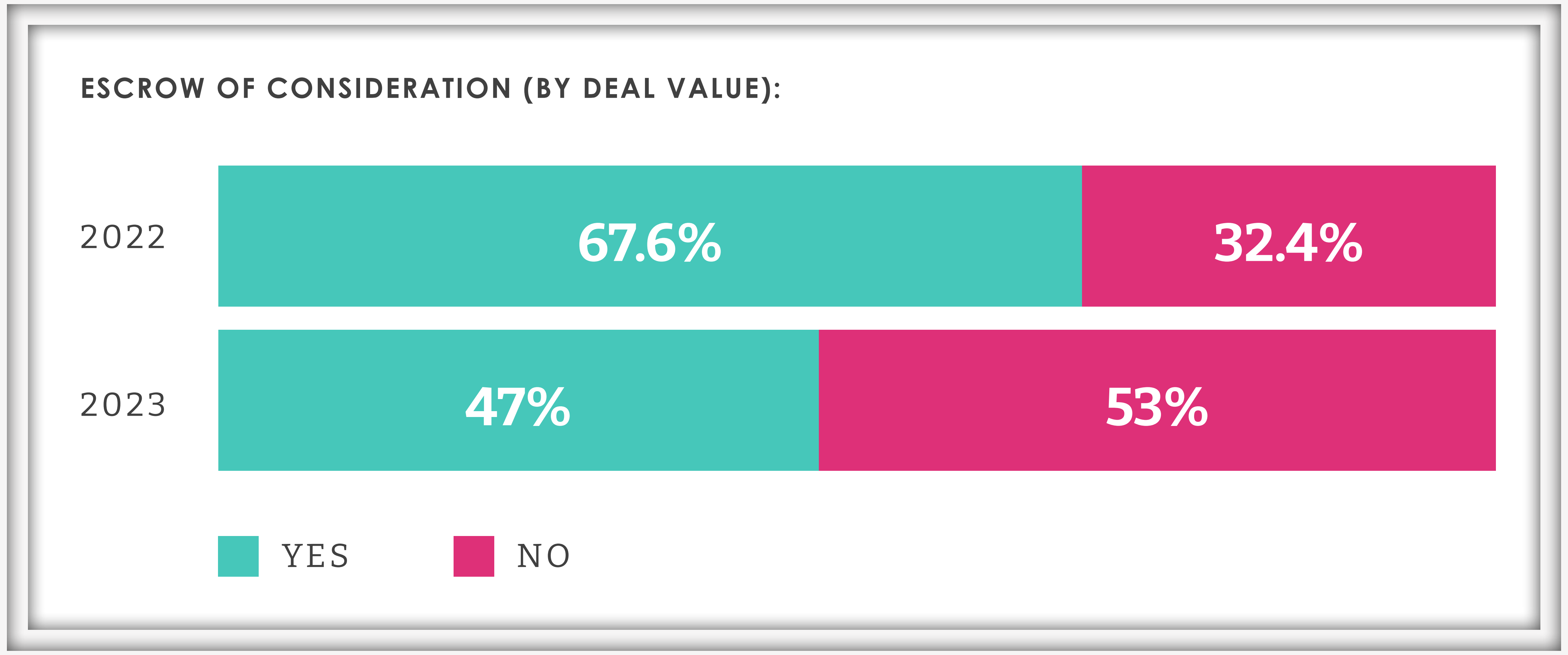
19 Escrow Mechanisms

2023 saw a decrease in transactions (by value) where a proportion of the consideration was placed in escrow on closing.



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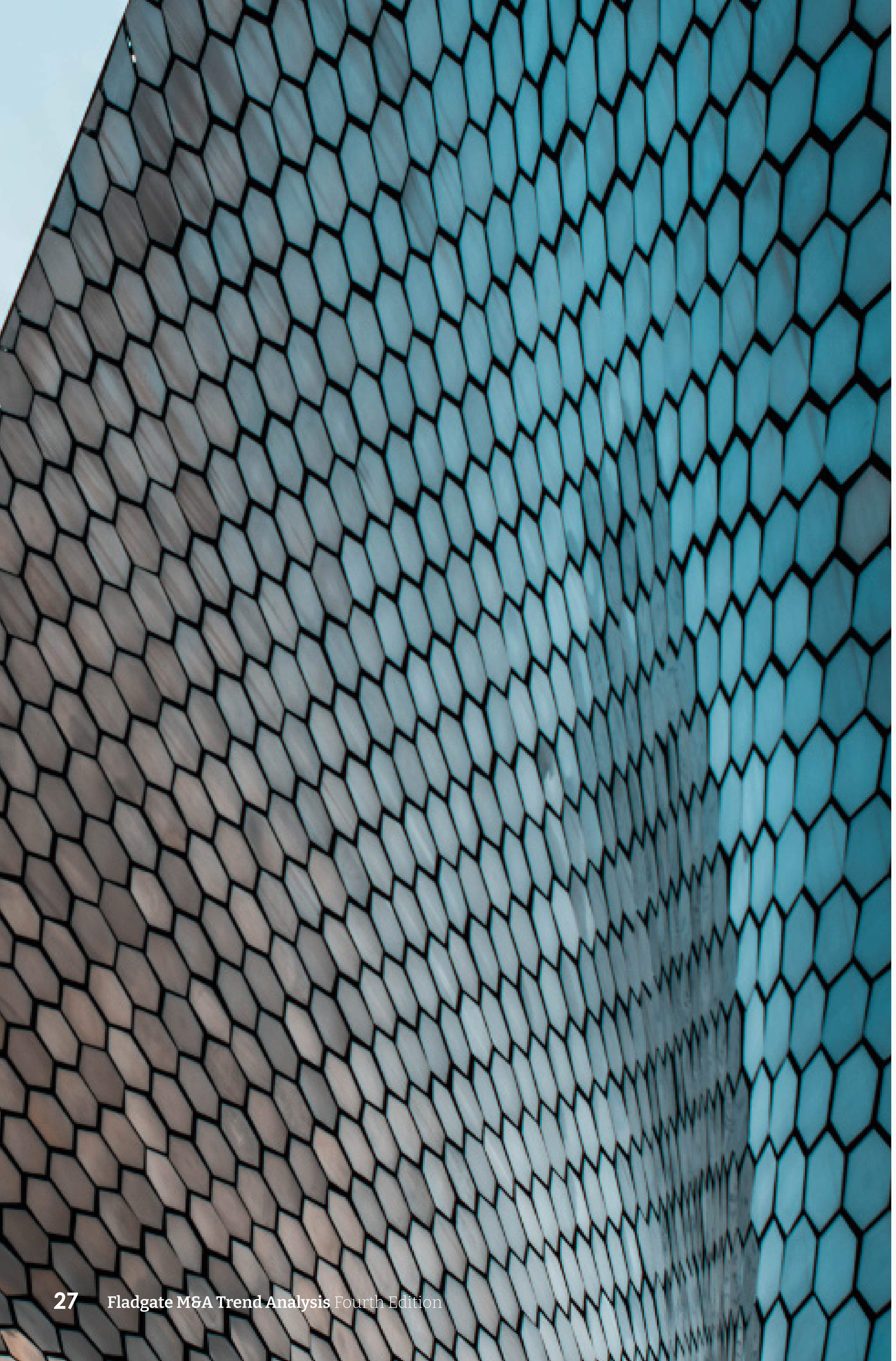
The Increasing Use of Escrow and Paying Agent Mechanisms in M&A Deals

Escrow and paying agent mechanisms have become a growing feature of M&A deals in recent years, principally owing to a desire to mitigate counterparty risk, more cross-border deals (and hence multiple time zones having to be navigated), and a reluctance for counsel to use their client accounts (often for regulatory reasons) and provide closing undertakings.

In M&A deals, escrow and paying agent mechanisms are being used for multiple reasons, as follows:

- **Holding of funds or assets:** an escrow arrangement can be set up under which a neutral third party holds funds or other assets that will be exchanged in a transaction involving a buyer and seller. This ensures that the buyer and seller will fulfil their respective financial and other obligations.
- **Minimizing risk of non-completion:** Escrow arrangements offer mutual protection to the buyer and seller by minimizing the risk of counterparty non-completion, failure to deliver, or inability to attend a closing meeting.
- **Cross-border transactions:** Escrow and paying agent arrangements are particularly useful when conducting cross-border transactions. They help mitigate timing and counterparty risks, protect funds, and provide adequate risk and execution frameworks.
- **Proof of funds:** a buyer can use escrow accounts to provide "proof of funds" to reassure sellers that they have available funds or financing to complete a transaction.
- **Holdback amounts**: Escrow agreements in M&A transactions are sometimes used to retain or "hold back" part of the purchase price. The retained amount is kept for a warranty period, allowing the buyer to confirm that representations and warranties made by the seller in the sale documents are true and correct.
- **Release of existing lender security:** if secured debt finance is used to fund part of the consideration and/or to facilitate repayment of existing secured target debt, the incoming funders will want to ensure that the existing security is released before they fund, but the outgoing lender will want to ensure they are repaid on release of their security. This is an efficient mechanism for achieving this simultaneously.
- **Complex cap tables:** where the target has a complex capital structure, often the case in venture capital backed companies, paying agent mechanisms allow multiple recipients of consideration to be paid quickly and efficiently, taking into account any applicable withholding taxes.

Luke Morris
Partner
lmorris@fladgate.com
+44 (0)7899 066477



20 Warranty and Indemnity Insurance

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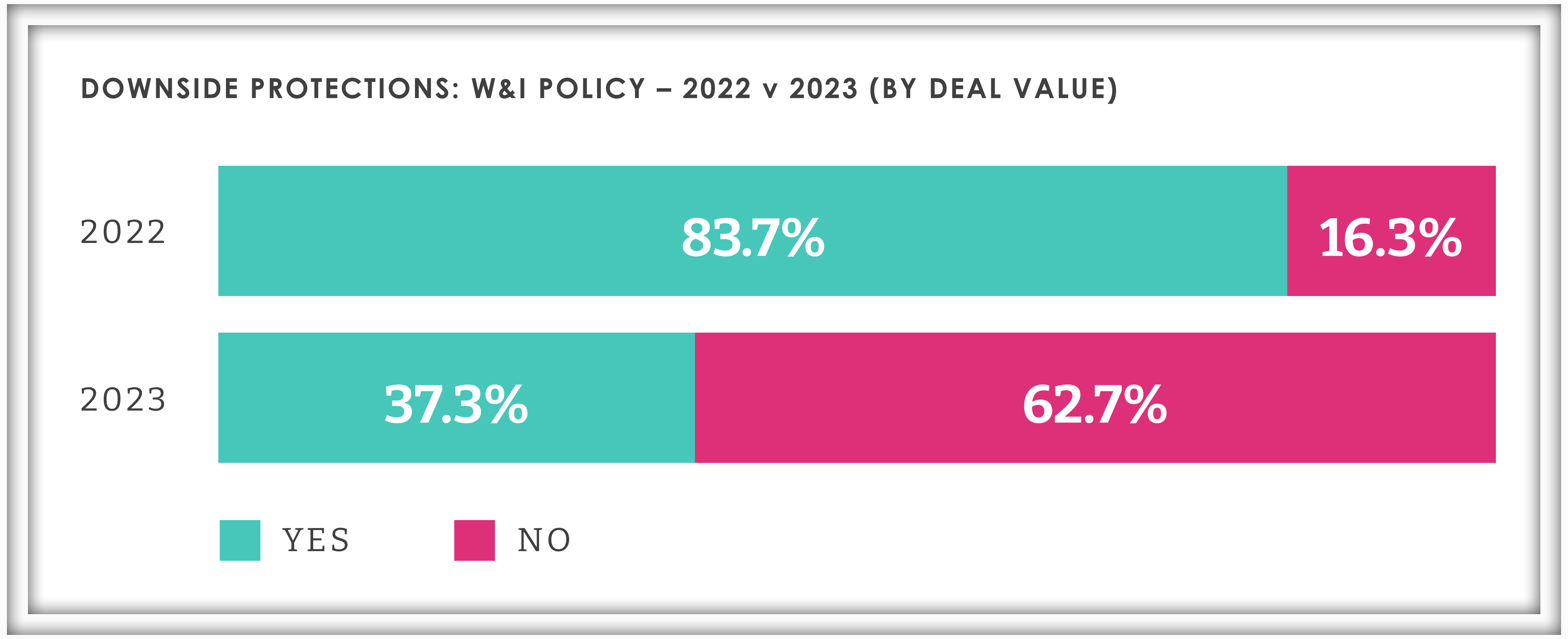
Between 2022 and 2023, there was a decrease in the proportion of transactions (by value) that featured a warranty and indemnity insurance policy. This might be caused by the price of such policies increasing during this period, and the scope of the exclusions to such policies being expanded; although there is some evidence of the cost of such policies now falling given a thinner M&A market and more underwriting capacity consequently being available.

That said, it was generally the case that larger deals did feature a warranty and indemnity policy that was sourced by the buyer.



21 Restrictive Covenants on Sellers

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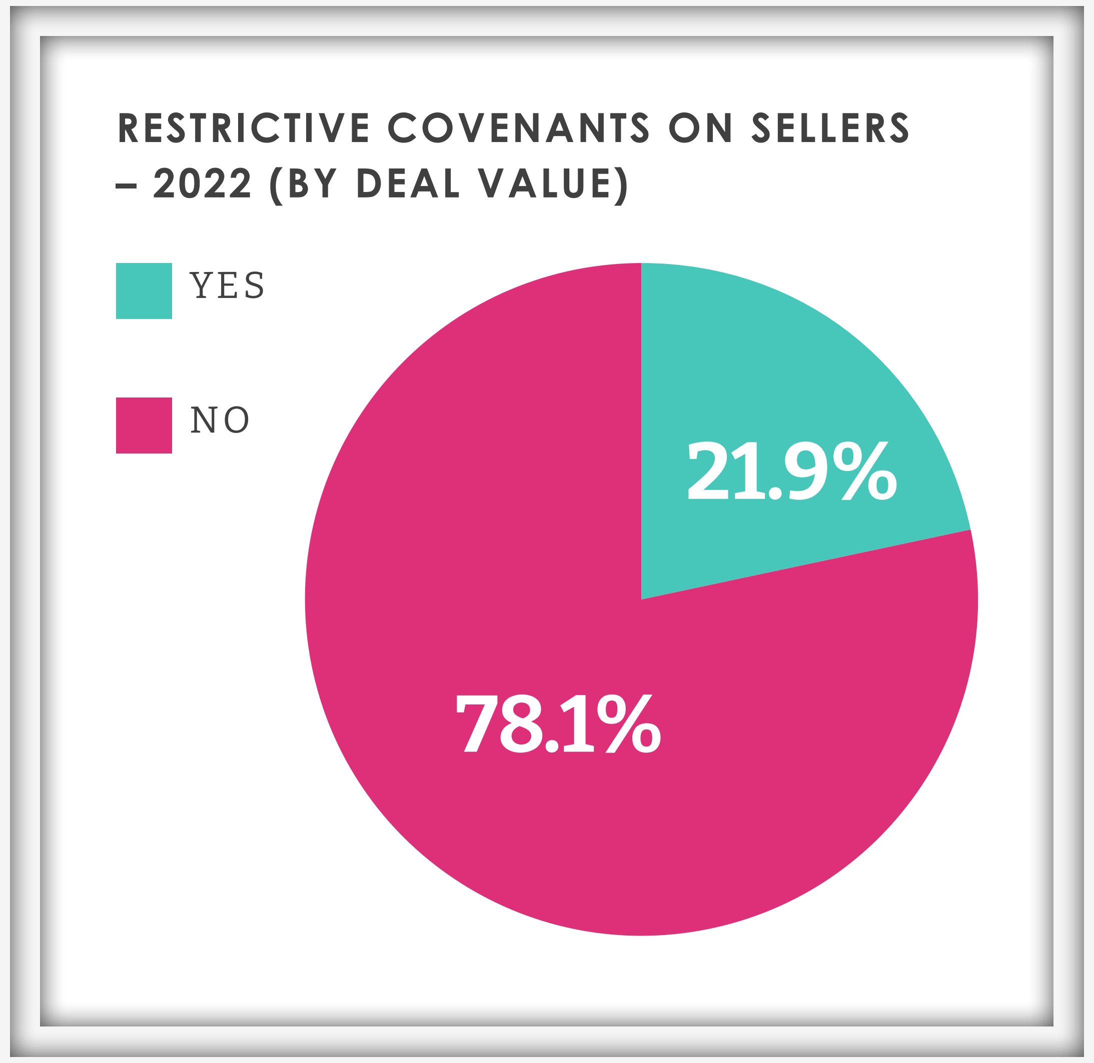
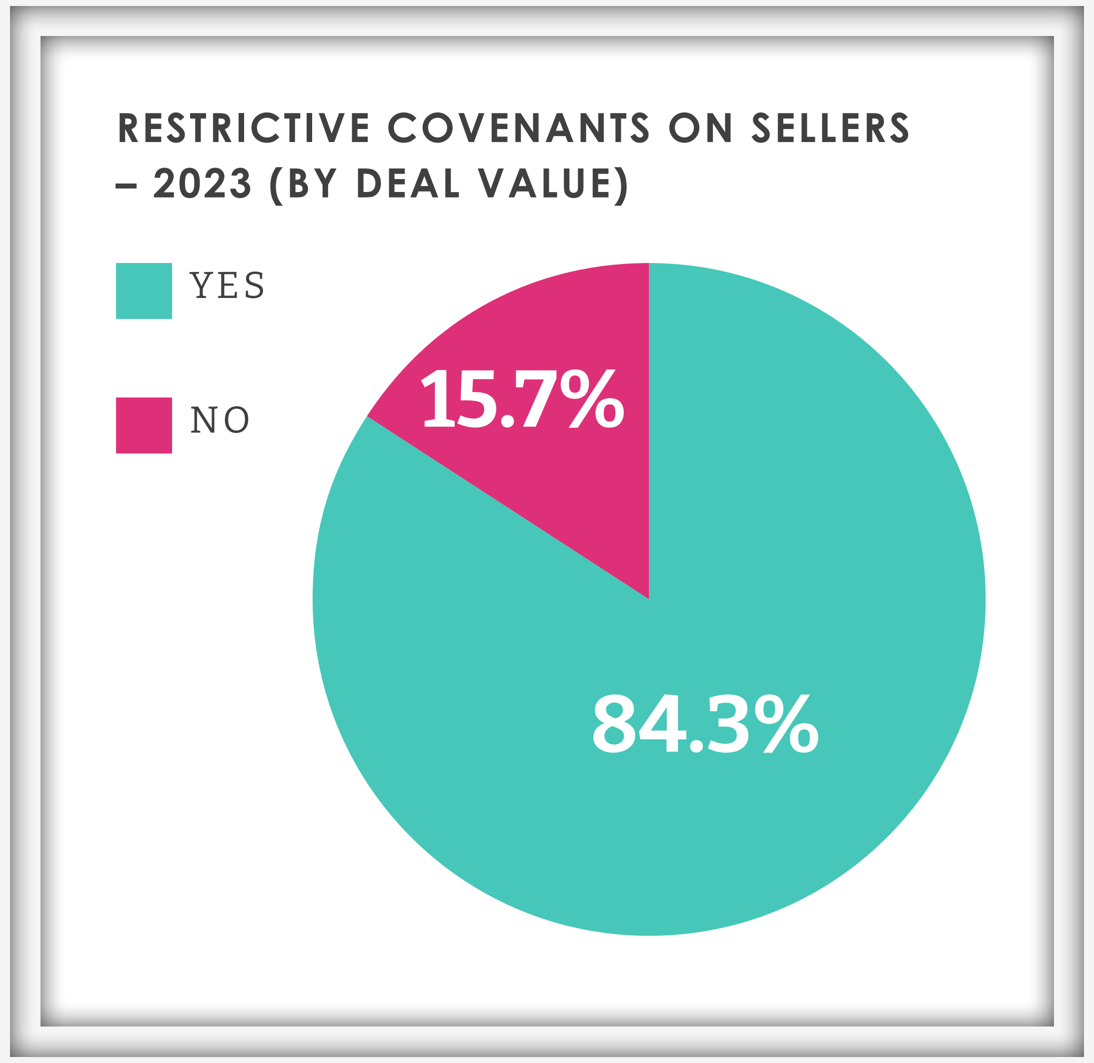
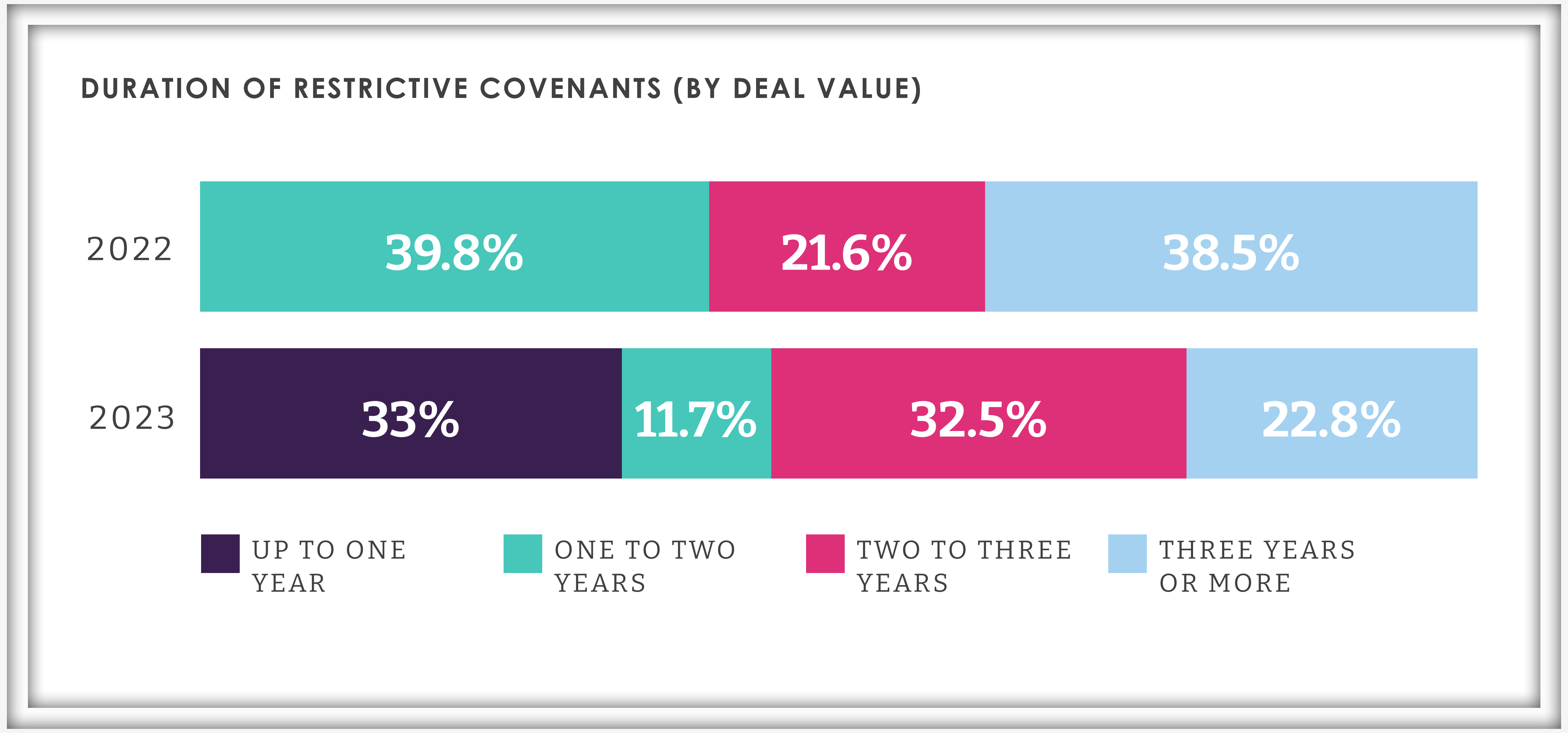
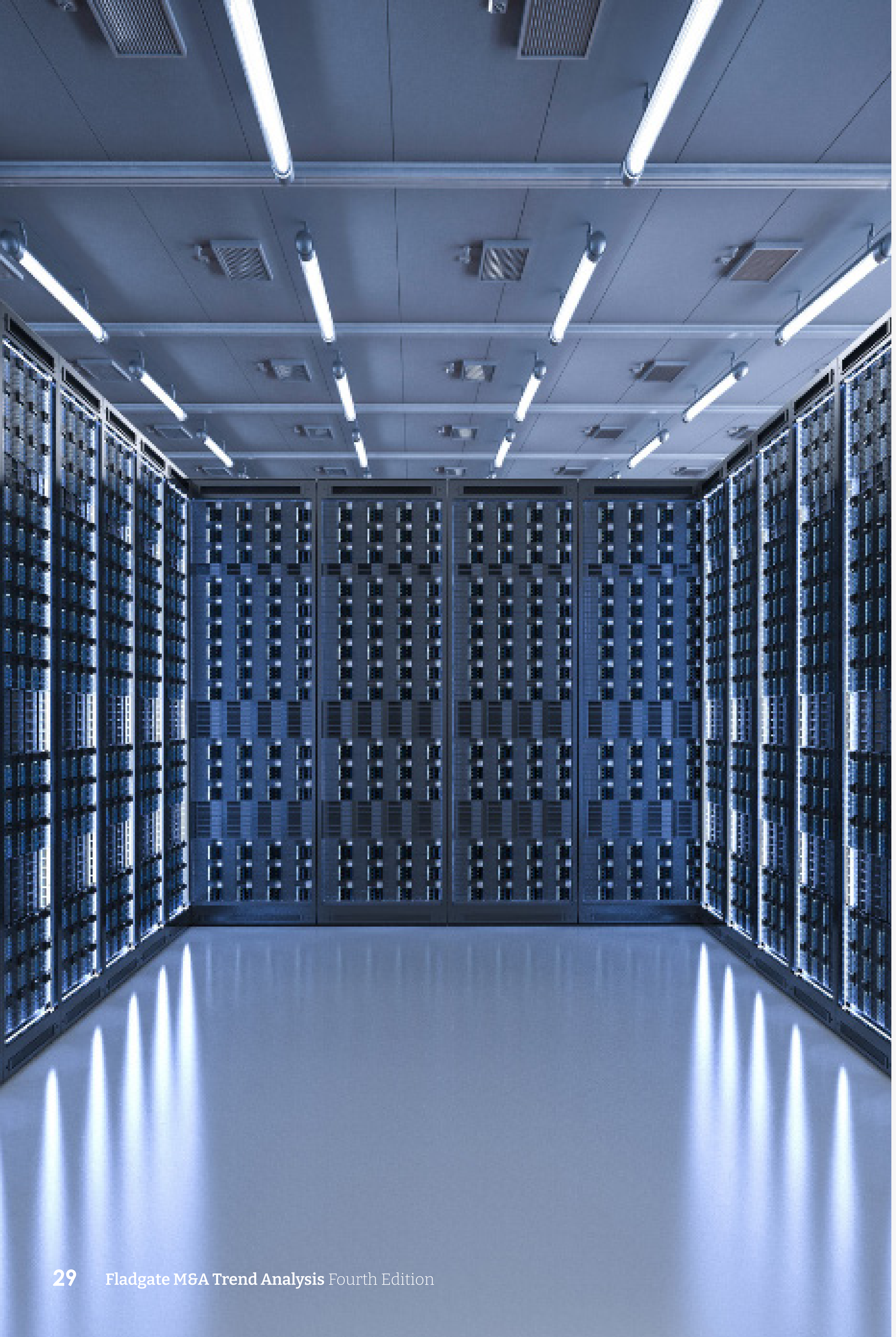
Transactions which featured restrictive covenants on the selling shareholders increased significantly from 21.9% of transactions in 2022 to 84.3% of transactions in 2023 (by value).





In 2023, there was an increased prevalence of shorter duration restrictive covenants being imposed on sellers.





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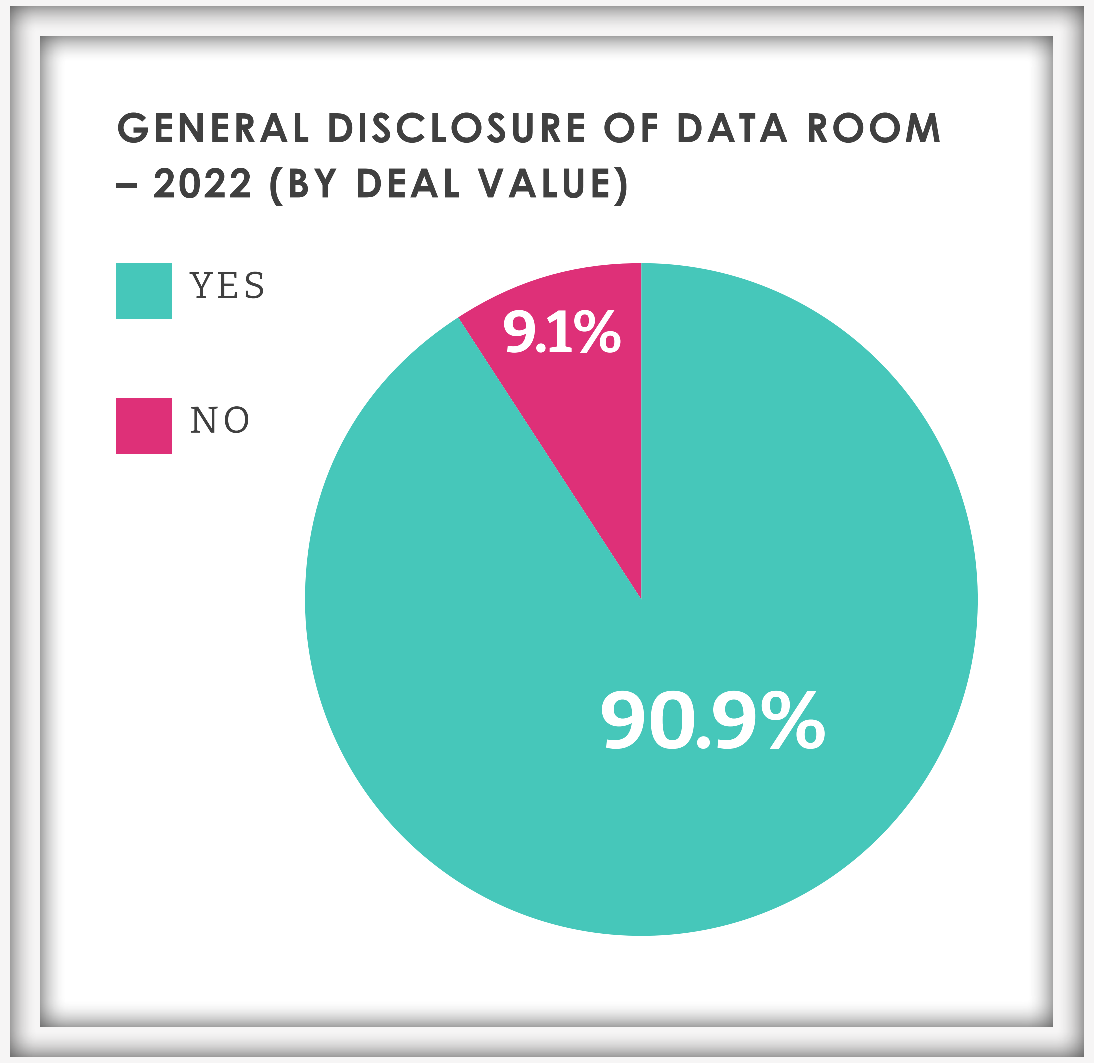
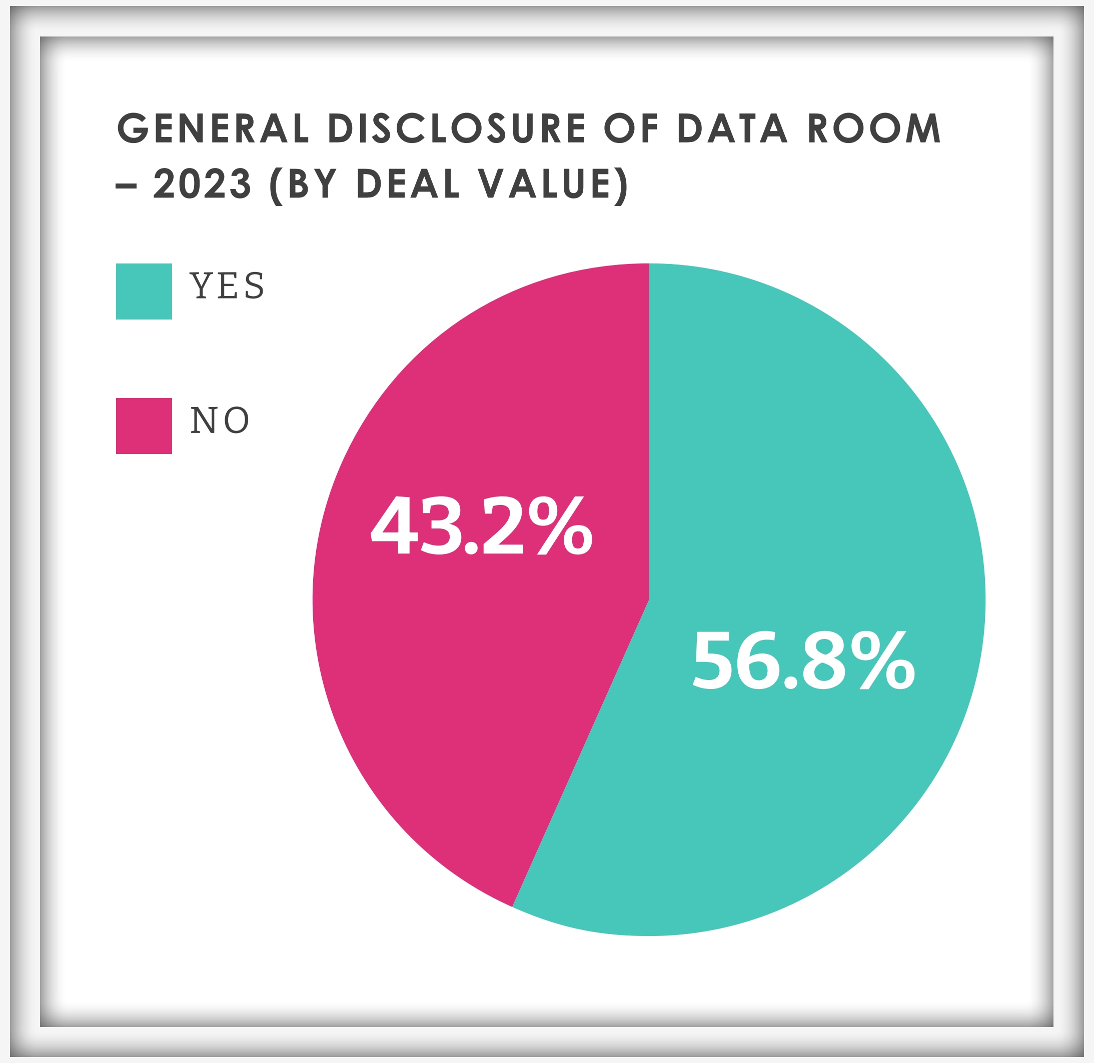
22 Disclosure of Data Room

2023 saw a reduction in the deals (by value) where the seller benefitted from a general disclosure of the data room against the warranties.





Contact us

For general or media enquiries please contact:

Vanessa Liew

Business Development Manager

T +44 (0) 20 3036 7405

M +44 (0) 7415 906800

vliew@fladgate.com

fladgate

Fladgate LLP
16 Great Queen Street
London
WC2B 5DG

T: +44 (0) 20 3036 7000
E: fladgate@fladgate.com