Rise in transatlantic transactions puts M&A deal terms in focus

More US buyers – and more buyer-friendly deal terms – are entering the seller-friendly UK market, although the picture is increasingly nuanced, say Joshua M. Dubofsky, Sam Newhouse, Jennifer N. Cadet, and Catherine Campbell

While global M&A deal volumes have dipped at the start of Q1 2023, UK-bound M&A activity is expected to be one of the year's highlights in 2023 as overseas buyers seek out attractively priced public and private targets. Within this activity, the deal term preferences of US buyers are likely to impact private UK M&A. A detailed understanding of UK and US expectations is therefore essential for transatlantic dealmakers.

While M&A slowed down from the highs of 2020 and 2021, the three months to December 2022 were the strongest quarter of the year for US inbound M&A to the UK, with deal values rebounding to just over $15 billion. This rise underlines the growing attractiveness of UK companies following exchange rate shifts, as illustrated by deals in the final months of 2022 and early 2023.

US private M&A deal terms – particularly related to deal certainty and post-closing recourse – have historically been viewed as more buyer-friendly than those in the more seller-friendly UK market. However, the picture is increasingly nuanced, and deal teams navigating economic uncertainty and financial market dislocation are being called upon to find new solutions to deal valuation, certainty, and recourse concerns.

Valuation and transfer of risk

The US and UK markets have different approaches to valuation and the transfer of economic risk. Private European and UK deals commonly feature locked-box mechanisms, which fix the deal price at an agreed date based on a set of accounts and view the buyer as owning the financing requirements and results of operation of the business from that date. In a locked-box structure, the seller provides undertakings to the buyer that value will not be extracted or 'leak' from the target before completion of the acquisition.

In contrast, most US deals use completion account mechanisms, such as cash, debt and working capital adjustments. These calculate a final deal price after completion of the acquisition by referring to an estimate of the target's accounts at the date of completion and allow for post-closing valuation adjustments based on a final accounting adjustment mechanism. US completion account mechanisms generally provide the seller with the operational benefit of the business, including cash and account receivable generation, as well as the ongoing cost of funding the business and related operational risk, until closing.

Locked box v completion accounts

Locked-box mechanisms remain popular in Europe and featured in 49% of private deals, according to the eighth edition of the Latham & Watkins Private M&A Study. In contrast, completion accounts featured in just 25% of deals. In the UK, transactions were a bit more balanced – locked-box mechanisms featured in 37% of sales, and completion accounts featured in 29% of transactions. Meanwhile, SRS Acquiom reported in its 2022 M&A Deal Terms Study that 94% of private-target acquisitions in the US included post-closing purchase price adjustments in 2021.

Takeaways from recent deals

In private deals, UK sellers should expect US acquirers to ask for completion accounts, and US buyers should be aware of a typical UK seller's expectations. To advance its position, a UK seller focused on using a locked-box structure should be ready to deliver audited financial statements to a US buyer or have accounts prepared that buyers can confidently rely on. If working to a tight timeline, US buyers can push for completion accounts on the basis that they do not need to do the upfront work of agreeing on locked-box accounts and instead just need to agree on the methods that will be used to adjust the purchase price at closing.

The prevalence of locked-box mechanisms may decrease further in the UK in 2023 if US acquirers favouring completion accounts outpace UK private equity (PE) buyout firms, which are expected to continue a slower pace of transactions given debt markets constraints. Where locked-box mechanics are used, ticking fees may become more prevalent, in particular as global complexity and the timelines for M&A antitrust and regulatory processes continue to increase.

Deal certainty

UK and US dealmakers take different approaches to closing conditions, which must be satisfied before a deal can complete. In the UK and Europe, deals rarely involve conditions other than receipt of any required regulatory and antitrust approvals. As a result, assuming satisfaction of any regulatory or antitrust conditions, deal and business risk is typically transferred to the buyer upon signing of a deal.

Under US practice, deal and business risk is typically not transferred until deal completion. While completion conditions will vary, conditions in a US-led deal may include a requirement for the seller's representations and warranties to be materially accurate at completion, material compliance with interim covenants, and the absence of a material adverse change (MAC), in addition to any regulatory or antitrust conditions. With increasing numbers of US acquirers in the UK market, UK dealmakers can expect to discuss a wider range of deal conditions than in the past and should familiarise themselves with the US approach to conditionality.

MAC clauses in focus

MAC clauses, which give a buyer the right to walk away from a deal in the event of a MAC to the target business between signing and closing, are far less common in the UK than in the US. In the UK, just 12% of private deals included MAC clauses in 2021. In comparison, 98% of US deals included some form of MAC clause.

Although MAC clauses are commonly included in US documentation, a MAC is seen as a truly significant and sustained adverse change in the target's business that was not known to, or anticipated by, the buyer at the time of signing. As a result of this high threshold, US courts rarely find that a MAC exists. Instead, US buyers will walk away from acquisitions following the target's failure to satisfy a closing condition likely tied to a material breach of interim covenants or, where a materiality standard other than a MAC applies, a breach of warranties by the target.

As more US buyers enter the UK market, MAC clauses may become more common in UK deals. However, deal certainty remains critical, and UK sellers can be expected to resist requests for MAC clauses, particularly on competitive deals, instead relying on market precedent in Europe and the scarcity of case law in the UK as to what may signify a MAC event (albeit this can be addressed with appropriate drafting). UK sellers that do agree to a more traditional US conditionality construct should focus on conditions related to compliance with covenants and accuracy of warranties.

Recourse

Post-closing economic risk allocation in M&A in the US and the UK is increasingly nuanced and requires a multifaceted approach to risk minimisation and mitigation.

The rising appeal of 'public-style' deals

Historically, commercial warranties were a key tool in US and UK private deals for understanding and allocating risk, as well as forming part of the diligence and disclosure process. Acquisitions under US law have traditionally provided buyers with strong recourse against sellers through claims for breaches of representations and warranties, often given on an indemnity basis, in addition to escrow or holdback arrangements.

In contrast, a breach of warranty claim under English and Welsh law typically requires a buyer to prove how the breach reduced the overall value of the acquired shares, so these purchase agreements require buyers to rely more heavily on specific indemnities, and, in recent years, insurance.

Today, the allocation of risk between buyers and sellers for commercial warranties and other common areas of recourse is changing. In the US, 'public-style' or 'no-recourse' deals have become much more common in the highly competitive M&A markets of recent years, providing private sellers with risk protection levels similar to those in public deals. In a no-recourse deal, buyers have no recourse against sellers after closing for any breaches of representations, warranties, and pre-closing covenants.

In the UK, buyers' ability to seek recourse post closing has also narrowed, though this trend remains deal dependent. Competitive deals have featured buyers accepting a limited, or sometimes nominal, level of seller recourse by way of warranty protections. Regardless, parties generally make exceptions to carve out obligations that are to be performed following closing and for claims for fraud.

Warranty and indemnity insurance

If a seller is not willing to stand behind warranties, then warranty and indemnity insurance (W&I) (or representations and warranty insurance (RWI) in the US) can provide a solution, with the insurance market offering a range of M&A risk management options for acquirers.

Insurance has become an important component of UK transactions in recent years. However, many buyers are now more critically evaluating the merits of W&I due to changing market dynamics and challenging macro conditions (which have cooled deal flow). As W&I has matured and buyers have become more experienced consumers of the insurance (and of low or nominal liability caps for warranties), the emerging picture is one of a product with a nuanced value. Deal-specific characteristics, structures, and issues are playing a key role in the demand for, and success of, W&I.

Increasingly, buyers in the UK are opting to forgo W&I altogether; instead accepting that they will have no recourse against the sellers and choosing to spend the W&I premium costs elsewhere. They are relying on the disclosure process, taking comfort from management rollover/seller reinvestment, and assessing/pricing any issues as they come to light. Despite the current slowdown, W&I will likely remain a feature of UK dealmaking in the coming years. However, W&I is not a panacea for all transactions, and dealmakers should structure processes accordingly.

In the US, the use of RWI has increased significantly in recent years. In most transactions, PE buyers have migrated to a no-recourse structure back-stopped by RWI. Some US strategic acquirers have similarly moved towards a no-recourse or 'limited recourse' structure that generally permits claims for breaches of 'fundamental representations' and/or for some portion of the deductible under an RWI policy. As with their PE counterparts, these buyers retain RWI, particularly in competitive auctions with PE sellers, as a back-stop.

However, many US strategic acquirers remain more focused on traditional US remedies, including seller indemnification and escrow obligations. The buyer requirements for a traditional remedy structure are often framed as part of the buyer's willingness to pay a significant premium and the seller's need to retain perceived post-closing accountability.

Given ongoing market uncertainty, deal practitioners expect UK and US market practice to pull back from the recent heavy focus on no-recourse transactions. US acquirers will likely expect a more traditional US approach, particularly in strategic acquisitions and proprietary PE transactions, and parties are likely to land on a hybrid recourse package.

Looking forward

The next 12 months will likely present significant opportunities for UK and US dealmakers, but in a world increasingly difficult to predict, dealmakers will need expert legal counsel to translate transatlantic terminology and guide optimal M&A terms to navigate key risks.

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Market overview

The M&A market had been extraordinarily busy until the first half of 2022, given the high liquidity levels and a vast number of potential targets in attractive industries such as technology. However, the transactional pace has slowed down for several reasons.

With the invasion of Russian troops in Ukraine, geopolitical risks increased, as did energy prices, inflation and interest rates. Even today, a year after the invasion, reliable economic forecasts for target companies are difficult, as historical figures and the validity of business plans have lost some of their significance.

Although the economic outlook is improving and the gloomy forecasts for transactions are brightening, the times for M&A remain uncertain. Banks are still reluctant to provide financing, and debt funds, which are typically more willing to take risks, are also acting more cautiously.

All this places high demands on the transaction parties. They must anticipate unlikely developments and come up with creative solutions beyond established market standards.

Regardless of the muted market activities, in particular on the capital markets, public and private M&A remain key to Germany. While some recent IPOs and public takeovers brought noticeable media attention, private deals are still dominating the league tables. This may change, as the number of (planned) IPOs is remarkable and the recent drop of stock market prices might offer attractive investment opportunities related to listed targets.

Key deals

One of the larger deals, albeit noticing the first effects of the Ukraine invasion, was the establishment of a global joint venture by Advent International with LANXESS for high-performance engineering polymers with specialty chemicals (HPM Business). The joint venture simultaneously acquired the engineering materials business DEM – one of the leading global suppliers of high-performance specialty materials used in the electronics, electrical and consumer goods sectors – from Royal DSM.

The deal comprised two major simultaneous transactions – prompting a €6.2 billion (about $6.6 billion) joint venture in which Advent will hold a controlling stake. The transaction shows the trend of big corporations towards the concentration of businesses and the carve-out and disposal of non-core businesses, as well as the interest of sponsors to take over industry assets. The transaction also shows that despite the current environment, high-value deals continue to take place as there is still a huge amount of 'dry powder' in the market.

This trend is also seen in the infrastructure sector. One of the largest German deals in 2022 was the joint venture between Vodafone and a consortium of infrastructure investors led by Global Infrastructure Partners and KKR, which intends to acquire at least the approximately 81.7% stake in Vantage Towers AG held by Vodafone. The joint venture launched a voluntary public takeover offer to Vantage Towers AG shareholders in December 2022.

Vantage Towers AG is a leading telecommunications tower company in Europe with a market capitalisation of over €16 billion. It has, as a result of a spin-off from the Vodafone Group, been listed on the stock exchange since 2021, including on the MDAX. Besides another joint venture between private equity sponsors and corporations, this transaction is also a take-private transaction, which we are likely to see more of due to already lower valuations of listed companies compared with their private peers.

Economic recovery plans

The market activity for German targets is picking up, with several sales processes on the way. This development is likely to gain traction once the financing and syndication markets come back. What may be changing are deal structures and negotiation dynamics in a less seller-friendly environment.

As an asset class, infrastructure targets have entered centre stage. In addition, distressed assets with financial issues but an otherwise promising business case may attract attention not only from strategic but also private equity buyers.

Carve-outs will also remain important as the economic circumstances have not eliminated or decreased the need of corporations to transform themselves. This is, in particular, true for the automotive sector, which not only has to deal with the shift from traditional petrol and diesel engines to electric, hybrid or alternative models but, in Germany, has increasing competition from the US and Asia in this respect.

Another noticeable trend is outbound investments by German strategic investors, often into the US (rather than Asia), which are expected to grow.

Financial investors remain active and continue to be key to the M&A market. Fundraising had been easy in recent years and private

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equity sponsors still have considerable funds to deploy. Yet because only limited financing is available in the market at the moment, strategic buyers with readily available cash may have an advantage over financial sponsors with a leveraged buyout strategy. Fundraising becomes harder, in particular for smaller funds or funds with a below-average track record. That said, financial investors do, and will continue to, shape the German industrial landscape through their focus on performance ESG.

Legislation and policy changes

Acquisitions of private companies are primarily structured as share deals and are not governed by any statutory process (other than regulatory clearances). They are a matter of negotiation between the respective bidder and seller, as most relevant statutory provisions are not mandatory.

In contrast, public M&A transactions have to comply with the German Securities Acquisition and Takeover Act, the EU Market Abuse Regulation and the German Stock Corporation Act, and are subject to the supervision of the German Federal Financial Supervisory Authority (BaFin).

Private and public transactions may be subject to German merger control. Furthermore, the Federal Ministry of Economic Affairs and Climate Action (BMWi) has the power to review direct or indirect acquisitions of German-based companies by foreign investors. The BMWi may prohibit any acquisition of 25% or more of the voting rights by a non-EU/European Free Trade Area investor or request commitments if it threatens German public order or security, or violates essential national security interests. In addition, acquisitions of 10% or more of the voting rights in a company active in certain areas of critical infrastructure or in the area of military and defence may be subject to a mandatory filing requirement.

ESG

ESG aspects are increasingly considered in investment decisions and in M&A transactions. In particular, ESG due diligence has become an integral part in an M&A process examining whether the target's business model ensures sustainability and what risks and costs exist in relation to compliance with ESG criteria in the future. Findings from ESG due diligence have a direct impact on company valuation, purchase price and transaction documents.

Purchase agreements may, for example, require new guarantees and indemnities relating to, among others, supply chain management or sustainability reporting. The legal consequences provisions (of guarantees and indemnifications) could also be modified selectively to make it easier for the buyer to show and prove reputational damage, or damage caused by the temporary exclusion of the target company from public contracts.

New challenges

The interplay of the pandemic, the shortage of microchips and other supply chain issues, as well as geopolitical tensions – in particular between the US and Germany, as well as those following from Russia's invasion of Ukraine – have created challenges for M&A dealmakers. A matrix of sanctions and export control regimes, as well as foreign investment rules, needs to be observed.

Governments and regulators are regularly expanding the reach of sanctions and releasing new guidance, including on giving powers to the police to sanction breaches. An action permissible at the point of deal inception may be prohibited by the time the deal is consummated. Thus, deal teams must remain alert to the rapid pace of change and include clear language in any deal documents to ensure that they do not commit to actions that could become prohibited.

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Practice insight/market norms

Foreign investors continue to wonder about the notarisation requirements in Germany, in particular in connection with German limited liability companies (GmbH). Share purchase agreements, including all annexes, must be read out loud by a notary to the parties, a potentially long exercise. Even so, the notarisation process is generally no obstacle to deals but serves as a disciplinary tool to complete negotiations and get the documentation in final shape. Costs can be considerable and need to be factored into the buyer's transaction budget.

Depending on the deal structure, it is highly advisable to seek employment and tax advice early on, as German law has some unique peculiarities in these areas.

Technology helps to facilitate the M&A process by rapid documentation and data handling. However, given that the parties increasingly rely on digital tools, dealmakers are more and more concerned about cybersecurity risks, as a breach can be ruinous.

Public M&A

The scope of legal documentation required for the acquisition of shares in a public company depends on the type of business combination chosen, as well as on the type of shares being acquired and whether these shares are to be acquired through the stock exchange, via a capital increase, or from other shareholders.

Holding 30% of the voting rights in a listed company is considered to provide 'control' under German takeover law. Whoever is about to achieve or exceed this threshold directly or indirectly will need to consider a public takeover offer. The offer requires an offer document. Unsolicited takeover attempts are still rare in Germany; however, the general attitude towards hostile transactions is less negative than in the past.

After the decision to launch an offer has been published, the management board is prohibited from taking any action that could prevent the success of the takeover offer. But the management board may search for a 'white knight', take any action within the scope of the management board's powers if approved by the supervisory board, and, if no further legal requirements exist, and take actions that would have reasonably been taken if no offer had been launched. Furthermore, the shareholders may, under certain restrictions, authorise the management board to take action within the scope of the powers of the shareholders' meeting before and independent of any takeover offer.

The BaFin takes a rather restrictive position on the possibility of imposing offer conditions. Voluntary public takeover offers – offers that are made by buyers that do not own shares in the target company or whose shareholding is below 30% – are usually only subject to regulatory approvals, fairly standardised market and company material adverse change conditions, and no defensive measures (such as capital increases during the offer period) being taken. There is often a minimum acceptance threshold for offers, as the acquisition of only some of the shares may not be attractive. Mandatory offers – offers that are triggered once a shareholding of 30% is reached by one shareholder – can only be made subject to regulatory conditions.

Break-up fees in public M&A deals (when the target pays the prospective buyer) have traditionally been unpopular in Germany and few target companies or bidders are willing to accept them.

Private M&A

Because of the changed market conditions, the negotiating parties' price expectations are increasingly diverging. While sellers like to point to past profits and good long-term prospects based on historical assumptions, prospective buyers focus on the deteriorated economic conditions and uncertainties related to future earnings. They are increasingly reluctant to pay the high purchase prices that we saw in the boom years and, in particular, apply the same EBITDA multiples.

On the other hand, there are the sellers that have been spoilt with exceptionally high purchase prices due to the low interest environment which they do not (yet) want to let go without further ado. This is understandable, as they also might have bought at a high valuation, so that a reduction in the purchase price would be particularly painful.

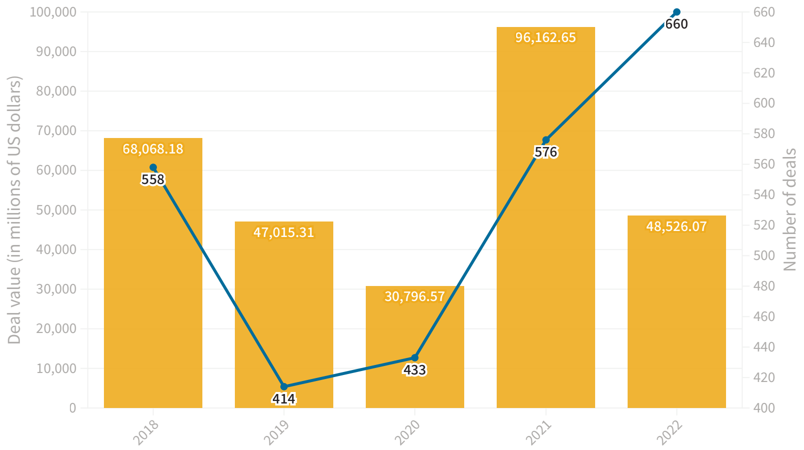
To close the gap, creative purchase price structures are required that bring the interests of both contracting parties to an appropriate balance. This includes the entire spectrum of earn-out clauses, in which variable purchase price components are linked to the future (earnings) development of the target company. In the event of a sale to a financial investor, a participation of the seller in the exit proceeds after a subsequent sale may also be considered.

Drafting the purchase price clauses so that they accurately reflect the commercial understanding of the parties and cover all possible scenarios can be very challenging and requires close coordination of all the advisers.

Overall, the potential for dispute is significantly greater in times of crisis, which can also affect fundamental aspects of the acquisition. This particularly applies to the warranty catalogue, which in some

Annual inbound M&A
Germany

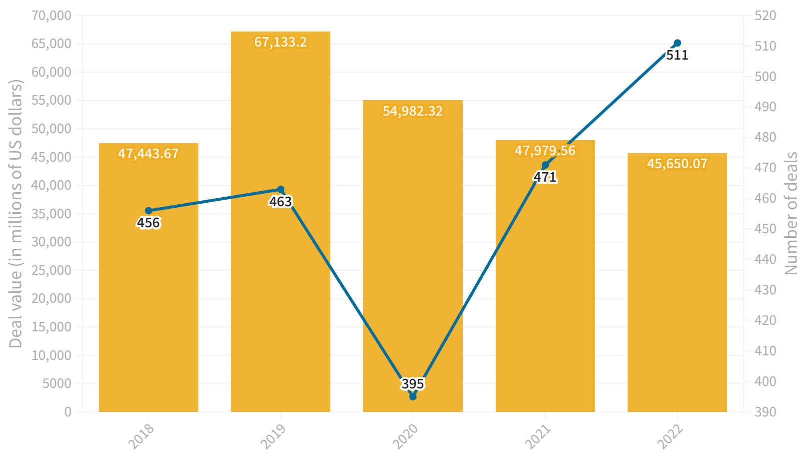
■ Number ■ Deal value (USD m)



Source: Dealogic

Annual outbound M&A
Germany

■ Number ■ Deal value (USD m)



Source: Dealogic

cases has to be supplemented with clauses that protect the buyer against new risks. It is to be expected that new standards are likely to develop here soon. However, warranty and indemnity (W&I) insurers, which protect parties from the consequences of a warranty breach, sometimes view innovations critically. As a result, transaction partners may not be able to outsource contractual liability to the W&I insurer as planned.

Due to the uncertainty about the valuation of identified risks, indemnifications by sellers are also being increasingly used again.

Deal certainty remains one of the most crucial factors besides the purchase price and limitation of liability. Hence, transactions are typically only subject to merger control clearance by the relevant authorities, and foreign investment control clearances. Any further deal conditions would depend on the transaction specifics but may increase together with the other buyer-friendly conditions.

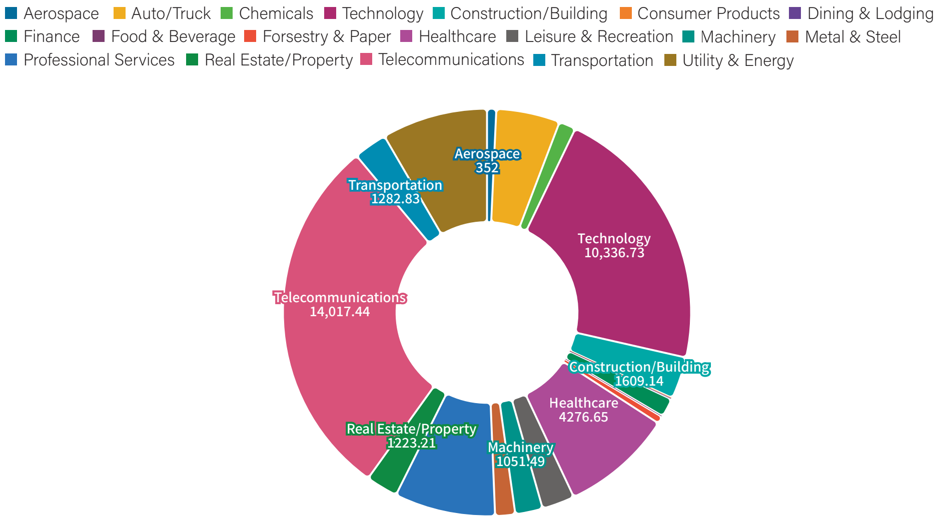
Share purchase agreements relating to German targets are usually governed by German law under the jurisdiction of German courts or arbitral tribunals. Depending on the preferences of the parties, agreements may also be made subject to non-German laws.

IPOs occurred in H2 2022 and Q1 2023, but only a few. There are many IPOs in the pipeline and 2023 promises to be an active year in this respect should the market conditions continue to improve. Trade sale exits are also picking up but there remains some level of uncertainty.

Looking ahead

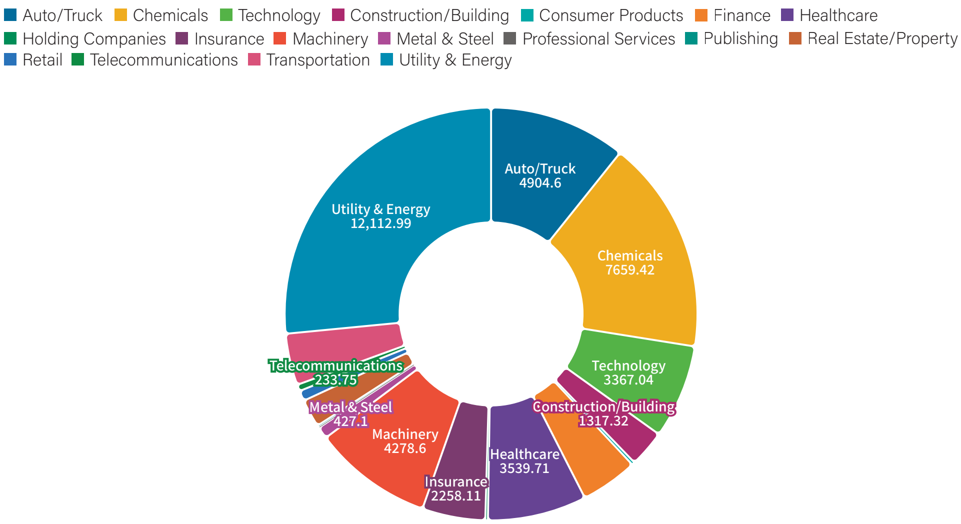
The past year has shown how quickly the seemingly stable M&A market can change because of unforeseen developments. Corporate

2022 inbound M&A by sector
Germany



Source: Dealogic

2022 outbound M&A by sector
Germany



Source: Dealogic

buyers (as well as lenders) are acting more cautiously today and are no longer willing to accept unilateral contractual risk distributions. This affects the drafting and negotiating of the transaction documents and suggests that the strong seller's market, which has existed for years, could once again shift towards a more buyer-friendly market.

Yet the M&A market is unlikely to collapse – as it did during the 2008 financial crisis – because the negative effects are also countered by several positive factors: many companies are still under high innovation and transformation pressure and are therefore often dependent on acquisitions. Private equity investors have considerable capital to invest and the current crisis also offers interesting opportunities in the M&A market that many decision-makers want to profit from, such as the acquisition of companies that have financial difficulties because of the present turbulence but otherwise have a solid business case and are well positioned in the long term.

United Kingdom

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Market overview

Compared to 2021, which had record-breaking levels of M&A activity in the UK, leading to a strong seller's market and extremely competitive deal processes for resilient assets (and even for less obviously attractive assets), the 2022 UK M&A market experienced a cooling in terms of deal value and volume.

Data from Dealogic shows 2022 inbound UK M&A deal value (based on target nationality) was down 34.7% to $112,216 million from $171,903 million in 2021. Inflation, currency declines, energy prices, the downturn of the high-yield market and geopolitical tensions (including the Ukraine–Russia war) impacted equity markets. Despite the slowdown, the 2022 volume figures demonstrate meaningful market resilience overall because the inbound UK M&A deal value (based on target nationality) increased 18.5% from pre-pandemic levels of $94,706 million in 2019.

2022 was a tale of two halves for M&A activity. There was a continuation of the high-intensity activity trend of 2021 in early 2022, which was driven by renewed optimism underpinned by the success of the vaccine rollout, the low-interest environment, private equity sponsors seeking to deploy 'dry powder', and strategic divestment and consolidation across the wider market (particularly within the high-tech industrial and infrastructure sectors). A marked difference was felt in the second half of 2022, however, as the Ukraine–Russia war, inflation, tightening debt markets and political change in the UK weighed on the market.

Take-private transactions (i.e., when a publicly traded company returns to private company status as a result of a sale), a firm feature of 2021 and the first half of 2022 (and, in fact, the past decade), also slowed in the latter part of 2022.

In terms of M&A market drivers, public and private M&A transactions play an important part in the UK market, but private M&A deals make up a significant majority of UK-target M&A deals. Public takeovers have a prescribed process under the City Code on Takeovers and Mergers (the Takeover Code), as administered by the Panel on Takeovers and Mergers (the Takeover Panel), whereas the structure and process of private acquisitions are a matter of negotiation between the buyer and seller.

Latham & Watkins advised on a number of significant M&A transactions in 2022, including acting as lead legal counsel to the consortium led by Todd Boehly, chairman and CEO of Eldridge, and Clearlake Capital Group, L.P., on its £4.2 billion acquisition of Chelsea Football Club, which was a landmark transaction and represents one of the largest sports M&A deals in history. Latham also advised Whirlpool Corporation on its strategic joint venture with Arçelik A.Ş., as part of its portfolio transformation, and EIG on the $19 billion joint venture with Repsol Upstream.

Each of these transactions highlights how large-scale M&A deals remain strategically important, particularly for experienced acquirers, as a means to achieve scale, extend capacity and expand product portfolios while consolidating industry position in an uncertain market.

Economic recovery plans

Although high-profile transactions did complete in the previous 12 months, the difference between the M&A environment of 2022 and the stimulus-fuelled M&A boom of 2021 is stark, with 2022 inbound UK M&A deal value (based on target nationality) down 34.7% compared with 2021. However, the market also demonstrated resilience, and there was an overall increase of 18.5% in deal value in 2022 compared with pre-pandemic levels in 2019.

Looking forward to the next 12 months, the macro headwinds that hampered UK M&A in the second half of 2022 are likely to persist in Q1 and Q2 of 2023. However, reasons for optimism exist, and activity can be expected to accelerate towards the latter part of the year. The private markets have demonstrated a marked resilience, many investors are still sitting on record levels of capital that needs to be deployed, and interest rates are expected to stabilise and open debt markets, which should pave the way for increased deal flow. That said, the M&A playbook that has dominated the past few years will likely need to be tweaked. It is anticipated that buyers will readjust their valuation processes, demand increased investor protections through creative structures, and be wary of ambitious closing timelines, with dealmakers likely to spend additional time completing processes as they navigate choppy market conditions.

ESG-related factors are also set to be increasingly significant drivers for change in M&A in the next 12 months, driven initially by investor and consumer demand, and followed by legislative developments across multiple jurisdictions.

The most significant trends relate to:

- Industry consolidation, M&A-driven growth, financing considerations or other factors;
- Distressed M&A work – takeover reorganisations, bidding, post-M&A closings;
- The impact of COVID on M&A-related disputes;
- The use of indemnity provisions.

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The most significant factors influencing deal structures in 2022 were the introduction of new regulatory red tape and the low availability and high cost of traditional debt financing. The new regulations that are having an impact on M&A activity are discussed in detail below.

In terms of debt financing, the challenges faced by firms in sourcing debt at reasonable rates have meant that private equity and venture capital bidders have struggled to put in place long-term financing arrangements in the post-completion phase, impacting bidder returns and capital availability. As a result, private equity and venture capital firms that could not fully fund transactions pressed the pause button on investments in the latter part of 2022. Strategic bidders with committed but undrawn capital, however, could afford to be more flexible in how they deployed capital and were therefore more active in this space.

In the public M&A context, more difficult financing markets during 2022 led financial sponsors to look to non-traditional lenders and equity co-investors to finance deals.

Private equity acquirers continued to be very active in the UK M&A market in Q1 and Q2 of 2022, which was driven by the need to deploy funds and the relative weakness of the pound sterling versus the US dollar. However, this activity noticeably trailed off in the last two quarters of the year due to market-driven hesitancy.

The UK M&A market has also experienced a significant increase in shareholder activism seeking to secure higher offers for a target company before backing a bid. Despite a decline in activity by activist shareholders during the pandemic, activism is expected to play a key participative role in, and present a challenge to, M&A transactions in the next few years.

Legislation and policy changes

In terms of legislation and the regulatory bodies that govern M&A activity in the UK, the UK Companies Act 2006 applies to public and private companies registered in the UK. While the Companies Act 2006 does not govern M&A activity as such, its requirements dictate the way that deals by UK companies are effected.

The acquisition of private companies is a matter of negotiation between the buyer and seller, and no regulated offer process is required. In non-regulated industries (i.e., other than financial services, telecoms, media, and pharmaceuticals), deals are not typically subject to input from regulatory bodies, save for competition and foreign direct investment (FDI) matters.

Public acquisitions are governed by the Takeover Code, a principles-based set of rules issued and administrated by the Takeover Panel.

The end of the Brexit transition period on 31 December 2020 marked the end of the European Commission's status as a 'one-stop shop' for the review of mergers relating to the UK meeting monetary thresholds. This means that if a merger satisfies the jurisdictional thresholds of the EU Merger Regulation and the UK's Enterprise Act 2002, the Competition and Markets Authority and the European Commission may conduct parallel assessments of the same merger in their respective jurisdictions.

Certain regulatory changes in 2022 had an impact on M&A transactions and will continue to do so. In particular, the introduction of the National Security and Investment Act (the NSI Act) and the agreement of the Foreign Subsidies Regulation (FSR) will impact the structure and timelines of deals.

The NSI Act came into force on January 4 2022, granting powers to the Secretary of State for Business, Energy and Industrial Strategy (BEIS) to screen a broad range of transactions on national security grounds and allowing the BEIS to block or impose conditions on deals. Due to its retroactive application, the NSI Act is already affecting deals. Early consideration of NSI Act-related timing implications is likely to impact M&A timelines going forward.

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He also advises financial institutions serving as lenders and advisers to parties on M&A transactions.

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Additionally, the European Parliament and European Council agreed the FSR in 2022, a regime introduced to control foreign subsidies that distort the EU internal market. Under the FSR, the European Commission will have the power to review a wide range of M&A transactions involving a company that has received a subsidy from a non-EU country and impose remedies against any market distortion created by such subsidies. This new regulatory layer will apply in addition to existing merger control and FDI scrutiny of M&A.

Although the FSR is expected to result in more costly and time-consuming deal processes, there is no suggestion that the European Commission intends to use the regulation to block all deals involving a company that receives a state subsidy from outside the European Union. Thus, while the FSR is certainly a new hurdle for corporate acquirers to contend with, it is not seen as an insurmountable one.

2022 also brought with it a number of amendments and consultations regarding amendments to the Takeover Code. These changes on the whole, however, are not expected to have a material impact on public M&A.

COVID caused significant challenges for companies in the UK, as it did globally, but overall the lasting impact of COVID on deal terms appears limited. ESG issues, however, have become increasingly important for corporates in recent years.

A wider range of deal provisions are being considered in light of their potential to enhance the ESG outlook of acquisitions. While ESG-linked M&A deal terms such as ESG warranties and indemnities have largely remained off the table for auction processes (often due to the compressed timetables imposed on bidders), in certain deals there has been early interest in the private equity space for ESG-linked terms, such as ratchets to help to foster stakeholder alignment on the importance of post-completion ESG enhancements to an acquired business.

In terms of upcoming policy framework changes that may impact M&A in the UK, merger control scrutiny is tightening. In particular, agencies are scrutinising the suitability of buyers and market dynamics more closely and imposing greater evidentiary burdens on merging parties. Strategic management of merger control from the outset is key to ensuring successful deal execution.

Rising regulation of tech innovation is also noteworthy. In the UK, for example, the Financial Conduct Authority is pursuing a formal transformation programme and intends to be more assertive. As such, stakeholders should expect a more interventionist approach from the regulator.

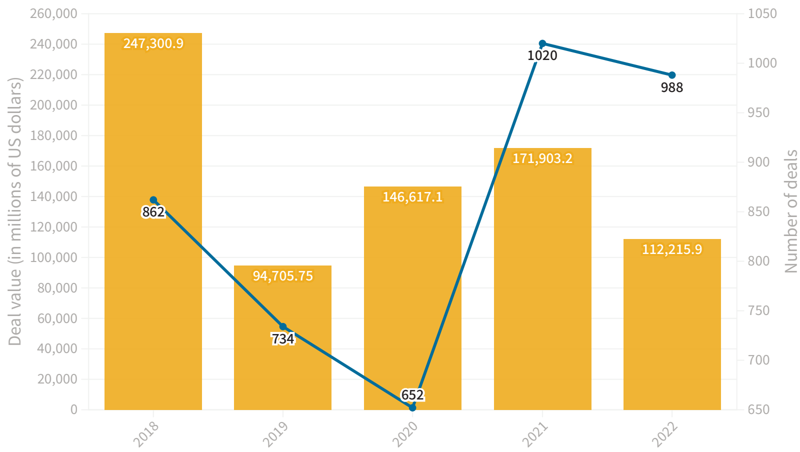
Practice insight/market norms

A common misconception about the UK M&A market is that transactions cannot be consummated by way of merger. The Companies Act 2006 does, in fact, provide for merger by absorption for UK public companies, but these provisions are generally not used and a scheme of arrangement is more commonly seen. This approach is in contrast to other jurisdictions, in particular the US, where mergers are frequently encountered.

An area that is often overlooked by parties involved in M&A transactions is that buyers do not usually attend to consolidation of group companies immediately after closing, resulting in continued administrative and financial burdens (for example, filing annual accounts) to maintain dormant or inactive subsidiaries.

Dealmakers are increasingly using artificial intelligence technology to conduct more efficient due diligence in M&A transactions. During the pandemic, dealmakers made extensive use of virtual meeting technology and electronic signature platforms to negotiate and close transactions, and this trend looks set to continue.

Annual inbound M&A
United Kingdom



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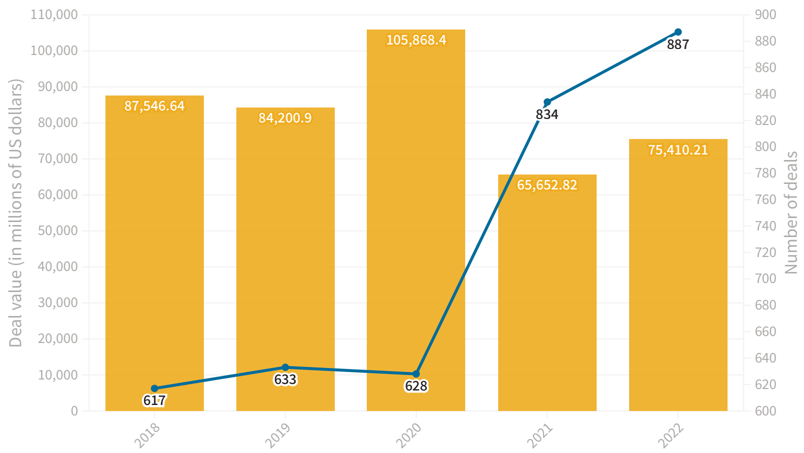
Annual outbound M&A
United Kingdom



Source: Dealogic

Public M&A

The acquisition of control of a public company is regulated by the Takeover Code and the Takeover Panel. A bidder may choose to stake-build to obtain a toehold in a public company. However, depending on the timing of such acquisition and the form of consideration, stake-building may set a floor price and fix the form of consideration for any future offer. Furthermore, acquiring 30% of the voting rights in a public company will require a bidder to launch a mandatory cash offer for the remainder of the shares it does not own.

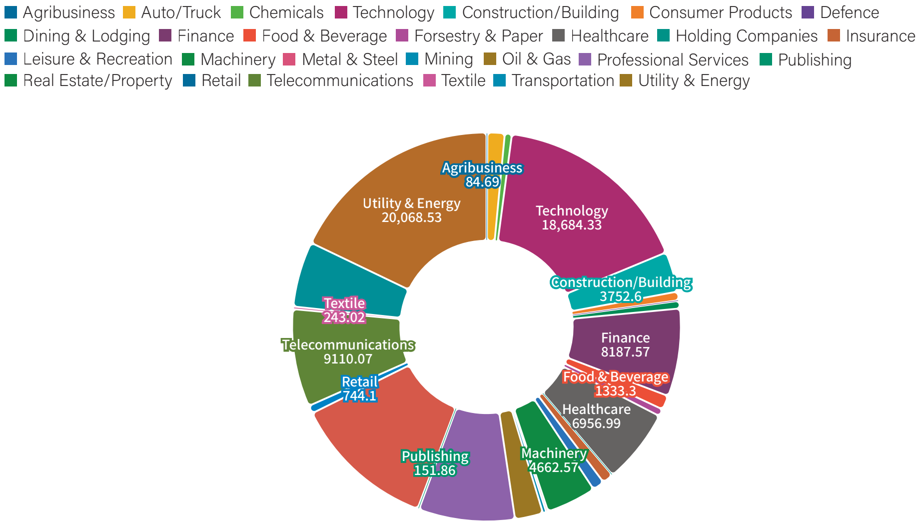
In addition, any dealing giving rise to speculation, rumour, or an untoward movement in the public company's share price may mean an announcement is required (if the acquirer is considering making an offer for the whole company), while disclosures will also be necessary once certain thresholds of ownership are crossed.

A takeover offer will usually be subject to an extensive set of conditions, including:

- Securing acceptances carrying more than 50% of the voting rights in the target (or, in the case of a court-sanctioned scheme of arrangement, the requisite 75% target shareholder approval);
- Antitrust and regulatory approvals;
- The bidder's shareholder approvals;
- Listing of consideration shares (when applicable); and
- Conditions dealing with the state of the target's business.

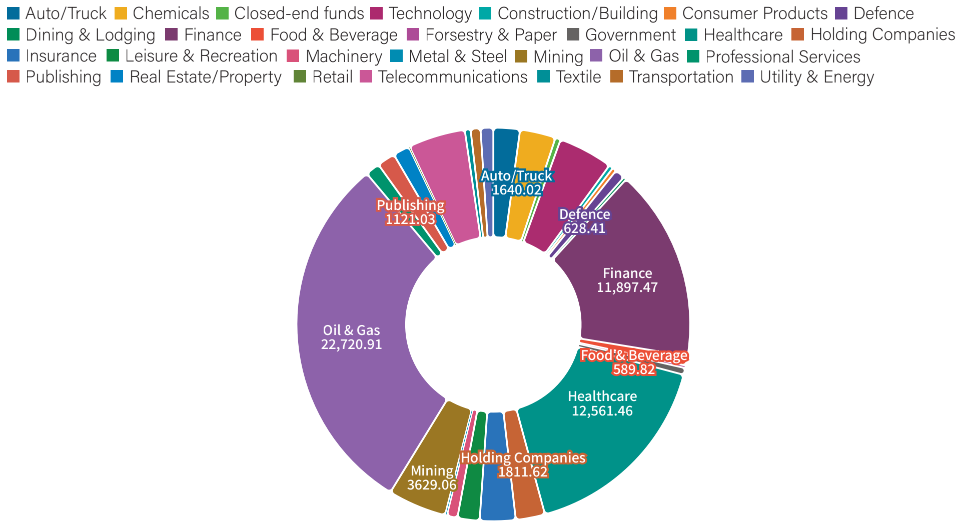
A bid cannot be subject to conditions that depend on the judgement of the bidder. Additionally, bidders seeking to rely on a material adverse effect or similar bidder protective condition to not proceed

2022 inbound M&A by sector
United Kingdom



Source: Dealogic

2022 outbound M&A by sector
United Kingdom



Source: Dealogic

with an offer require the consent of the Takeover Panel, which applies a materiality test with a high bar (requiring the circumstances to be of considerable significance and aiming to strike at the heart of the purpose of the transaction) before it will permit an offer to be lapsed.

In public takeover offers, break fees (when the target pays the prospective buyer) are now largely prohibited, whereas reverse break fees (when the prospective buyer pays the target) are not prohibited. Only in limited circumstances can a break fee be offered; for example, a break fee may be offered to a 'white knight' making a bid in competition with a hostile offer that has already been announced (subject to such fee being de minimis and payable only upon the first offer becoming, or being declared, wholly unconditional).

If the bidder is a UK public company and subject to the UK Listing Rules, and the total value of the reverse break fee exceeds 1% of the market capitalisation of the bidder, the bidder's directors will need to treat the reverse break fee as a material transaction (which, among other things, requires shareholder approval). If the bidder controls more than 10% of the target, a reverse break fee may also constitute a related-party transaction for the purposes of the UK Listing Rules.

Private M&A

According to the eighth edition of the Latham & Watkins Private M&A Market Study (the Latham & Watkins Market Study), 49% of deals included a locked-box mechanism, 26% of deals included a completion accounts mechanism, and 25% of deals did not provide for price adjustment. This trend is consistent with results from the previous four editions. However, as antitrust scrutiny increases (which may lead to delays between signing and the completion of transactions) and we generally move towards a more 'buyer-friendly' M&A environment, the completion accounts mechanism could see a comeback.

Earn-outs are often employed to bridge the gap between buyer and seller expectations. The proportion of deals that included an earn-out increased in 2022 in light of the uncertain economic environment. As per the Latham & Watkins Market Study, earn-outs featured in 13% of the UK deals analysed. Given the challenges with the valuation of assets in the economic climate predicted for 2023, earn-outs will likely continue to play a material role in UK M&A transactions to align valuation gaps between the parties.

In private M&A, the conditions to closing that are included in a purchase agreement will vary based on the circumstances of each transaction. Historically, conditionality beyond regulatory and antitrust clearances has been uncommon, but the increasing role of regulation in dealmaking is having an impact in this regard.

The prevalence of FDI approval conditions continues to increase, corresponding with the increased number of jurisdictions with FDI regimes and the high-value, high-profile and strategically significant nature of a number of deals included in the Latham & Watkins Market Study – 15% of deals analysed included FDI approval as a condition.

In the UK, it is not common practice to provide for a foreign governing law and/or jurisdiction in private M&A share purchase agreements. Such agreements relating to UK companies and assets are typically governed by English law and are subject to the jurisdiction of the English courts. In fact, for global transactions, depending on the location of the parties and their advisers, purchase agreements are also often governed by English and Welsh law, because it is viewed as stable, impartial and commercial, with a developed litigation infrastructure.

The exit environment in the UK across 2022 was mixed. The beginning of the year was active for financial sponsors as an abundance of dealmaking carried over from 2021, but this slowed in the second half of the year as economic uncertainty, rising interest rates and stock market volatility created hesitancy among acquirers.

Such macroeconomic conditions also played a major role in muting UK and global IPOs. Pent-up demand, however, may lead to an increase in IPOs and trade sales in the second half of 2023.

Looking ahead

Although it is difficult to predict how the current macroeconomic trends will play out in 2023, there are reasons to expect that some of the significant headwinds that impacted UK M&A activity in the second half of 2022 may give way.

While UK M&A activity levels will likely continue to lag in the first two quarters of 2023, consistent with the environment in the second half of 2022, deal activity is likely to accelerate at the end of the year as investors continue to hold record levels of cash and inflation and interest rates stabilise. Nevertheless, factors that suppressed M&A activity in 2022 remain, and it is unlikely that the 2023 market will be as seller-friendly as it has been in previous years.

While investors will likely return to the market to attempt to take advantage of a reset in valuations and generally depressed competition for deals, they will likely proceed with caution and be particularly focused on the greater regulatory burdens when they target UK companies. Latham & Watkins expects that this will result in longer deal processes overall as the risks and benefits of potential transactions are more carefully considered, enhanced diligence is requested, and deal structures and terms are adjusted in response to perceived risks.

United States

Robert Katz and Charles Ruck, Latham & Watkins

Market overview

Following a more moderated deal environment in 2022 compared with previous years, the outlook for the US M&A market in 2023 is cautiously optimistic.

Headwinds that muted the pace, breadth and depth of the M&A market in 2022 persist. These include increased scrutiny from regulators globally, rising interest rates, global tensions and stock market volatility.

However, there are factors that point to an accelerated, more robust outlook in 2023. These factors include:

- Financial sponsors with 'dry powder' at the ready;
- More attractive valuations as buyers and sellers internalise valuation expectations;
- Event-driven investors catalysing opportunities; and
- Well-capitalised strategic corporates undertaking transactions that look beyond the current economic cycle.

Dealmakers will continue to heavily consider regulatory enforcement in 2023. Legislation in the US remains pending with respect to wide-ranging antitrust/competition reform and it is expected that regulators will continue a more aggressive approach to merger investigations and enforcement.

The policies of the US Department of Justice and Federal Trade Commission are in line with the more aggressive approach of non-US competition authorities that have also stepped up enforcement actions, in some cases based on newer theories of competitive harm and newer legislation intended to prevent an abuse of market power.

Similar to antitrust/competition enforcement, foreign investment review in the US (including the Committee on Foreign Investment in the United States, or CFIUS) and around the globe (including the EU foreign direct investment review) will require increased attention and analysis by market participants. The trend of closer scrutiny with regard to non-domestic investors is expected to continue. Dealmakers and corporate boards must take these considerations into account when evaluating strategic transactions and assessing risk and deal certainty.

The market continues to be driven by private and public M&A transactions, although private M&A is more prevalent because there are many more private than public companies. The cost of capital and the availability of debt financing is a driving factor, particularly for private company and private equity (PE) dealmaking where acquirer stock is not available as transaction currency. For public companies, well-capitalised balance sheets and an ability to use stock as an acquisition currency remain key drivers for potentially strong deal volume in 2023.

Regulation

Increased scrutiny and evolving models of antitrust enforcement and review continue to be topics of conversation among M&A participants within the US and around the globe. US regulators have been reviewing, and continue to actively review, challenging business combinations. Regulators are focused on particular industry verticals, including technology and healthcare. In the US, regulators challenged and sought to block a number of high-profile transactions within those industries. Regardless of the agencies' win/loss record, regulators are undeterred because the potential for new legislation within the US with respect to horizontal and vertical mergers may alter long-held views on antitrust review and enforcement.

M&A practitioners continue to discuss approaches with regulators to maximise outcomes. The changes would include preparing to divest assets in advance of approaching regulators ('fix it first' approaches) such that settlement packages are part of the proposed transaction rather than provided by regulators.

Practitioners have also extended 'outside dates' of transactions with an understanding that regulators may be reviewing transactions, and thus extending executory periods of proposed combinations.

In addition, requiring parties to litigate with regulators in court to the extent that regulators seek to enjoin transactions has become more prevalent, and in some cases necessary to win competitive auction processes.

Economic recovery plans

The 2022 M&A market was markedly different from 2021 and more recent years. M&A activity set records in 2021. Early 2022 benefited from those tailwinds. Overall, however, 2022 transaction volume declined by approximately 35%. The second half of 2022 was the primary culprit, with transaction volume declining significantly from the first six months.

There was a confluence of events that weighed on the M&A market. Stock market volatility, monetary tightening by the US Federal Reserve Bank in the form of significant interest rate hikes, the conflict in Ukraine and general macroeconomic uncertainty combined to dampen activity in the M&A market. Generally speaking, confidence in corporate boardrooms lessened and market participants were cautious in a different economic paradigm from that which had been in place for nearly a decade.

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However, market participants are cautiously optimistic that deal flow will improve through 2023. PE buyout funds continue to maintain high levels of uncommitted capital for M&A transactions. In addition, strategic acquirors are still focused on growth, with a focus on M&A and organically. In particular, it is expected that M&A activity may be concentrated in certain industries, including energy/infrastructure, technology and healthcare.

Market participants with better internalised valuations in the current environment (as opposed to measuring versus previous 52-week highs), greater clarity from the US Federal Reserve Bank on interest rate hikes (and when they may cease), event-driven investors (which often create their own events) spurring potential transactions, and easing trade tensions (particularly between the US and United States) could be the catalyst for a pick-up in transaction volume. Strategic players and PE sponsors have capital to deploy and with a boost of confidence in the markets, M&A activity seems likely to follow.

Increased scrutiny and creative solutions

Transaction participants have been more keenly focused on the scrutiny that regulators will apply to M&A transactions and how such risks are allocated among the parties to transactions. Regulators in the US have explicitly signalled a heightened sensitivity to the competitive effects of certain transactions and have taken more aggressive actions, including prohibiting the consummation of transactions based upon the presumed anti-competitive effects. This increased regulatory scrutiny has impacted, and will continue to impact, transaction strategies in the global markets. In particular, industries such as technology, industrials and healthcare will remain subject to heightened oversight.

Participants in the US M&A market would surely have seen more acute disagreement between buyers and sellers with respect to valuations in 2022. Sellers, having recently experienced higher valuation multiples and more active buy-side processes, were less willing to transact in the new valuation paradigms relative to recent 52-week highs. In an attempt to bridge the difference between the bid/ask spread in M&A transactions, the use of earn-outs, contingent value rights and other means by which buyers and sellers could mitigate pricing risks becomes more common.

Continuing a trend, representation and warranty insurance (RWI) remains a tool used by M&A market participants to bridge and disintermediate exposures for unknown liabilities. The absence of debt financing also dampened deal activity in the second half of 2022. With increased market uncertainty and volatility, lenders were less willing to back-stop M&A transactions.

In an effort to compensate for the absence of more traditional financing, parties were more active in 2022 in discussing alternative financing arrangements with direct lenders and the use of seller financing. In 2023, it is expected that private capital – financing from non-bank lenders – will increase and become part of the established landscape.

PE firms remain a driving force of dealmaking. Despite a rise in US interest rates and an increase in market volatility, PE participants are expected still to be active in 2023, with uncommitted capital at PE firms remaining at record levels. With the challenges in the debt financing markets, larger PE transactions have been more difficult to execute. 'Middle market' PE transactions (i.e., transaction values ranging from $50 million to $500 million) have been, and are expected to represent, a significant portion of PE M&A volume.

Shareholder activism is also expected to have a higher profile in 2023. The number of activist campaigns in 2022 was approximately 15% higher than in 2021 and that trend is expected to continue. Activists are expected to wage campaigns based on what would be considered usual and customary grounds (asset allocation, sub-par returns on investment), but also on ESG platforms and 'say on pay'. These activist campaigns are often M&A related, with an underlying thesis that shareholders are better off with companies being sold or reconfigured to drive maximum shareholder value.

Legislation and policy changes

US M&A transactions are subject to regulation by the federal government and the target's state of incorporation.

The federal government primarily regulates the issuance and sales of securities through the Securities and Exchange Commission (SEC), antitrust matters through the Federal Trade Commission and the Antitrust Division of the Department of Justice, and foreign investment that may have national security implications through CFIUS.

The laws, rules and regulations administered by the SEC are particularly relevant in the purchase or sale of a US public company. The laws of the target's state of incorporation govern that company's internal affairs and impose requirements for shareholder approval of mergers and the procedures for effecting mergers.

The Biden administration, the legislative branch of the US government, and government enforcement and regulatory agencies have publicly spoken about antitrust priorities in 2022 designed to address perceived shortcomings in antitrust enforcement and, importantly, perceived consumer harm resulting from business combinations. These evolving antitrust priorities will expand antitrust scrutiny, consistent with the changes practitioners are already seeing at the antitrust agencies within the US. The potential for new legislation within the US with respect to horizontal and vertical mergers that could alter long-held views on antitrust review and enforcement will continue to be top of mind for dealmakers.

In negotiating transaction agreements, practitioners will need to be aware of these risks and how they are allocated, the actions and undertakings that buyers must agree to secure regulatory approval, and the time required to navigate the antitrust review process and potential challenges and court proceedings.

Dealmakers and C-suite executives will likely demand increased attention as to how a transaction may be viewed and positioned from an ESG perspective. ESG has become a topic that investors review in their due diligence undertakings. Private firms have designated diligence groups and diligence protocols relating to ESG.

In general, the US framework of protecting 'consumers' rather than 'competitors' is being revisited writ large. Regulators are now more keenly focused on other constituencies, including labour, the environment and other ESG-related concerns. This potential revised regulatory framework, together with the time required to navigate regulatory review and the remedies that regulators may ultimately require, is something that all parties should consider thoughtfully when contemplating a potential M&A transaction.

Recently, regulators in the US have introduced proposals to potentially invalidate (but most certainly narrow) employee non-competition agreements. M&A market participants will need to review existing non-competition agreements and provisions and thoughtfully consider whether alternative protections, such as confidentiality agreements and other employment provisions (i.e., those related to incentive compensation), assist in providing the comfort required when evaluating the risks in acquiring a target company.

Practice insight/market norms

Unlike the locked-box approach that is more common in many non-US jurisdictions, in most US private acquisitions the purchase price agreed to at signing is usually subject to closing or post-closing adjustment based on the amounts of certain financial accounts of the target (for example, cash, indebtedness, and net working capital) on the closing date. Under this approach, the parties generally must spend more time negotiating the adjustment mechanics and related accounting methodologies.

Under the laws of most states, public target boards must generally retain the right (commonly referred to as a 'fiduciary out') to terminate the transaction agreement after signing but before the target's shareholders approve the transaction to accept a higher offer. Shareholder litigation is common in such transactions, and the buyer is generally liable for related costs.

RWI and transaction structures that provide for no post-closing recourse by the buyer against the seller except for fraud are increasingly common in private company transactions.

As a result of the pandemic, dealmakers have had to adjust to a virtual environment in which almost every aspect of an M&A transaction relies on technology, necessitating a keener focus on cybersecurity issues in the deal execution process. Also, data privacy and cybersecurity have become critical elements of the business and operations of most companies and thus should be a key focus of due diligence in any M&A transaction.

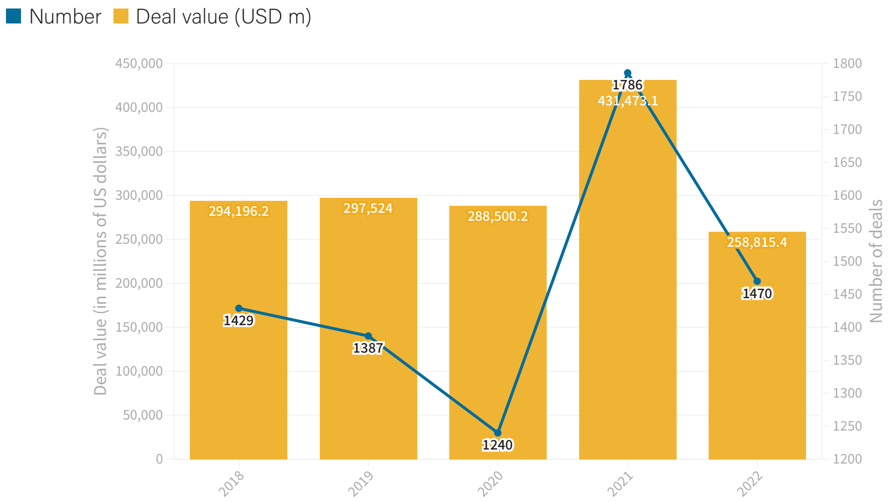
Public M&A

In light of the fiduciary duties of public company directors that generally require them to maximise shareholder value in a sale, target boards often conduct some form of a pre-signing market check. However, in some deals the target board will forgo a pre-signing market check in exchange for a 'go shop' right to solicit competing offers for a limited period (usually 30–60 days) after signing the transaction agreement.

While state law generally requires target boards to preserve a fiduciary out to accept a higher offer under certain circumstances, buyers usually negotiate for a prohibition on the target's right to affirmatively solicit competing offers (except in the case of a go shop right), and the right to receive a break-up fee if the target's board terminates the transaction agreement to accept a higher offer.

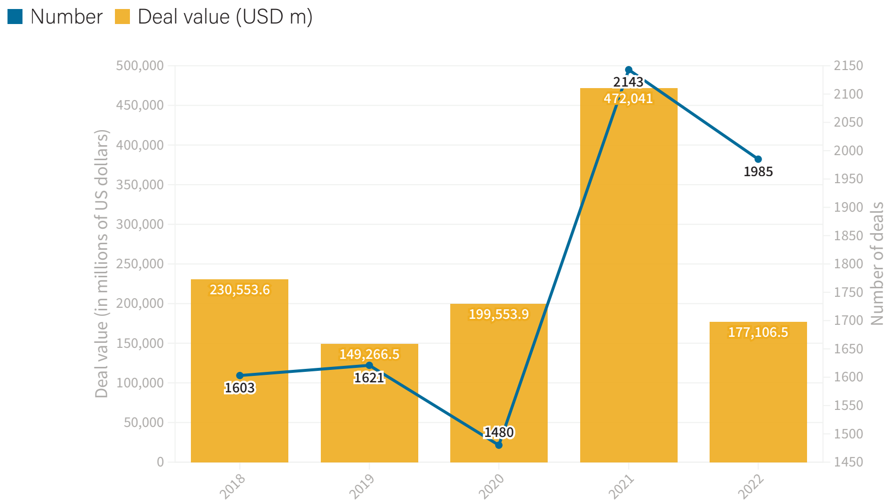
Most states require shareholder approval (usually by a majority of outstanding shares) of most mergers. Certain regulatory approvals – including clearance under the Hart–Scott–Rodino antitrust statute, and for non-U.S. acquirers, from CFIUS – must be obtained before an acquirer can take control of a US company.

Annual inbound M&A
United States



Source: Dealogic

Annual outbound M&A
United States



Source: Dealogic

Acquiring a US company in regulated industries such as financial services and energy may be subject to additional regulatory scrutiny at the federal and/or state level.

Public company acquisitions can be structured as:

- A one-step merger between the acquirer (or, more commonly, a subsidiary of the acquirer) and the target (typically requiring majority shareholder approval); or
- A two-step transaction involving a tender or exchange offer by the acquirer for all the target's outstanding shares (which is generally subject to a 'minimum tender condition' requiring the tender of at least a majority of the outstanding shares) followed by a back-end merger.

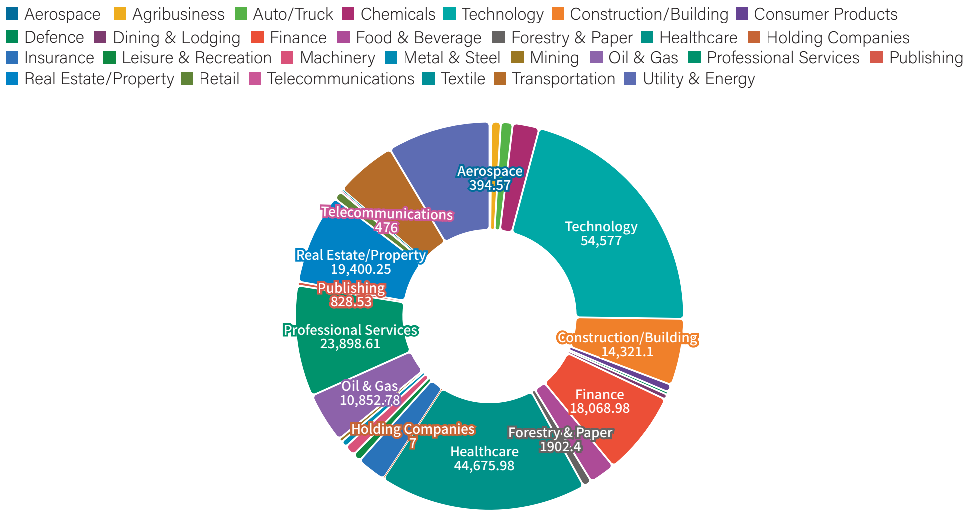
Both types of transactions are typically subject to the following conditions (among others):

- Accuracy of representations and warranties;
- Material compliance with covenants;
- No material adverse effect (MAE) on the target; and
- The receipt of regulatory approvals.

Nearly all public target M&A deals in 2021 included an MAE exception for changes, effects or conditions arising out of the COVID pandemic and governmental responses thereto, according to Deal Point Data. Many agreements also provide for greater flexibility under the interim operating covenants to permit the target to take action in response to COVID.

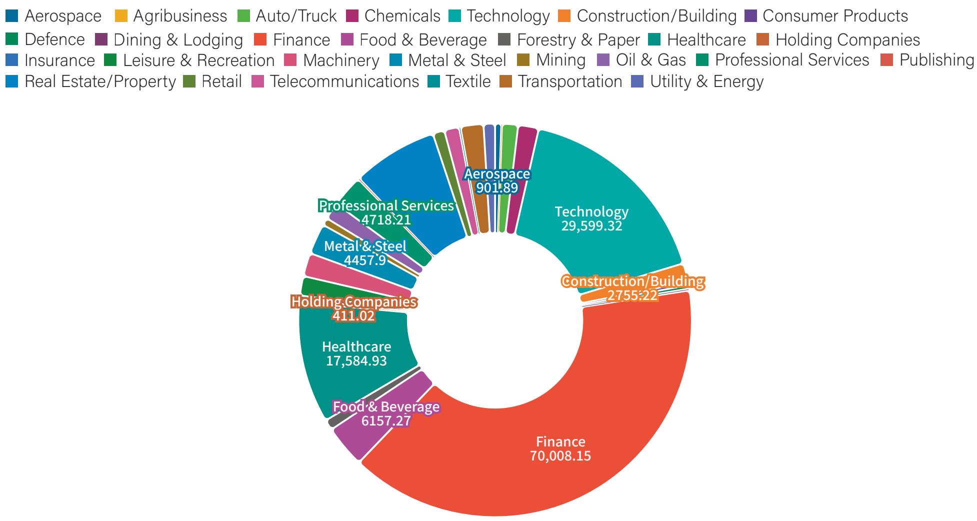
Public company merger agreements generally require the target to pay a termination fee if the target terminates the agreement to accept a superior offer, or if the buyer terminates because the target changes its recommendation in favour of the deal. These fees are usually

2022 inbound M&A by sector
United States



Source: Dealogic

2022 outbound M&A by sector
United States



Source: Dealogic

between 2 and 4% of the transaction's equity or enterprise value, but may fall outside this range based on deal size and other factors.

In some transactions, the buyer is required to pay the seller or the target a reverse termination fee under certain circumstances (for example, the failure to obtain required regulatory approvals or if all the buyer's closing conditions are satisfied and it nevertheless fails to close the transaction). These fees are highly variable but often range between 5 and 7% of the transaction's equity or enterprise value.

Private M&A

There was continued use of earn-outs in 2022, under which the seller will receive one or more additional payments, contingent on the target's future performance, in part to account for increased earnings uncertainty due to volatility and macroeconomic uncertainties.

Completion accounts (known as working capital or balance sheet adjustments) are common in private company acquisitions. Locked-box transaction structures are much less prevalent in private company acquisitions in the US than in many other jurisdictions.

All the aforementioned conditions for public M&A generally also apply in private M&A transactions. However, in the absence of RWI, representations and warranties usually survive the closing in private M&A transactions and may give rise to post-closing indemnity claims.

Agreements are typically governed by the law of the target's state of incorporation. If the state has sparsely developed corporate law, the parties sometimes agree that Delaware law will govern certain issues.

The exit environment in 2022 was markedly different from 2021 and the previous years. The market for IPOs slowed to a trickle due to economic and market conditions. At the same time, the pace of the M&A market slowed for similar reasons. As such, exit options became more limited and more challenging from a valuation perspective. Finally, de-SPAC (special purpose acquisition companies) transactions – i.e., mergers between SPACs and private companies – came to a virtual halt due to a combination of factors, including investors seeking to redeem their shares in SPACs rather than participate in the merged companies and an absence of investors willing to invest in the 'pipe' market (i.e., privately invest in the securities of the newly combined public company).

The first half of 2023 will likely continue to feature muted interest in the IPO market; however, there is optimism that there will be a more robust equity market in the second half of 2023. Trade sales are expected to remain strong, because corporates with well-capitalised balance sheets will have the opportunity to make acquisitions at more attractive valuations than in previous years. Sales to financial sponsors should also remain strong subject to available third-party financing.

Looking ahead

There is confidence, albeit cautious, that M&A activity will rebound in 2023 and, in particular, as the year progresses. Among the factors that could lead to increased transaction volume are signs that inflation has peaked and interest rate hikes have ceased; greater confidence in a macroeconomic rebound, including the lessening of recessionary fears; better availability of credit; and improved trade relations between the US and China.