

M&A Deal Data Report

June 2018





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Executive Summary



Hamilton Locke is pleased to launch the M&A Deal Data Report. It has an extensive analysis on deal trends and negotiation points in M&A transactions here and in the US, including prevalence of earn-outs, use of W&I insurance, warranty caps and collars.

The report provides a useful insight into industry practice and standards in mid-market negotiated M&A deals and has extensive data in chart form to help parties determine what is 'market custom', in a simple easy to read format.

It is important to consider the findings of the study within a broader context when deciding what is "customary". Inter-relationships between deal mechanisms, jurisdictional differences, different structures and unique character of the parties affect the specific features of each deal agreement.

The high quality data available from the US and the prevalence of US buyers means that insightful parallels can be drawn between Australian and US M&A practice. US data has been taken from the SRS Acquiom M&A Deal Terms Study (2018) and the ABA Private Target Mergers & Acquisitions Deal Points Study (2017).

Based on recent US terms data, and our own Australian mid-market data, we assess the prevalence of certain types of deal terms in recent years and look to likely future trends.

Nick Humphrey
Managing Partner, Hamilton Locke

Key themes



The Australian market often tracks M&A trends that are occurring in the US, particularly when market sentiment is similar between the two countries. As such, we expect an increase in the use of escrow accounts to secure warranties, an increase in the use of US style "no undisclosed liability" warranties and also anti-bribery warranties. We also expect greater sophistication around structuring earn-out mechanisms, including US style acceleration, lapsing and covenants to run.



There is currently a seller friendly market in both Australia and the US, driven by low interest rates and IPO availability, and this is set to continue. We have seen an increase in the prevalence of locked-box mechanisms and similarly, "material adverse change" condition precedent provisions are less stringent. We are also seeing higher warranty baskets.



W&I insurance has steadily increased in popularity over the last 6 or 7 years and is no longer a PE style protection. Claims data shows that 1 in 5 deals using W&I receives a notification, usually around financial statements, tax or compliance with law warranties.

Warranties

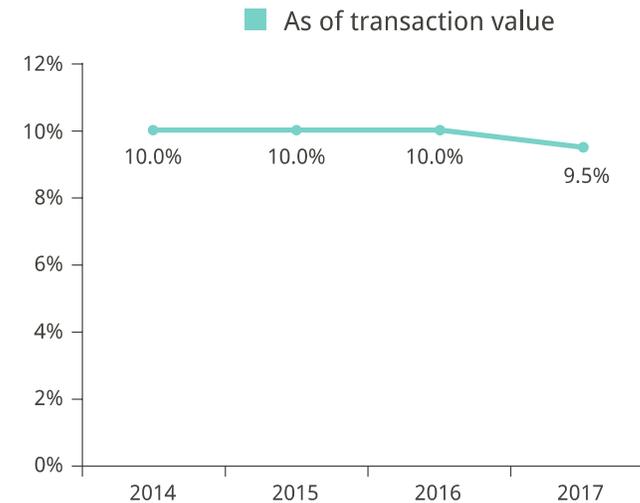


Warranties – escrow

- There is a significant difference between US and Australian practice in the use of an escrow to back the seller’s liability for warranty claims.
- Only **12%** of Australian deals in our sample used an escrow, compared to **76%*** of US deals.
- Australian escrows tend to be of smaller amounts (less than **1%** whereas US averages **7%***) and for shorter periods (12 months or less in Australia versus 18 to 36 months in the US[^]).
- We expect the use of escrows to increase in Australia as we see an increase in US investors in Australia.

US DEALS#

Median indemnification escrow/holdback size

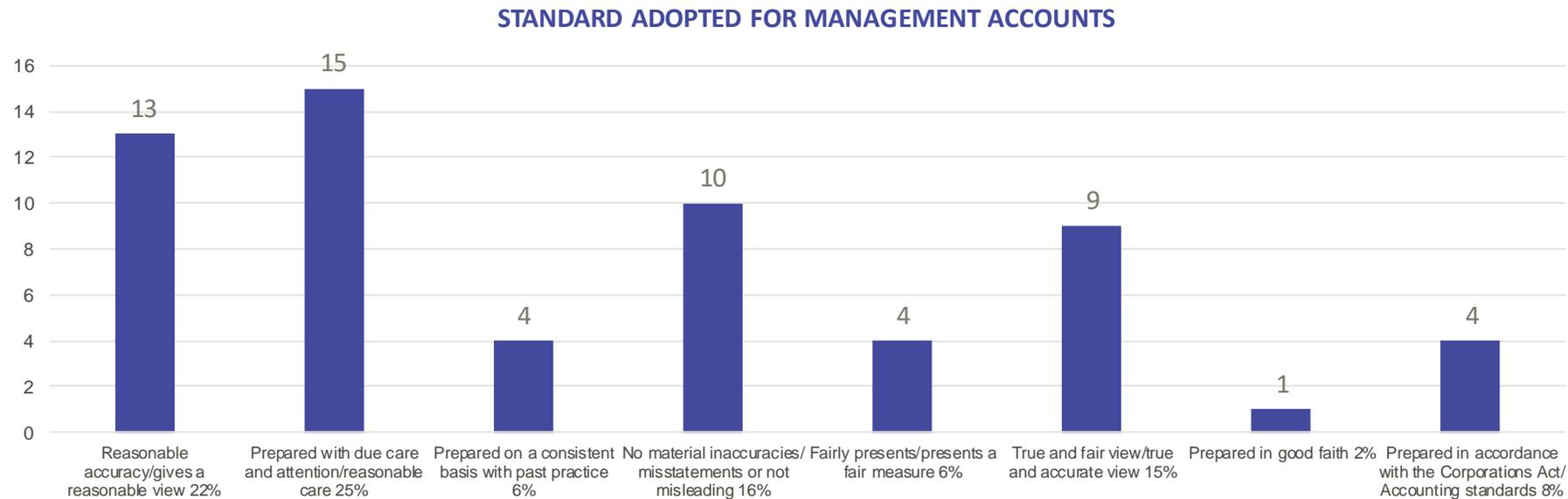


Source: *ABA Private Target M&A Deal Points Study (2017)
^SRS Acquiom M&A Deal Terms Study (2014)
*SRS Acquiom M&A Deal Terms Study (2018)



Warranties - management accounts

- In 49% of Australian deals in our sample, a warranty was provided in relation to the accuracy of management accounts.
- Management account warranties can be a risky area for sellers. They are often sued upon; so careful consideration in drafting is necessary. Our review of management accounts warranties showed a diverse spectrum of standards. Generally, sellers should resist warranting management accounts to the “true and fair” standards of audited accounts. That said, such a standard was warranted in 15% of Australian deals.
- The table shows the standards adopted for management accounts in Australian deals, shown as a % of total SPAs that had a management account warranty:





Warranties – disclosure and indemnities

Percentage of Australian deals

AUSTRALIA

Specific seller indemnities	44%
Disclosure letter/schedule	60%
Seller was permitted to disclose data room generally against warranties	63%
Warranty provided for quality of data in data room	65%



Warranties – no undisclosed liability & anti-bribery

- Nearly all US deal agreements contain a “no undisclosed liability” warranty, whereas only 32% of Australian deals contain such a warranty (of those deals, 21% were qualified by the seller’s knowledge).*
- Interestingly, these types of warranties are rarely seen in the UK. In line with the convergence of Australian deal terms trends with those in the US, we expect to see this type of warranty used more frequently in the Australian market, especially on in-bound US investments and acquisitions.
- There has been an increase in deal terms specifically addressing anti-bribery and corruption risk. 14% of domestic deals featured specific anti-bribery provisions. It is more common in cross-border deals, especially with US buyers.#



NO UNDISCLOSED LIABILITY

US
97%

AUSTRALIA
32%



DOMESTIC DEALS FEATURING ANTI BRIBERY

14%

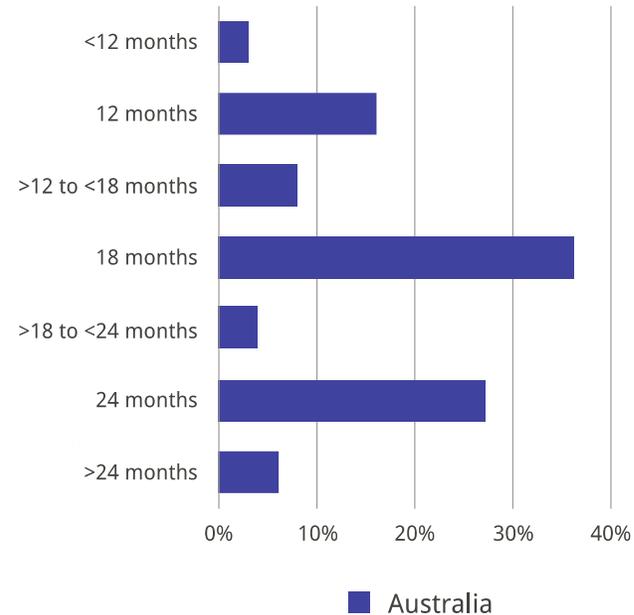
Source: *SRS Acquiom *M&A Deal Terms Study (2018)*
#King & Wood Mallesons *Deal Trends Report (2016)*



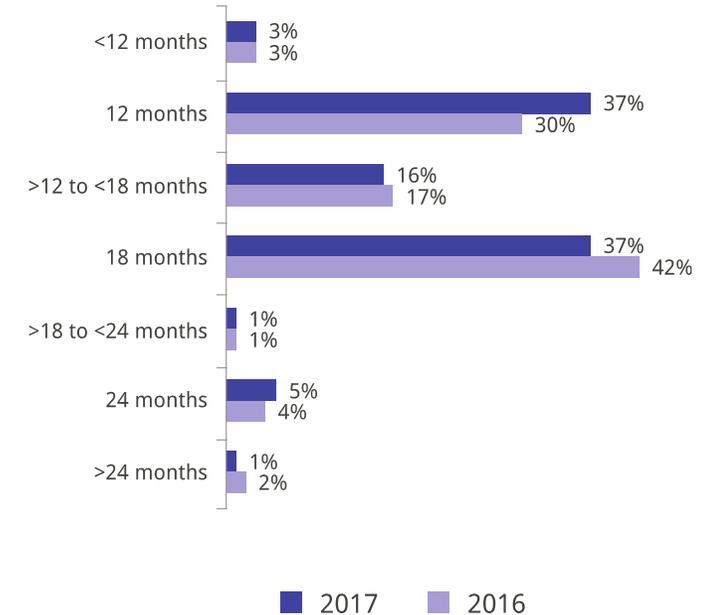
Warranties – time limits

- In most Australian deals the claim period was 18 months for general warranties and 7 years for tax claims.
- Although there is a wide range of time limits adopted for bringing general business warranty claims (other than tax/title warranties) in Australia, over one third of Australian deals have a warranty period of 18 months.
- 12 to 18 month time limits are also the most common in US deals other than tax/title warranties.
- Overall time limits are shorter in the US with very few being over 24 months.
- There was a noticeable increase in the length of time limits post-GFC (2008-2012) in both countries.
- Subsequently, as the market has become more seller friendly and trading conditions have normalised, time limits on warranty claims have become shorter.

**AUSTRALIAN
(NON-TAX/TITLE)**



**US DEALS*
SURVIVAL PERIOD
(2017 MEDIAN: 15 MONTHS)**

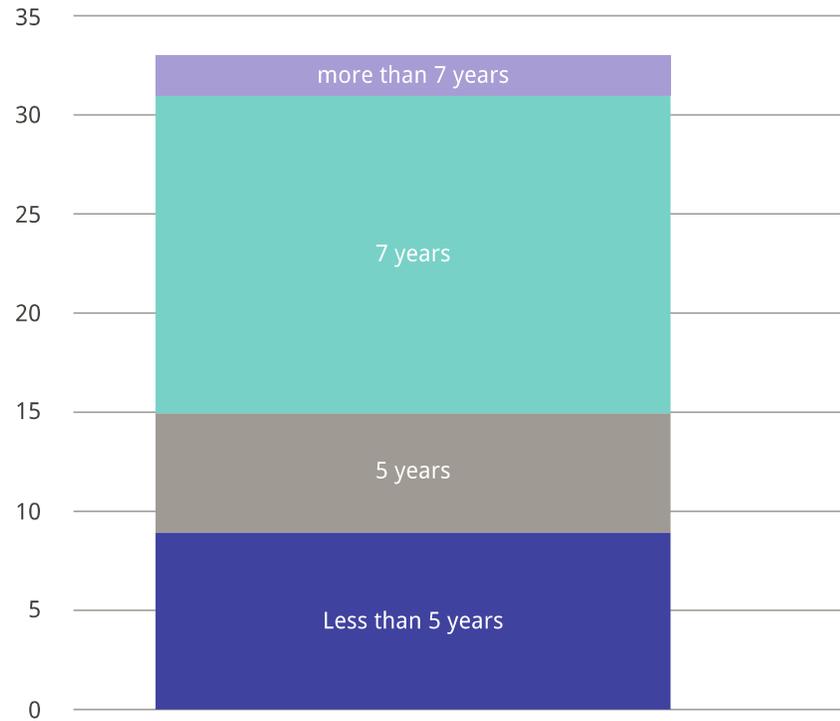


Source: *SRS Acqiom M&A Deal Terms Study (2018)



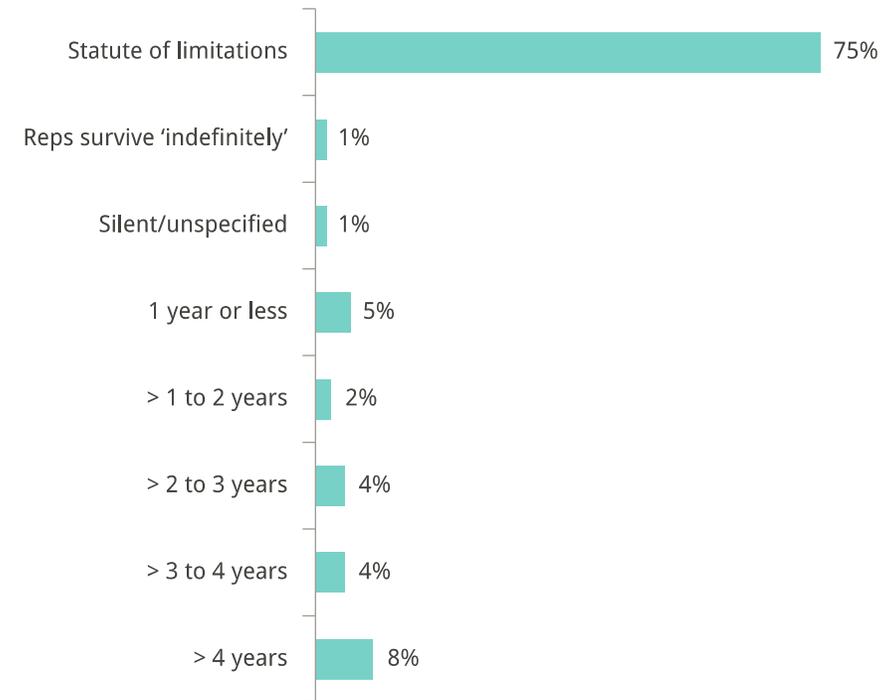
Warranties – time limits

AUSTRALIAN DEALS (Time Limit in Tax Warranty Claims)



Source: *SRS Acquiom M&A Deal Terms Study (2018)

US DEALS* Tax Representations

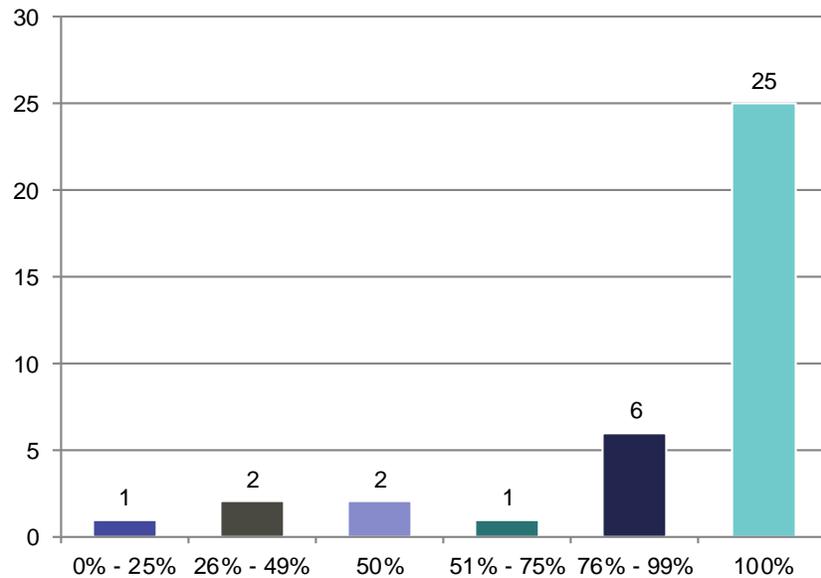




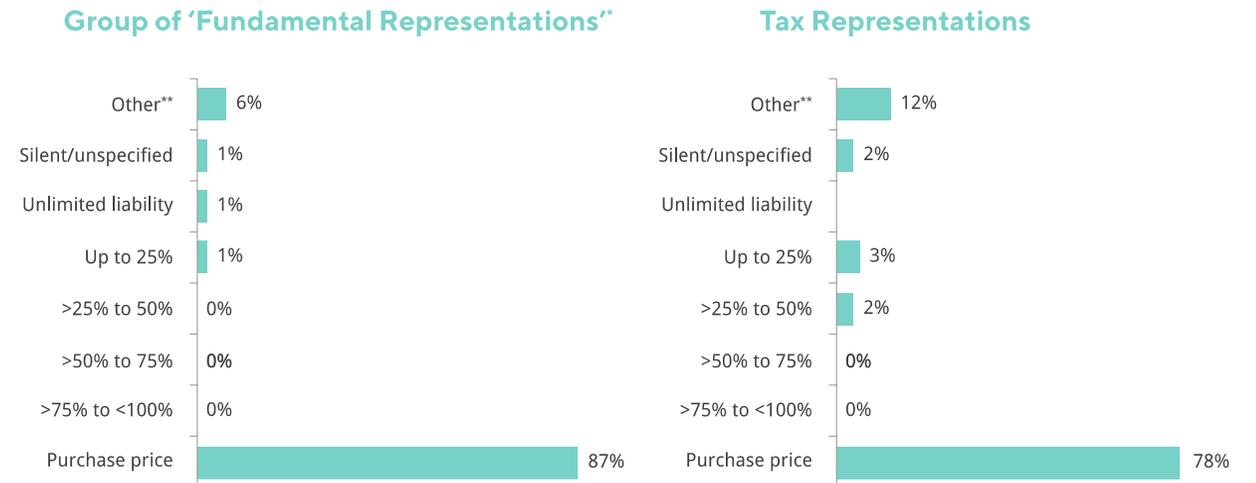
Warranties – tax/title warranties

In **76%** of Australian deals in our sample there was a cap on claims for breaches of title/tax warranties. In most deals, the cap on breaches of title/tax warranties is tied to the purchase price (**68%** in Australia and **87%** in US).

AUSTRALIAN DEALS (% OF PURCHASE PRICE)



US DEALS*



* For example: due organisation, due authority, capitalisation, etc. (other than taxes, intellectual property and fraud).
 ** 'Other' includes, for example, offsets against future earnouts above the general cap.

Warranties

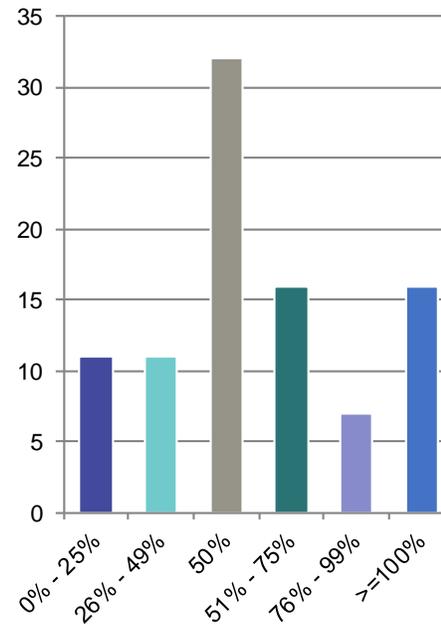
Caps and collars



Warranties - caps on claims (other than title and tax)

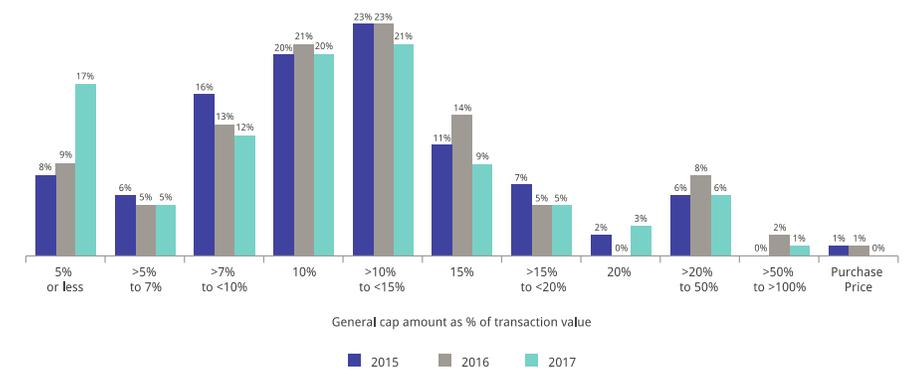
- In 78% of Australian deals there is a cap on claims for breaches of seller business warranties. There is no “standard” cap in Australia and they vary greatly depending on the nature of the deal. The US tends to have significantly lower caps on business warranty claims.
- This directly correlates with the highly prevalent use of escrow in the US, which provides buyer security in a deal. We also found that competitive deals generally had lower caps.
- The US approach is to have lower overall caps on business warranty claims but higher recoverability within these caps – warranties are almost always given on an indemnity basis.
- 80% of US deals don’t have a de minimums threshold.
- We consider this approach to be driven by a number of factors, including the relative prevalence of litigation in the US, the greater sophistication in contractual drafting and the greater resources spent in the disclosure exercise.

**AUSTRALIAN DEALS
(AS % OF PURCHASE PRICE)**



**US DEALS
(AS % OF TRANSACTION VALUE)***

Details 2015 - 2017



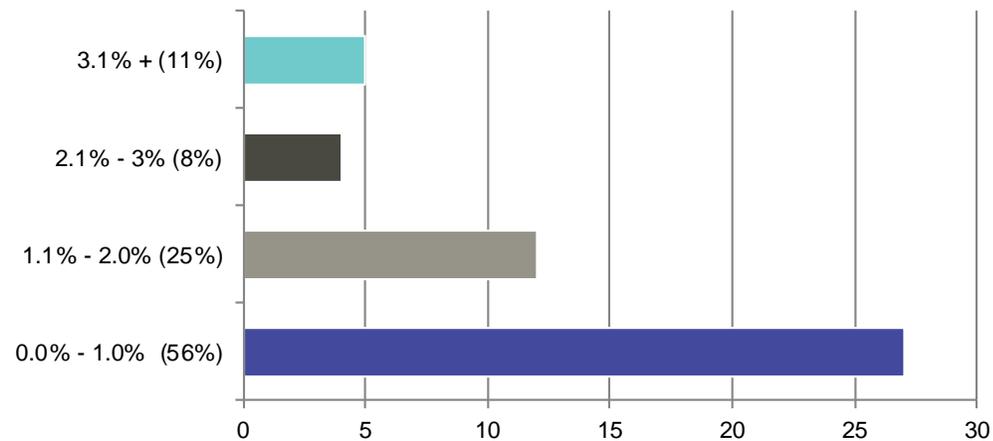
Source: *SRS Acqiom M&A Deal Terms Study (2018)



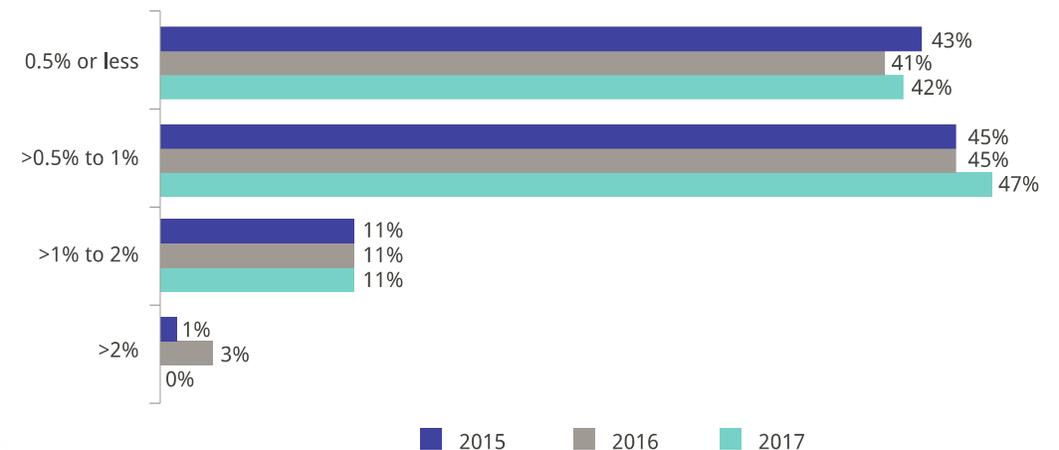
Warranties - baskets

- 68% of Australian deals have an aggregate threshold for warranty claims (often called a “basket”), a minimum amount that all claims must add up to in order to claim, whereas nearly all US deals do.
- 56% of aggregate claims thresholds in Australia and 89% in the US are 1% or less of the purchase price*.
- The smaller basket sizes seen in the US are a reflection of the more buyer friendly market.

**AUSTRALIAN DEALS
BASKET SIZES**



**US DEALS*
BASKET SIZES**

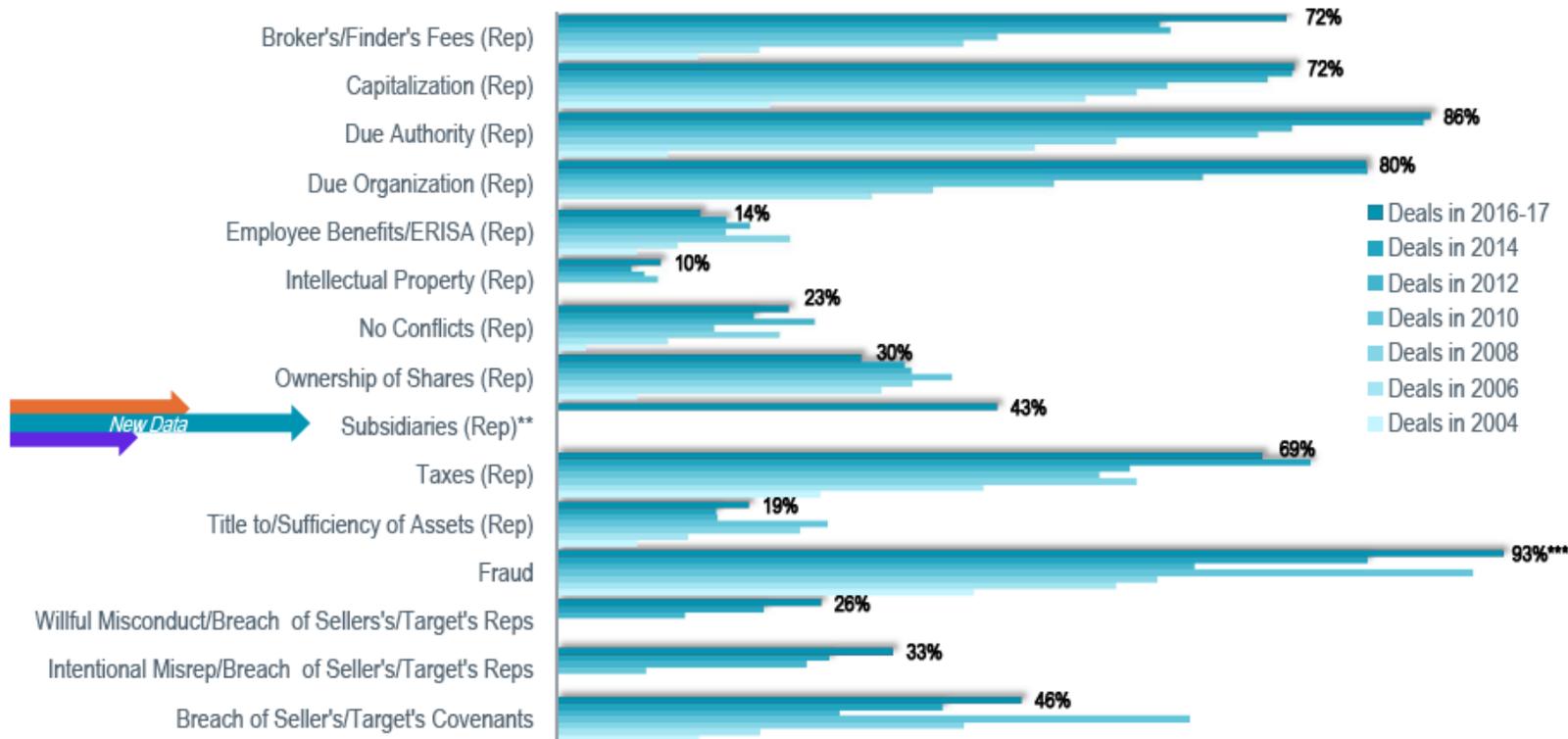


Source: *SRS Acqiom M&A Deal Terms Study (2018)



Warranties - basket carve outs

Baskets are not required before a claim can be bought primarily for fraud, authority and finders fees.



* Only those categories appearing more than 10% appearing more than 10% of the time for deals in 2016-17 are shown. Carve outs for breaches of Seller/Target covenants taken into account on prior page.

** Not measured before deals in 2016-17.

*** Includes deals with a fraud carve out in an exclusive remedy provision that has general applicability to all indemnification limitations.

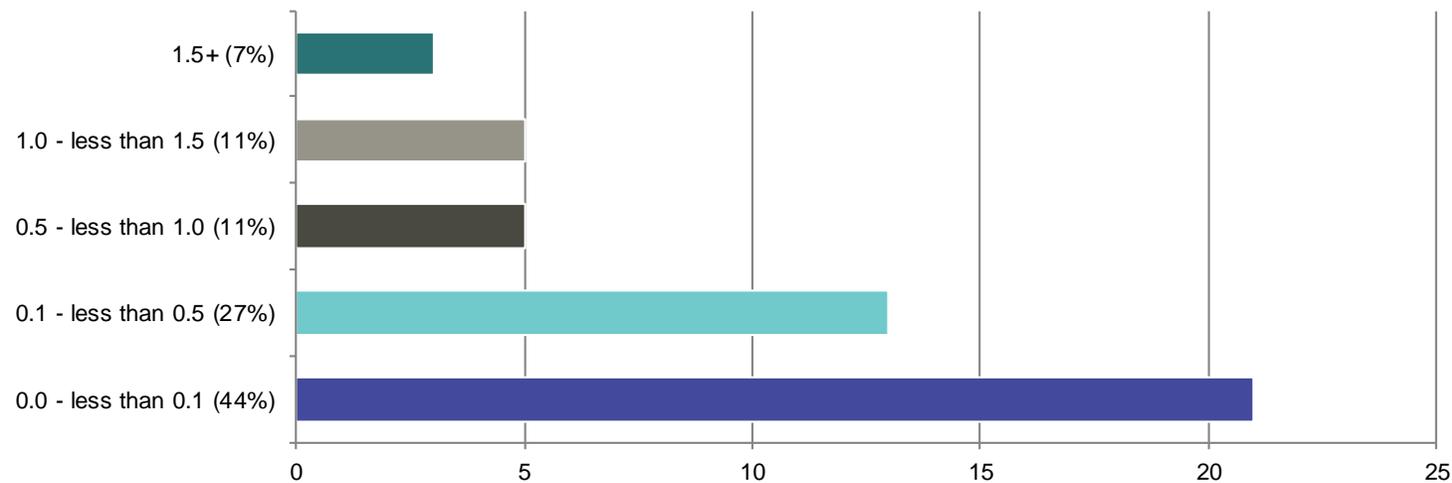
New Data →



Warranties - de minimusthresholds

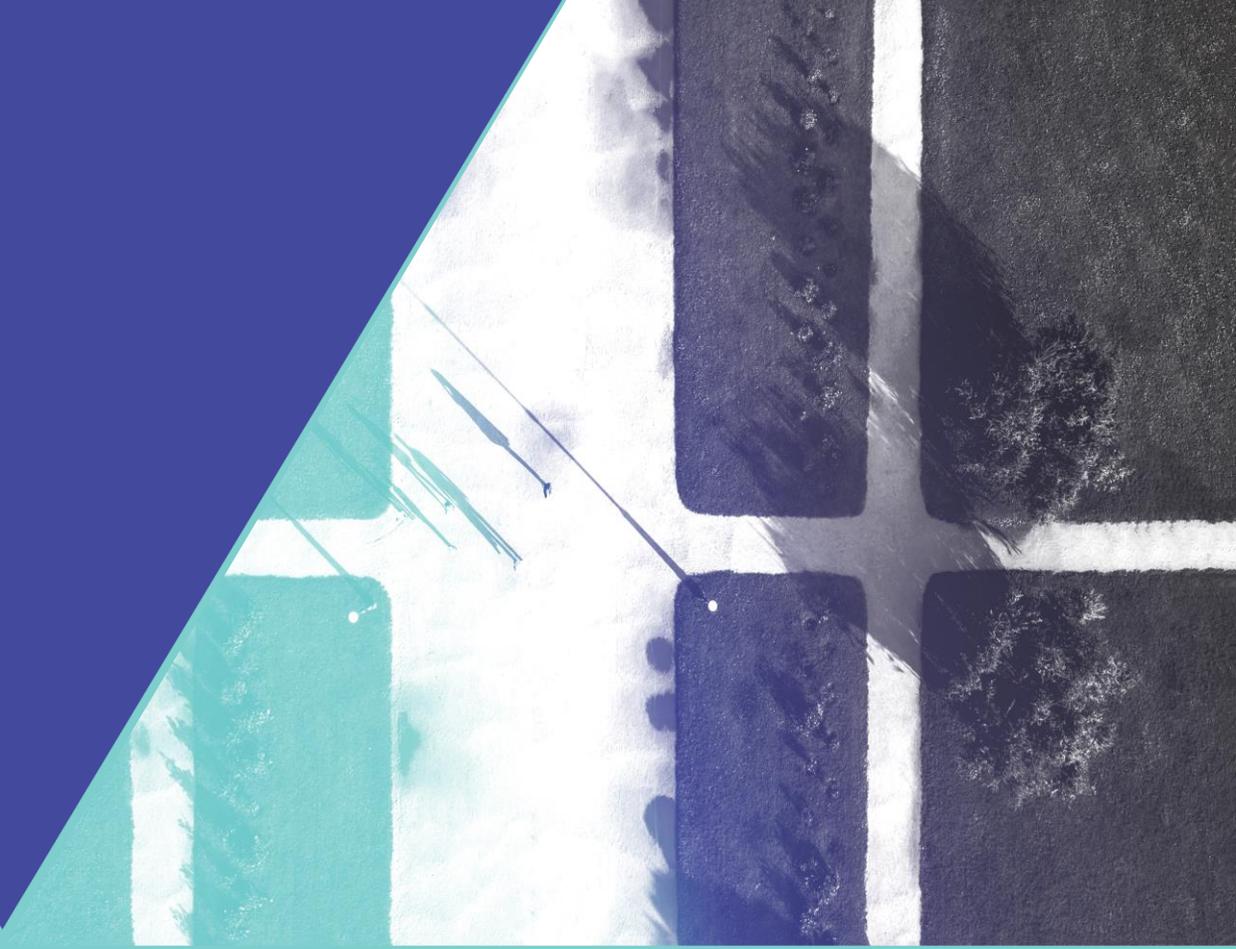
- A de minimus is a minimum amount a single claim (or series of claims relating to the same breach) must reach before the buyer can claim.
- A higher de minimus is a seller friendly mechanism as it limits the buyer's ability to claim.
- 71% of Australian agreements and 20% of US agreements* have a de minimus on warranty claims. The general rule of thumb in setting a de minimus is that it is to be 10% of the basket.

MINIMUM CLAIM THRESHOLDS – AUSTRALIAN DEALS (AS % OF PURCHASE PRICE)



Source: *SRS Acqiom M&A Deal Terms Study (2018)

Purchase price adjustments

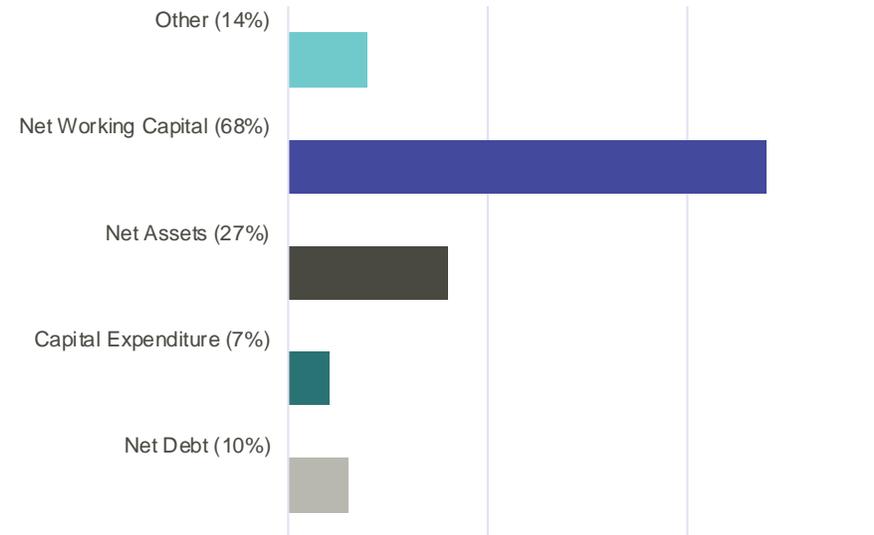




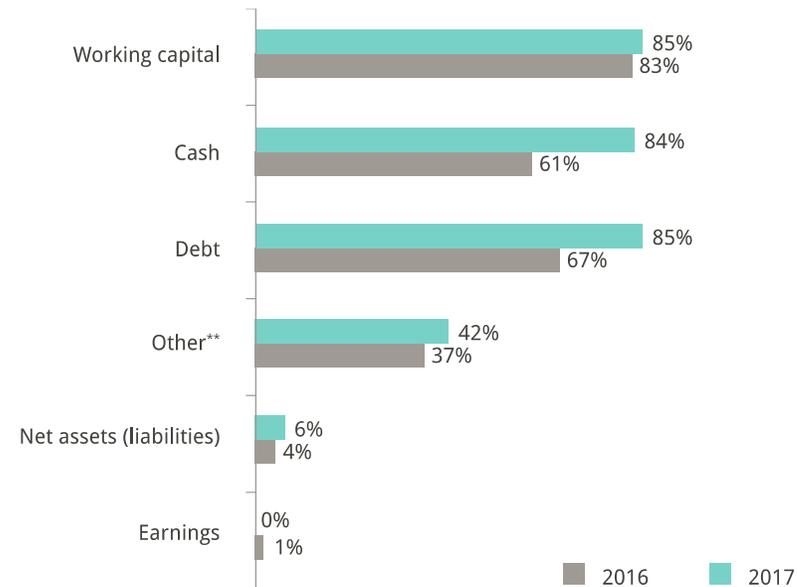
Purchase price adjustments – methodology

Purchase price adjustments are frequently used in the US (87%)* and are becoming more popular in Australia (52%). The most common adjustment methodology used to determine a purchase price adjustment is net working capital with 85% of US deals* and 68% of Australian deals using this methodology.

AUSTRALIAN DEALS



US DEALS*



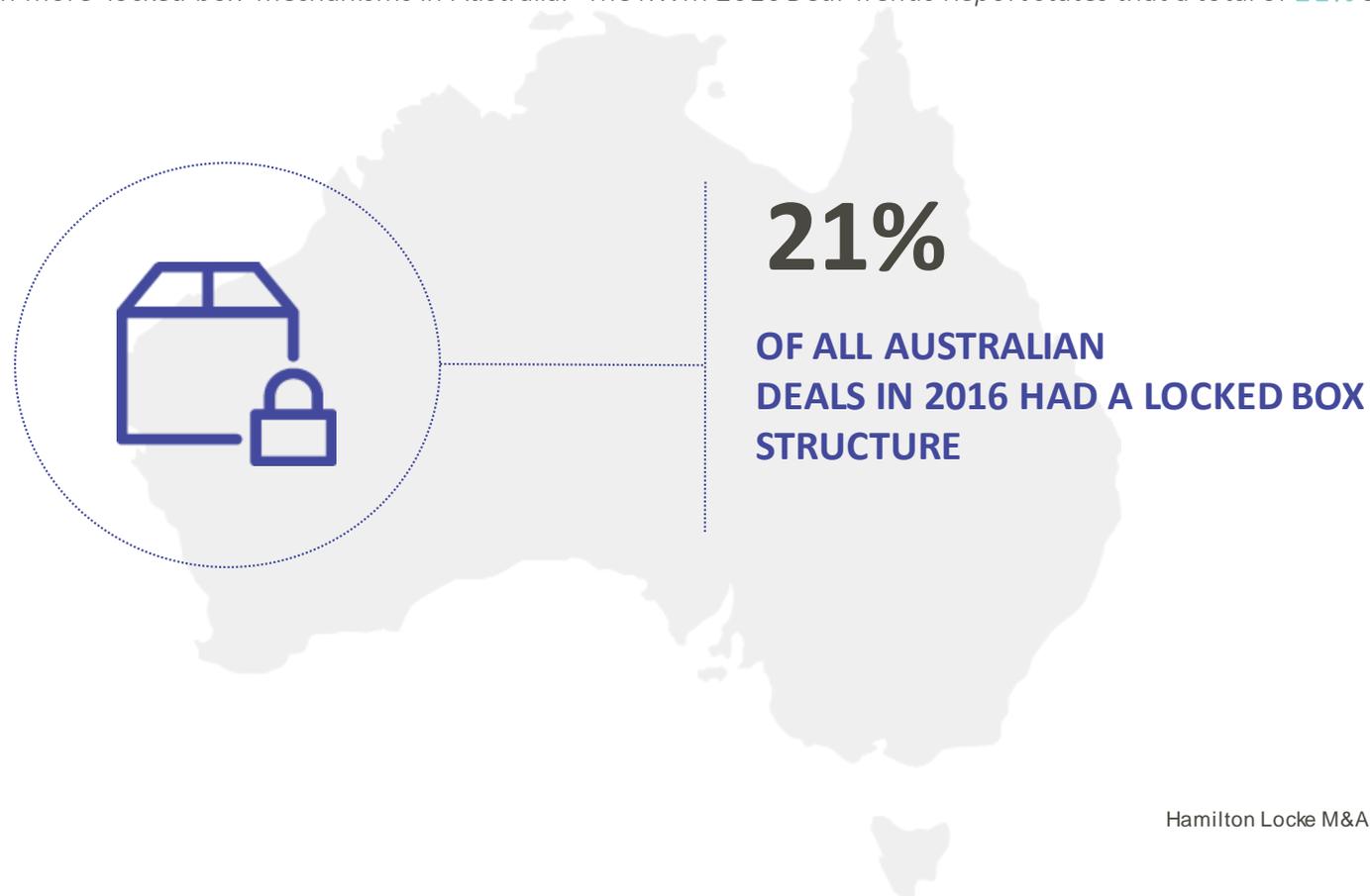
Purchase price adjustment paid only if exceeds threshold:
 4% of our deals
 9% US deals

Source: *SRS Acquiom M&A Deal Terms Study (2018)

Purchase price adjustments – locked box mechanisms



- Locked box (or fixed price deals where there is no adjustment for completion working capital) have been relatively slow to gain acceptance in private M&A in Australia compared to the US and UK.
- The last few years have seen more ‘locked box’ mechanisms in Australia. The KWM 2016 *Deal Trends Report* states that a total of **21%** of all deals they surveyed had that structure.



Earnouts





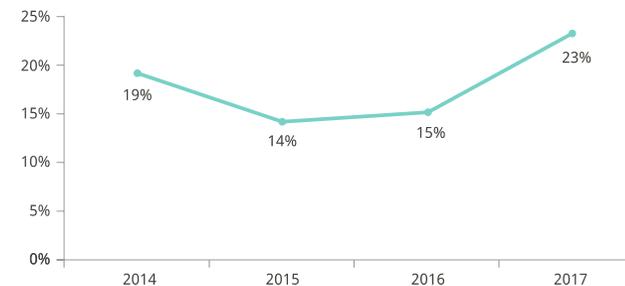
Earnouts - overview

- An earn-out bridges the gap in valuation between seller and buyer as consideration is partially determined by the earnings of the business post-completion.
- **23%** of Australian deals and US deals use an earn-out.*
- The use of earn-outs has increased from **13%** in 2014 in the US to **23%** in 2017 as the market adjusts to higher seller price expectations.*
- We found many sectors had sector specific norms in the use of earnouts. For example in the pharmaceutical and medical devices sector, approximately **80%** of agreements had earn-outs and they were longer than other sectors on average.

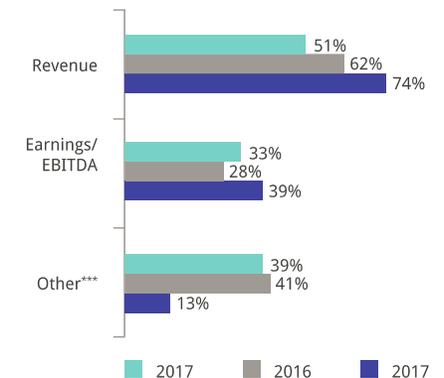
	Australian deals	US deals* in 2017
% of deals with earn-out	23%	23%
Earn-out was referable to EBITDA/earnings	80%	20%
Median earn-out duration	20 months	13 months

EARN-OUTS IN US*

Earnout included



Earnout metrics



Source: SRS Acquiror M&A Deal Terms Study (2018)



Earnouts – acceleration and covenants

OF THOSE DEALS WITH EARN-OUTS:	AUSTRALIAN DEALS	US DEALS*
Covenant to run	17%	<ul style="list-style-type: none"> 10% of US deals in 2017 had a covenant to run in accordance with seller's past practices 6% of US deals in 2013 had a covenant to run the business to maximise earn-out payment clause
Acceleration clause	14%	<ul style="list-style-type: none"> 31% of US deals had an acceleration clause that accelerated payment (fully or partially) on change in control of earn-out assets
Lapsing clause	14%	

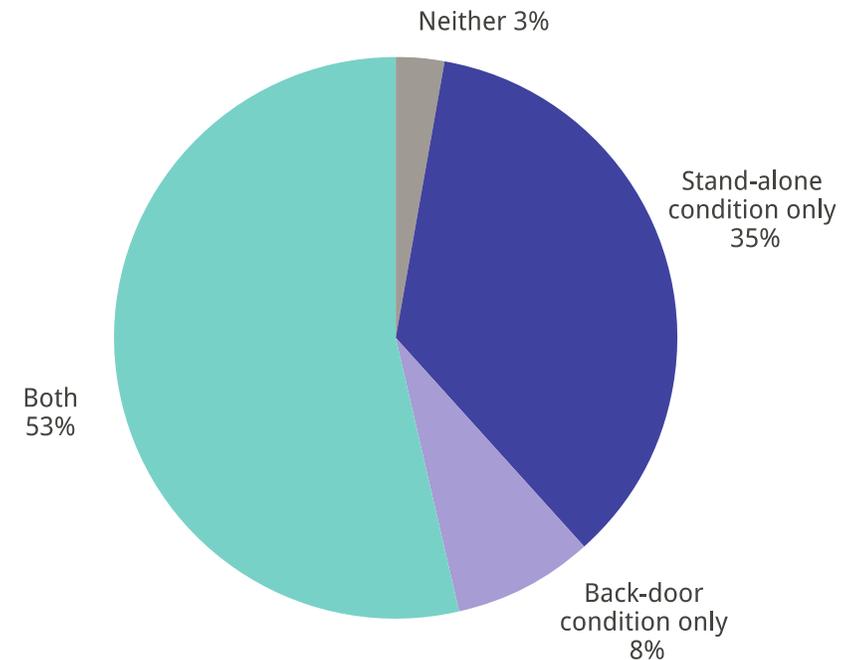
Other key terms



Other key terms - material adverse change

- Material adverse change (MAC) condition precedent more commonly used than pre-GFC.
- 30% of Australian deals in our sample used a MAC condition precedent.
- In US in 2017*:
 - only 10% of MAC include “prospects” (trending down from 14% in 2016) - so more seller friendly;
 - 95% of these conditions include “force majeure carve-outs” (ie. material change other than due to change in economic conditions, act of war or terrorism, change in law etc).
- Back-door condition refers to a “no MAC” warranty post-balance date (rather than an express condition precedent).

MAC CONDITION DETAILS
(2017 DEALS)*

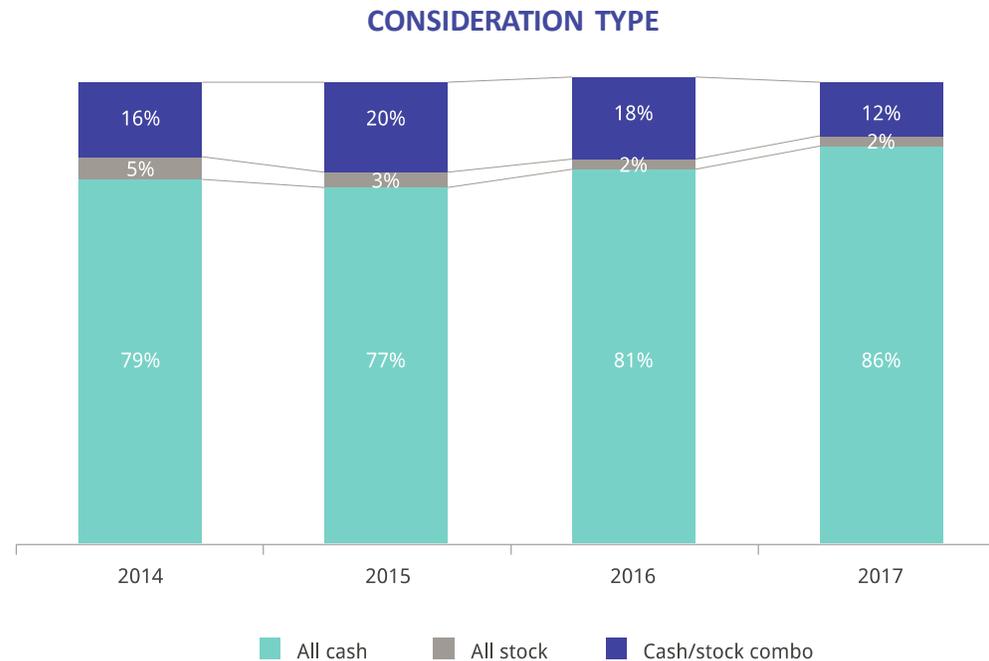


Source: *SRS Acquiom M&A Deal Terms Study (2018)



Other key terms - scrip consideration

Non-cash consideration (scrip) was utilised in **20%** of Australia deals in our sample. In US deals, **14%** of deals utilised scrip consideration.



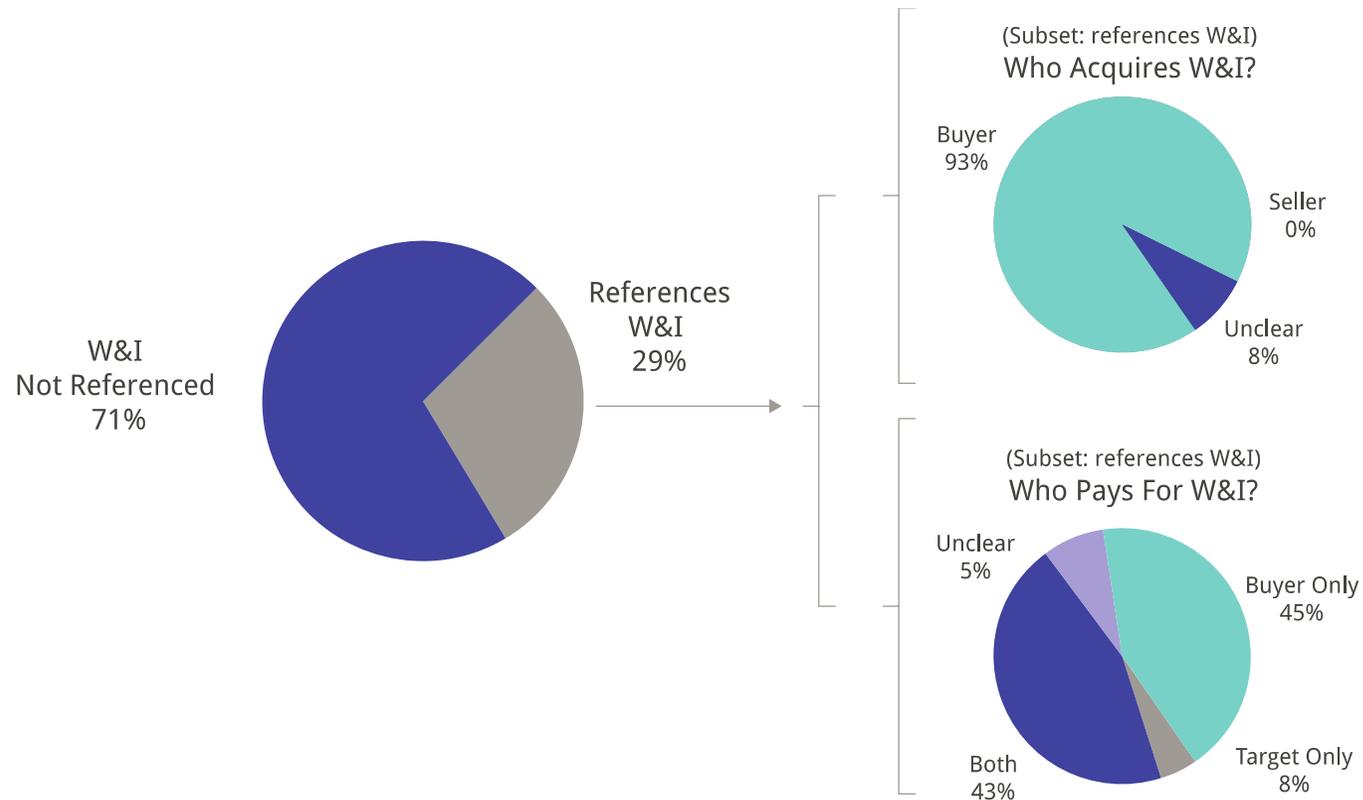
Warranty & Indemnity (W&I) Insurance





W&I Insurance - US

Warranty and indemnity insurance ("W&I") contemplated by sale agreement in the US*:



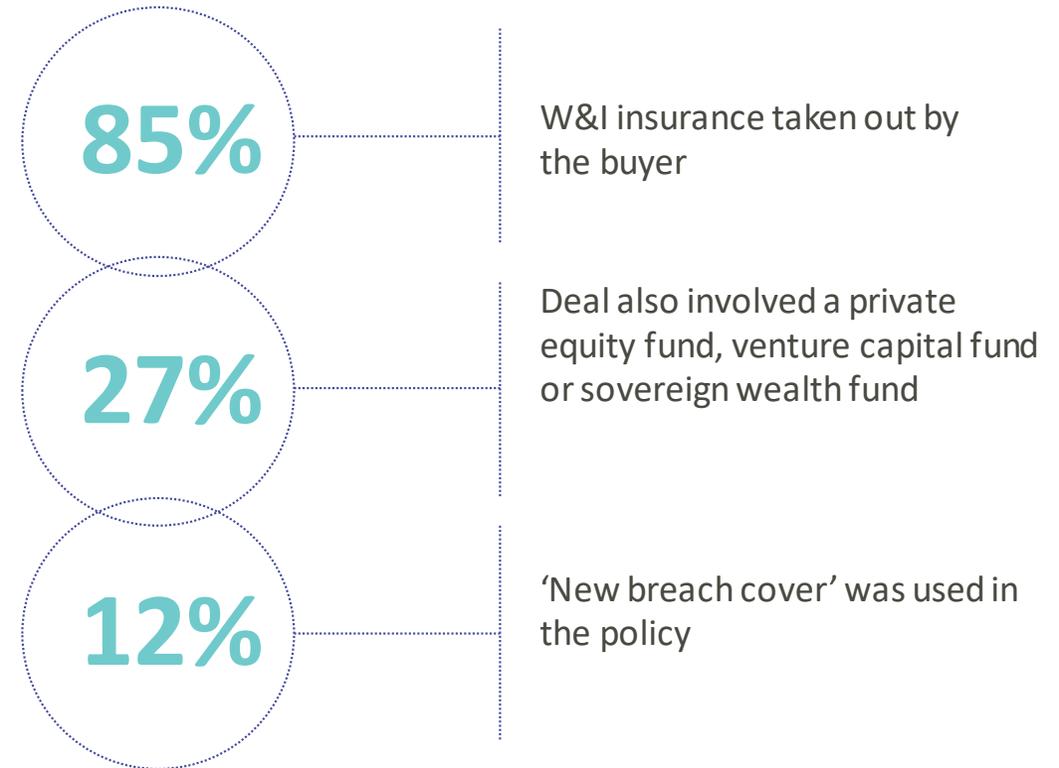
Source: *ABA Private Target M&A Deal Points Study (2017)



W&I Insurance - Australia

- For the sixth year in a row, the use of W&I insurance has increased, rising to **40%** of Australian deals in 2016 surveyed (up from only **15%** in 2011).*
- In addition to PE exits, it has now become more common in corporate transactions, with **33%** of non-PE deals using W&I insurance. W&I insurance a common feature of cross-border deals at **37%** of cross-border deals.*
- In **85%** of our deals that had W&I insurance it was taken out by the buyer
- In **27%** of our deals where W&I insurance was used, the deal also involved a private equity fund, venture capital fund or sovereign wealth fund
- In **12%** of our deals that had W&I insurance, 'new breach cover' was used in the policy

AUSTRALIAN DEALS

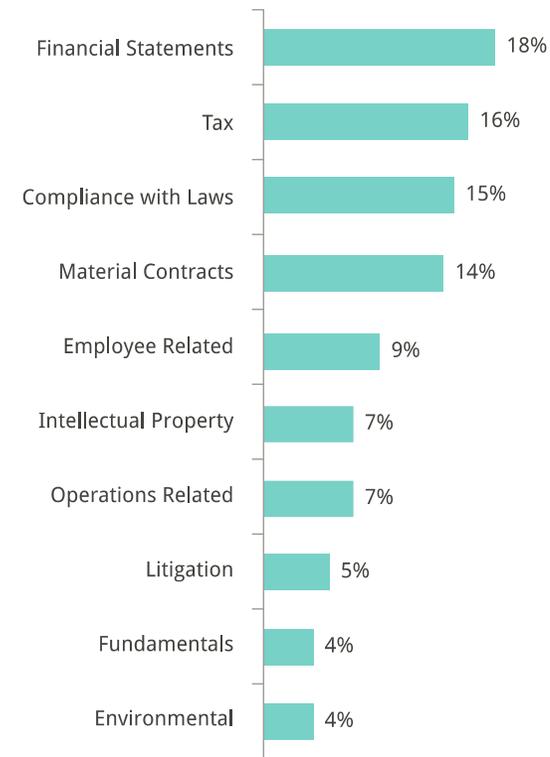




W&I Insurance - claims

- Almost one in five W&I policies received a claim notification.
- The biggest deals have the highest average claims frequency (24%) and the largest average claims (\$19m), and the size of claims on smaller deals is increasing.
- Breaches vary depending on the specific industry, with compliance with laws being most common for Health & Pharma (31%), financial statements for Financial Services (25%) and Manufacturing (17%), and tax for Technology firms (25%).

W&I REPORTED INCIDENTS BY BREACH TYPE – GLOBAL TYPE



About the Deal Data Report





Hamilton Locke M&A Deal Data Report

We reviewed **over 79** share purchase agreements (SPA) from 2011 to 2014 and compared to US data

We focused on **mid-market** and **excluded deals over \$500m**

We had **mixture of roles** (buyer, seller, management, insurer)

There were **dozens of different law firms** (so reasonable test of market custom)

25% of deals involving a PE fund, VC fund or sovereign wealth fund



Deal Trends Report - general

When referring to what is “customary” consider:

- Some mechanisms are interrelated (e.g. if buyer has protection of W&I insurance then they may be less likely to push for other protections such as parent guarantee or escrow)
- Depends on pricing, balance of power, regional differences
- Competitive deals (auction situation) are more likely to be seller friendly
- Depends on “house rules” (there’s a big difference between trade deal, receiver sale and PE deal)
- If the buyer is paying a high multiple, they may push harder to improve coverage from warranties and indemnities



About Hamilton Locke

Hamilton Locke is a corporate law firm specialising in complex corporate finance transactions, including mergers and acquisitions, private equity, capital markets and distressed investing.

WORLD CLASS CAPABILITY

Our team has 5 partners and 15 lawyers who all joined us after careers in top-tier Australian and global law firms

GREAT VALUE

We develop the best pricing approaches with our clients to strike the right balance of fairness, certainty and risk-sharing

CUTTING EDGE EXPERIENCE

We have advised on hundreds of iconic, cutting-edge corporate deals and in the last 24 months advised on deals with a value totalling \$3 billion

THE BEST APPROACH

We invest time at our cost to understand our clients' objectives, risk appetites and operating styles

DEEP SECTOR EXPERIENCE

We have experience in a broad spectrum of industry sectors, including retail, financial services, technology, food and agribusiness and healthcare



Our team



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Nick is Managing Partner of Hamilton Locke. He has been recognised as one of Australia's leading private equity and M&A lawyers, including Chambers Asia - Private Equity, Best Lawyer - Private Equity, Best Lawyer - Venture Capital, Doyles - recommended for M&A, Legal500 - ranked for M&A, Dealmaker of the Year and ACQ Australian M&A Team of year. He has advised on hundreds of deals in his distinguished 25 year legal career. Major clients include CHAMP Ventures, Mercury Capital, Macquarie Bank, Pemba Capital and Anacacia Capital. Recent deals include the buyout of Macpac, the sale of Cassons, the buyout of Lorna Jane, the sale of Gloria Jeans and the IPO of Kelly & Partners.

Nick is also the author of a number of best-selling books on business, law and leadership including "*Maverick Executive: Strategies for Driving Clarity, Effectiveness and Focus*"; "*Penguin Small Business Guide*", "*Negotiated Acquisitions and Buyouts*", and the "*Australian Private Equity Handbook*" (CCH).

He is the Chairman of the Australian Growth Company Awards, which is sponsored by Deloitte, Macquarie Bank, GlobalX, NAB Health and Intralinks. He recently attended the Harvard Law School, Executive Leadership programme. Nick previously worked for K&L Gates as Global Co-Head of M&A, he was a partner and Head of Private Equity for Norton Rose and worked in London for Clifford Chance.



Hal Lloyd
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Hal has more than 20 years' experience in mergers and acquisitions, private equity, capital raising and distressed transactions across a number of industry sectors.

Hal has been recognised for his expertise in a broad range of areas, including AFR Best Lawyer and Legal 500 Asia Pacific for Restructuring and Distressed Investing and Legal 500 Asia Pacific for Mergers & Acquisitions.

Hal was previously a partner at Baker & McKenzie and also worked at King & Wood Mallesons and Latham & Watkins in New York.



Our team continued...



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Gordon is a corporate transactional partner primarily involved in private treaty mergers and acquisitions in the Australian mid-market. He has extensive experience in negotiating complex acquisitions, divestments and investments and is highly valued for his technical ability and commercial acumen. Gordon has a broad practice ranging from private equity funds to blue chip corporates or founders. Gordon also has specific industry expertise in warranty and indemnity insurance having advised global insurance companies on hundreds of insured M&A transactions.

Gordon was previously a partner at K&L Gates and also worked at Baker & McKenzie and Sparke Helmore.



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Brent is an experienced corporate lawyer who specialises in mergers and acquisitions and capital markets. Brent has a broad corporate finance practice that includes public company acquisitions, private equity transactions, venture capital investments and fund structuring, distressed mergers and acquisitions and alternative finance transactions. Brent has worked across a broad range of industry sectors, including mining, agribusiness, technology, retail and government.

Previously Brent was Corporate Development Manager and Company Secretary of a technology start-up based in Singapore, and prior to that was a corporate lawyer at Ashurst.



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Zina has extensive experience advising major trading and investment banks, syndicates, funds and public companies in relation to various high profile and complex financial turnarounds, restructurings and special situations. Zina has worked on a large number of distressed and performing portfolio sale transactions in Australia and across Asia acting for both purchasers and sellers. She also specialises in debt trading and alternative finance transactions and has acted for a wide range of funds and alternative capital providers.

Zina previously worked in the restructuring, turnaround and insolvency team of Herbert Smith Freehills in Sydney. She has also worked in the London and Moscow office of Allen & Overy as part of the global restructuring group.



Our team continued...



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Cristín is a Senior Associate specialising in mergers and acquisitions and corporate transactions. Cristín has experience advising across a broad range of industries including retail, mining services, technology, manufacturing and financial services.

Cristín works on a range of matters including acquisition and disposal of shares and assets, private equity transactions, venture capital investments and general corporate advisory work. Cristín has previously worked at an international law firm in Australia and is admitted to practice in New South Wales, England and Ireland.



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Naomi is a Senior Associate specialising in foreign investment, corporate advisory and mergers and acquisitions and has worked in Australia, Hong Kong and Shanghai in multiple cross border transactions. Naomi is currently focused on project management for large-scale corporate transactions and advises on a range of related corporate issues.

Naomi has acted for a range of private equity investors including Permira, The Carlyle Group, The Blackstone Group, Goldman Sachs, Quadrant Private Equity (Qscan and Superior Food Group), Pemba and HighPoint Capital.



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Janelle is an experienced corporate and commercial lawyer, specialising in private M&A and venture capital.

She has worked within large national and global firms, and prior to joining Hamilton Locke, worked in-house at Telstra, looking after the Telstra Ventures portfolio and muru-D (Telstra's start up accelerator).

Thank you

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