M&A Market Monitor 2023

For what comes next

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Overview

The past 24 months has seen strong UK M&A activity, fuelled by corporates looking to reinforce and realign their businesses and private equity firms with plentiful funds to deploy.

The latter half of 2022 saw political instability in the UK, alongside rising interest rates and energy supply and cost issues creating a period of uncertainty. As a result there was a slow-down of deal activity as parties considered the impact on deal pricing and funding.

We expect the market to become more active as we move into 2023 and the political and economic outlook hopefully begins to stabilise. Valuing businesses, however, will remain challenging and we anticipate a greater regulatory burden (and enhanced due diligence) for many businesses, particularly in the financial services, national security and ESG space.

This is our fifth M&A Market monitor report, where we look at the key legal issues negotiated on the acquisition and disposal of private companies between 1 February 2021 and 31 December 2022. It is based on data captured from 63 M&A transactions completed by our Corporate team and is representative of what we have seen in the M&A market more broadly.

The areas on which we focus are:

- Sectors, parties and completion arrangements
- Pricing mechanisms
- Purchase price retentions
- Earn-out arrangements
- Seller limitations on liability (including Warranty & Indemnity insurance)
- Restrictive covenants
- National Security and Investment Act 2021
- Key themes and looking to the future

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Example deals – 2021 and 2022

Advised on the £90 million sale of **Roper Rhodes**, a leading independent supplier of bathroom products, on its sale to Svedbergs, the market leader in bathroom furniture in the Nordic region.

Advising private equity firm **LDC** on their investment in the award-winning manufacturer and supplier of artisan cakes, Cakesmiths.

Advising a national chain of award winning burrito bars **Barburrito** on its £7million sale to The Restaurant Group (TRG) one of the UK's biggest hospitality businesses.

Advised **Starling Bank** on its £50 million acquisition of specialist buy-to-let mortgage lender Fleet Mortgages. The acquisition is part of a wider plan at the bank to expand lending through strategic forward-flow arrangements, organic lending and targeted M&A activity.

Advising on the £59m sale of **Storagebase** to South African headquartered self-storage group Storage King.

Advising the eCommerce agency **Space48** on their acquisition of Shopify Plus experts Brave the Skies.

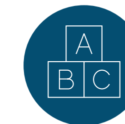
Acting for PE backed **Cary Group** on a number of acquisitions including its £65m acquisition of the Charles Pugh Group.

Advising the shareholders of **i4 pay group**, a leading umbrella payroll services provider to the veterinary, education and public sectors on their sale to Payme Group Limited.

Advising **McGill's Bus Service Limited**, Scotland's largest independent bus passenger transport group on its acquisition of First Group PLC's Scotland East bus business. This transaction follows McGill's acquisition of operations from National Express Group.

Advising Irish-owned global packaging solutions company **Zeus Packaging Group**, on its acquisition of UK packaging company Swanline Group and its sister company BoxMart in a transaction worth over €25 million.

Advising longstanding client **K3 Capital Group** on the acquisition of Professional Insight Marketing. The purchase complements K3 Capital's growth strategy and will allow the firm to expand the services of the K3 Hub.



Advising ambitious **Thrive Childcare and Education** on a number of acquisitions adding to their growing portfolio including The Village Nursery Group, Tots N Tykes, Culcheth Day Nursery, Benison Day Nursery and Homestead Nursery (Wirral) Ltd.

Future energy

During 2022, TLT's corporate future energy team has advised on 57 deals across wind, solar, energy storage, Bioenergy, hydro, geothermal and EVCI, totalling £1.4bn. However, due to the specific nature of these deals and their ability to distort the results without a more detailed review, the analysis we have undertaken for this review does not include any future energy transactions.

In general, the relevant legal issues on future energy transactions are driven by a number of key factors which can impact on the value mechanism, the risk appetite of the buyer and any seller limitations, such factors include:

- The stage of the project – whether it is greenfield, ready to build or operational;
- Whether the project attracts any form of subsidy or revenue preservations – whether ROCs, FiTs, RHI, Capacity Market payments or a CfD;
- Whether the transaction involves a portfolio of projects where risk can be spread;
- Whether the transaction is backed by warranty and indemnity insurance – an increasing trend in the future energy sector;
- The type of seller and buyer – investment funds will have a very different approach and set of requirements than others in the market.

Our team is always happy to discuss current market trends and to explain the key features of transactions at different stages. For example, the National Security and Investment Act 2021 has had an impact on the future energy M&A market.

TLT has a national reputation as one of the UK's leading law firms in the future energy sector. Its corporate future energy practice is led by Kay Hobbs, who has been recognised in The Lawyer as one of Europe's Elite in terms of future energy lawyers and TLT's corporate future energy team was ranked 3rd globally by Clean Energy Pipeline for the volume of clean energy M&A deals it undertakes.

TLT's future energy clients include many of the sector's key funders, investors and developers including: Santander, Triodos, SSE, Bluefield Partners, Blackrock, Capital Dynamics, Blackfinch Investments, Alpha Real, Low Carbon, GRIDSERVE, Thrive Renewables, Ecotricity, JBM, Enso and the team has advised on some of the world's largest future energy projects and some of the UK's first-of-a-kind projects.

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Sectors, parties and completion arrangements

TLT deals – sectors

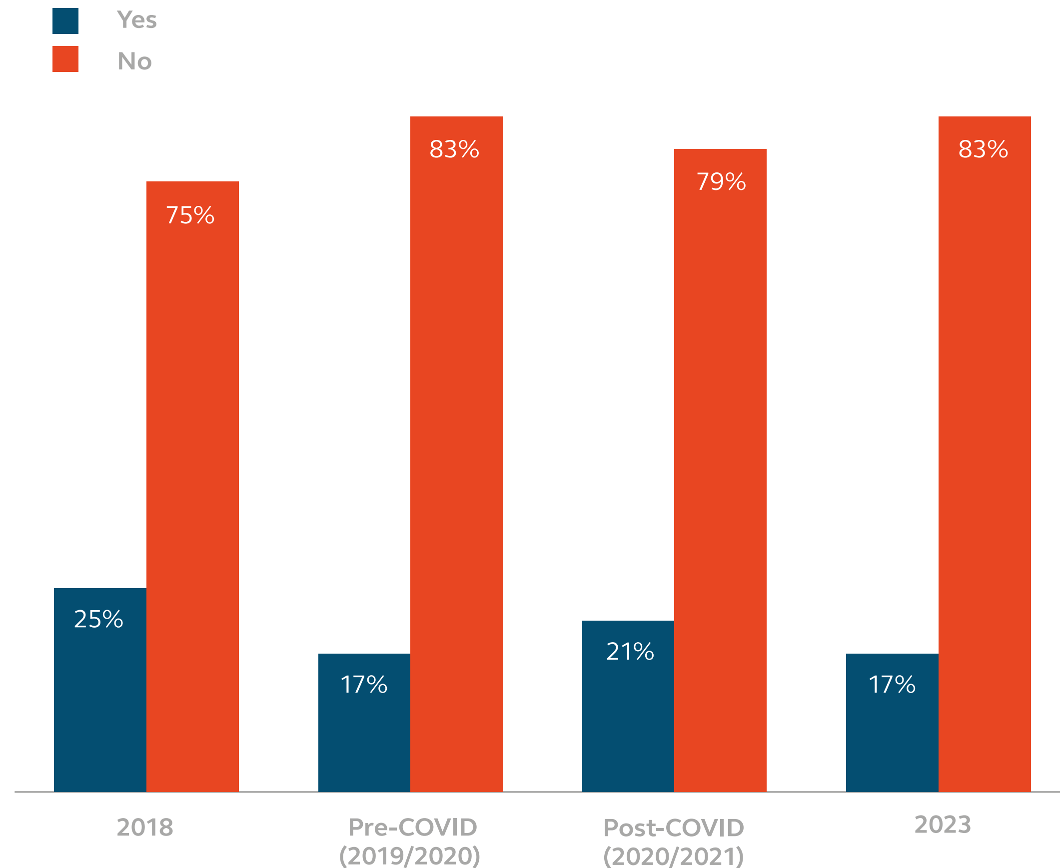
Nina Searle

"Strong activity levels in the Digital Sector come as no surprise. Every business now relies on technology to ensure its continued operation, evolution and competitive advantage, so that as a sector it remains resilient, and attractive to PE sponsors as well as trade acquirers already operating in the sector. The tech giants may be scaling back, but we expect to see mid-market digital sector M&A activity remaining strong in 2023, with particular focus on B2B, including regtech and ESG offerings, as well as fintech/digital payments and bio/health/med tech, and continued interest from overseas acquirers."

- Despite the residual impact of the COVID-19 pandemic and the impact on supply chains that some businesses will have suffered, M&A activity levels in 2021 and the first half of 2022 returned to pre-pandemic levels and even increased beyond this.
- Immediately following the pandemic, our M&A activity had a clear focus in the Digital, Retail & Consumer Goods, Professional Services and Education sectors.
- Over the past 12–18 months we have seen a greater number of sectors being represented but Digital and Retail and Consumer Goods continue to maintain high levels of deal activity.
- There will be continuing economic challenges given the rising cost of energy and other consumables as we move into 2023. These, coupled with potential tax rates and relief changes, will make for an interesting landscape. Businesses continue to seek innovation in order to adapt to the ever changing environment.

TLT deals – involving private equity element

- We have seen a slight reduction in the level of PE involvement in M&A over the past 18 months. This is perhaps unexpected as there are certainly PE funds ready and able to invest – we know that competition on the buy-side has been strong throughout 2021 and into the first half of 2022 and perhaps trade buyers have drawn opportunities away from PE through buy and build programmes. Sellers too may be opting for pure exits which do not require the ongoing management structures needed for PE, and employee ownership trusts are certainly something many selling clients are considering.
- Due diligence for PE houses will always have a strong focus on regulatory compliance. This has certainly been true as regards the UK's new national security regime (see page 36 for more detail). Our experience is that PE has quickly adapted to this but expects the regime to have been considered by sellers and targets at an early stage so that deal timetables are not too significantly affected.

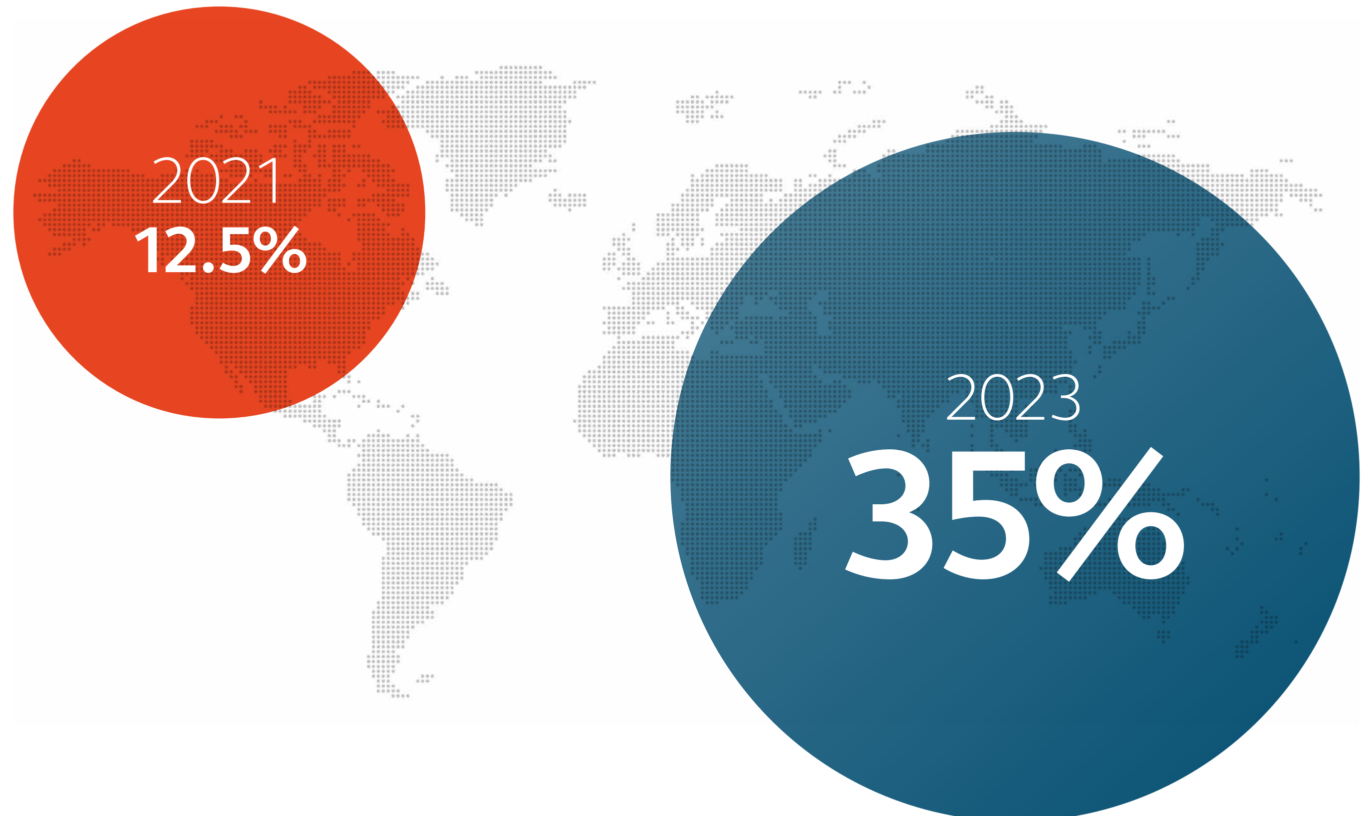


TLT deals – involving overseas entities

- There has been a significant uplift in the number of our transactions involving overseas entities. This has increased from 12.5% in 2021 to 35% in our 2023 review. This hopefully reflects renewed confidence following the UK's transition out of the EU and the challenges faced during the COVID-19 pandemic. This has exceeded pre-pandemic levels of 27%.
- A particular area of focus from an international perspective has been the new National Security and Investment Act 2021 which came into force in the UK in January 2022. It has a broad scope, capturing a wide variety of transactions (not just M&A), sectors (not just defence) and domestic, as well as overseas, parties. Overseas buyers and the investors will need to think early on about the impact of this new regime on their transaction(s), including timelines and contractual arrangements required.
- We are well placed to advise on the impact of foreign investment and international deals with our expertise in advising on global cross-border strategic transactions working with likeminded overseas firms who we have a strategic partnership with. Our approach to our international capability enables us to work with the right firm for each client and to provide seamless cross-border services. As part of our international strategy, we have a strategic alliance with Holla Legal & Tax in the Netherlands and GSJ Advocaten in Belgium.

Alice Gardner

"The increase in the number of our deals with an international element highlights the resilience of the UK M&A market as overseas investors and corporates still look to increase their global footprint, in particular US-based clients continue to use the UK as a gateway into Europe. The team here at TLT frequently advise our multi-national clients on cross-border deals working alongside our international network of firms."



TLT deals – was there a gap between exchange and completion?

- Immediately following the COVID-19 pandemic we saw both buyers and sellers wanting certainty around transactions resulting in in all transactions completing on a simultaneous basis.
- Since the start of 2021 we have seen more transactions incorporating a gap between exchange and completion. There have been a number of factors behind this trend but they include requirements for FCA regulatory approval, notifications being required under the new National Security and Investment Act 2021, third party consents and time to facilitate acquisition funding arrangements.
- Whilst it remains the case that parties to our transactions prefer the certainty of simultaneous exchange and completion, the regulatory landscape means that parties and their advisors need to consider at an early stage whether approvals or consents are required and factor this into the transaction timetable and purchase agreement.

12% 2018

10% Pre-COVID (2019–2020)

0% Post-COVID (2020–2021)

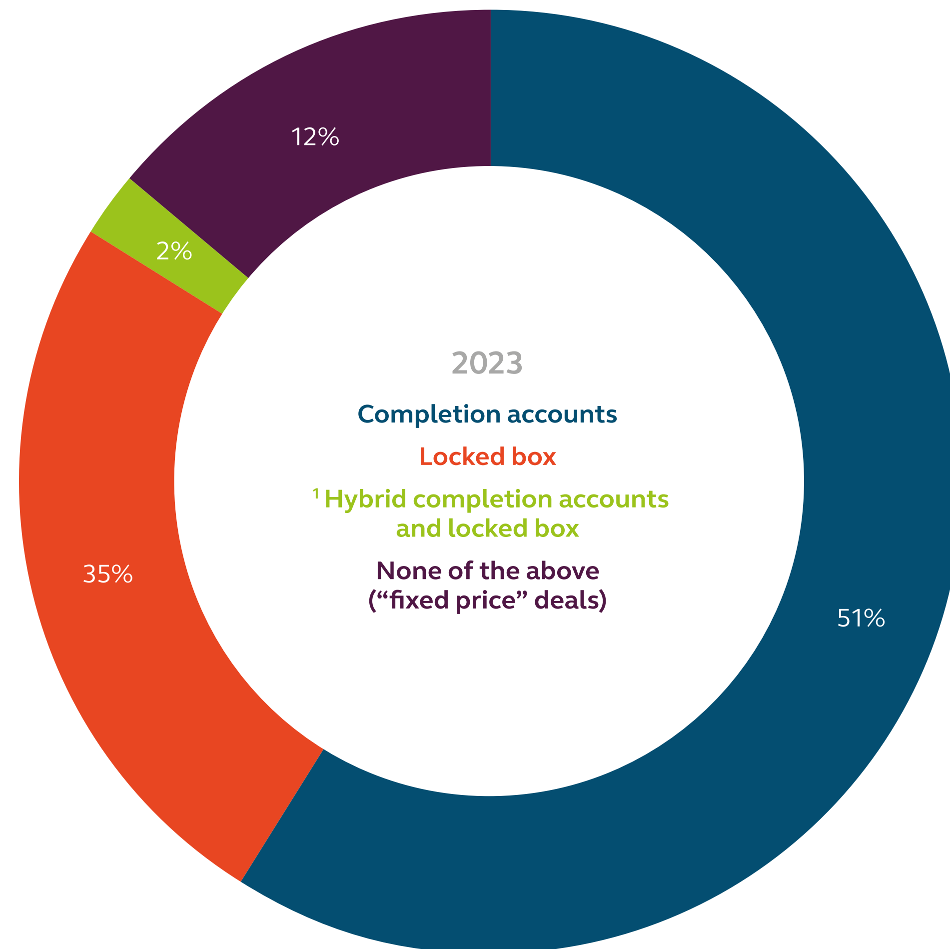
14% 2023

percentage of deals surveyed which included a **split exchange** and **completion**

Pricing mechanisms

Pricing mechanisms – completion accounts or locked box?

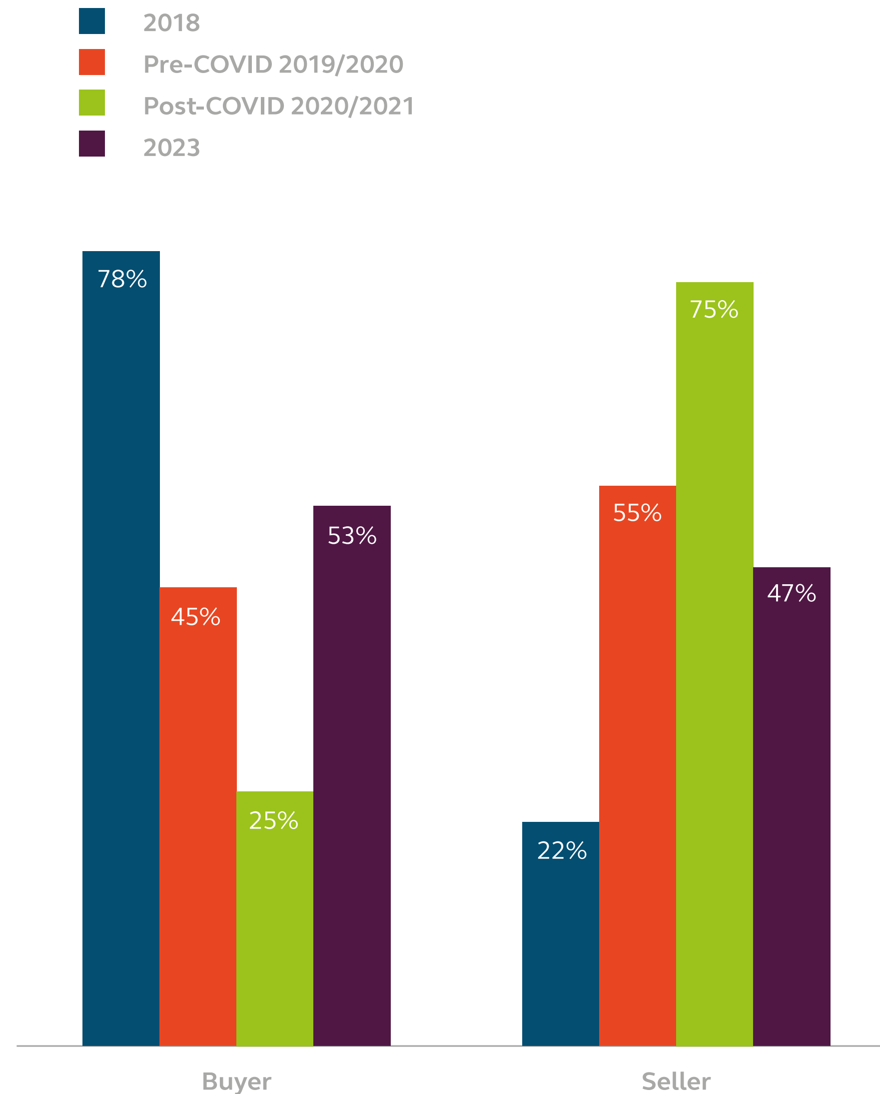
- Throughout 2021 and 2022 challenges remained with valuing businesses. As a result, the vast majority of our deals (88%) have used some form of pricing mechanism.
- The war in Ukraine, rising energy costs and supply chain disruption have all contributed to an unsettled landscape throughout the period of our analysis. Completion accounts have been the most popular choice of pricing mechanism, giving both parties the right to have a post-completion assessment.
- We saw an increase in the use of locked boxes compared to our pre-pandemic statistics (23% in our pre March 2020 sample), demonstrating the relative strength of sellers for a substantial part of our review period.



1 By way of explanation, the hybrid approach typically involves completion accounts being prepared for the month end before completion, with these becoming the 'locked box' accounts for the period to completion (with customary leakage protection).

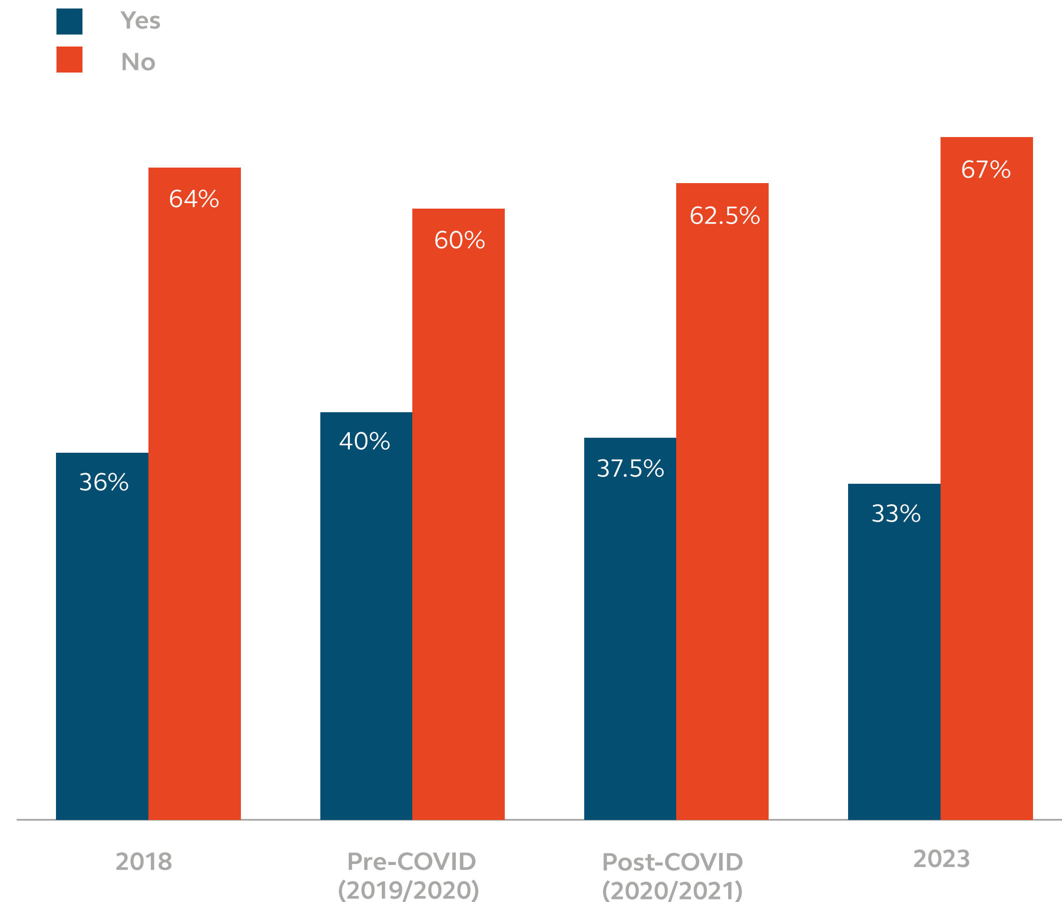
Completion accounts – who prepared and what was tested?

- Both before and after the COVID-19 pandemic (for these purposes, March 2020) we saw a shift from buyers preparing the first draft of the completion accounts. This reflected a seller's market in the lead up to the COVID-19 pandemic and the view subsequently that sellers were probably best placed to prepare draft accounts for a business impacted by the pandemic.
- Our 2021/2022 deal sample has shown a move back towards pre-pandemic trends. Although buyers may want to have control of the process and to lead price negotiations, it is clear that sellers are still controlling the process almost 50% of the time. This suggests that sellers have been in a strong position for much of the period this report covers.
- Transactions testing net assets have seen a resurgence in popularity with it being used in 34% of the deals in our sample, returning to a level last seen in 2016. This is a substantial increase given that we did not see any deals testing net assets in our last market monitor analysis (in 2021). Whilst not appropriate for all businesses, net assets can be simpler and easier to test, meaning greater certainty for the parties.
- Deals testing working capital (on a cash/debt free basis) continue to be most popular with that test being used in 66% of the deals sampled.



Deferred consideration – was there any?

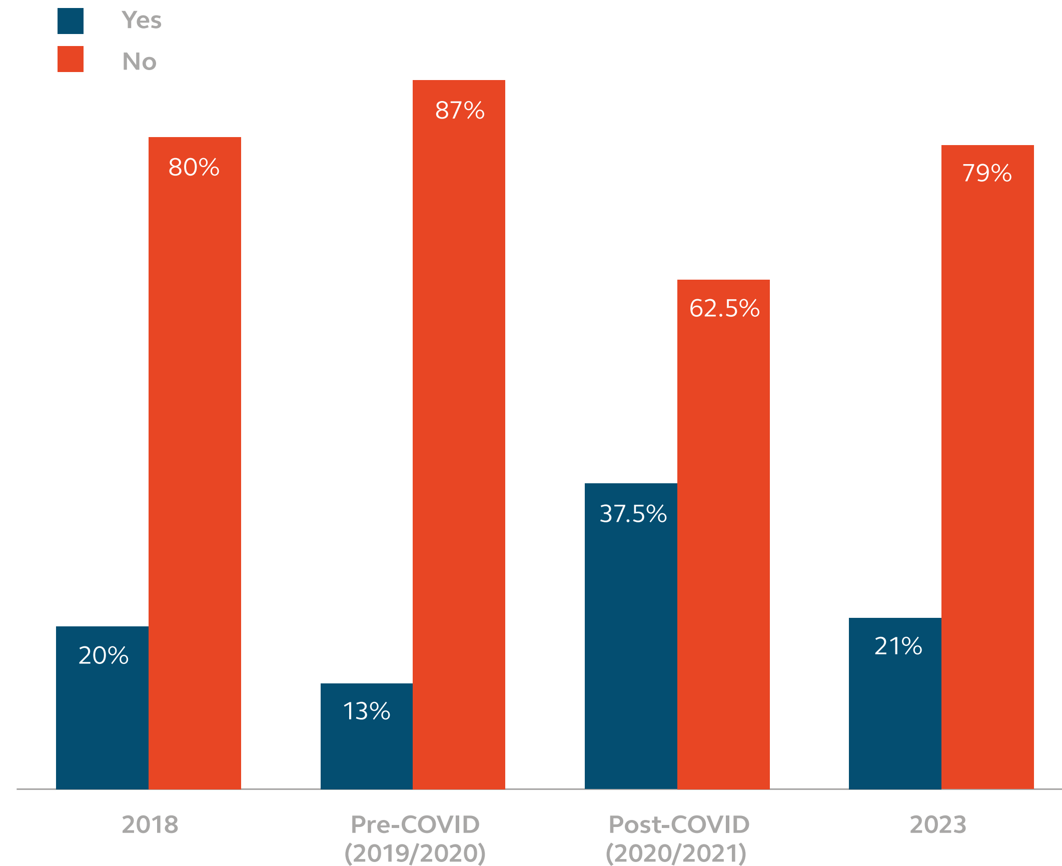
- As anticipated, the use of deferred consideration as part of deal pricing has remained at a similar level to that seen both pre- and post-pandemic.
- We have seen substantial variance in the amount of consideration that has been deferred with it ranging from 0.39% to 41.5% of the total purchase price. However, there are usually very deal specific reasons for the significantly high and low percentages and the mean average was 18% of the total purchase price. This is similar to the position in 2018 when the same statistic was 16%.
- In the case of the transaction where the deferred consideration comprised more than 40% of the total purchase price, this was a true use of 'vendor finance' as interest accrued on the deferred payments which were payable in instalments and subject only to the passing of time. Conversely, where we saw a very low percentage (0.39%) this was merely deferred payment for certain debts which were due to be recovered. As such, it was simply used to manage cashflow in the business.
- Note that contingent or earn-out consideration has been excluded for the purpose of this particular analysis, so this data shows deals where there was an element of "vendor finance".



Purchase price retentions

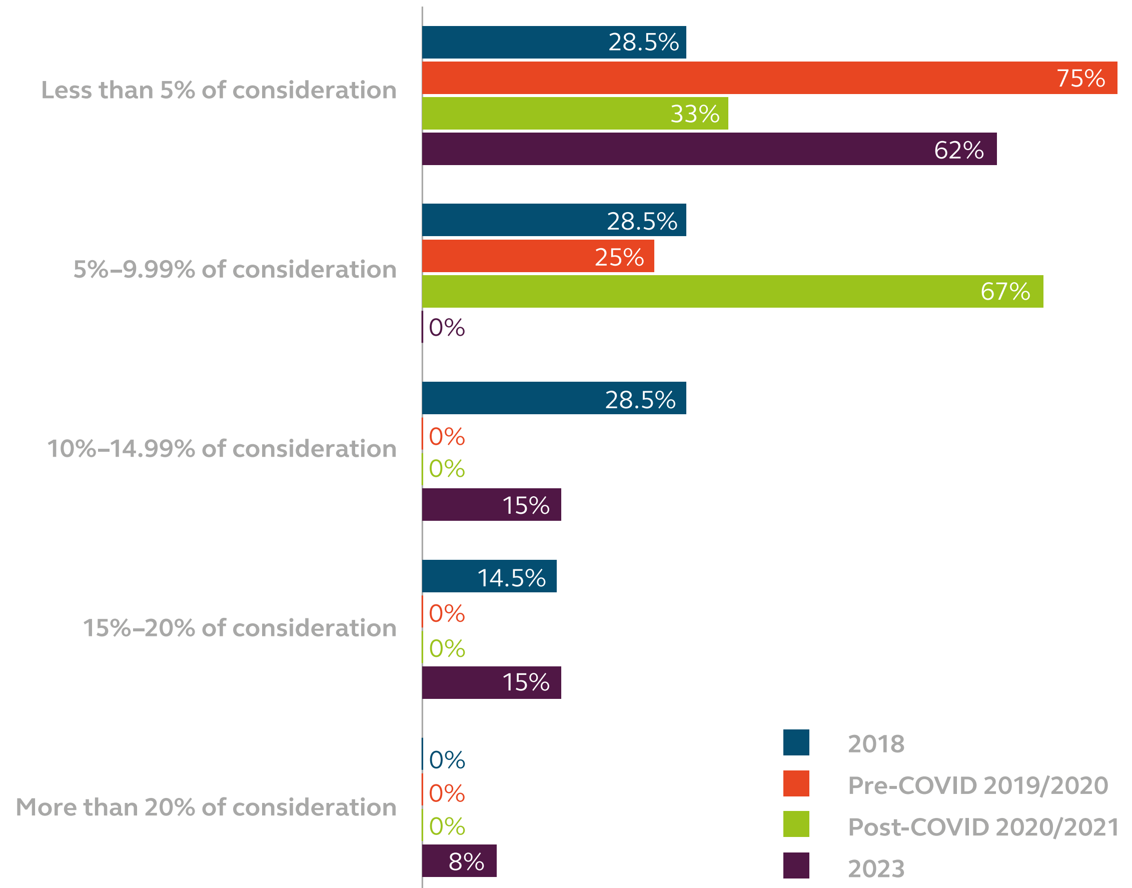
Purchase price – was there a retention?

- The number of deals involving a retention has decreased over the past 24 months indicative of sellers generally being in a strong position during most of this period.
- A retention for this purpose is a portion of the consideration paid by the buyer into a specific escrow or retention fund at completion.
- The use of deferred consideration instead can be a way to hold back cash at completion without the complexity and cost of formal escrow arrangements.



Retention – size relative to price

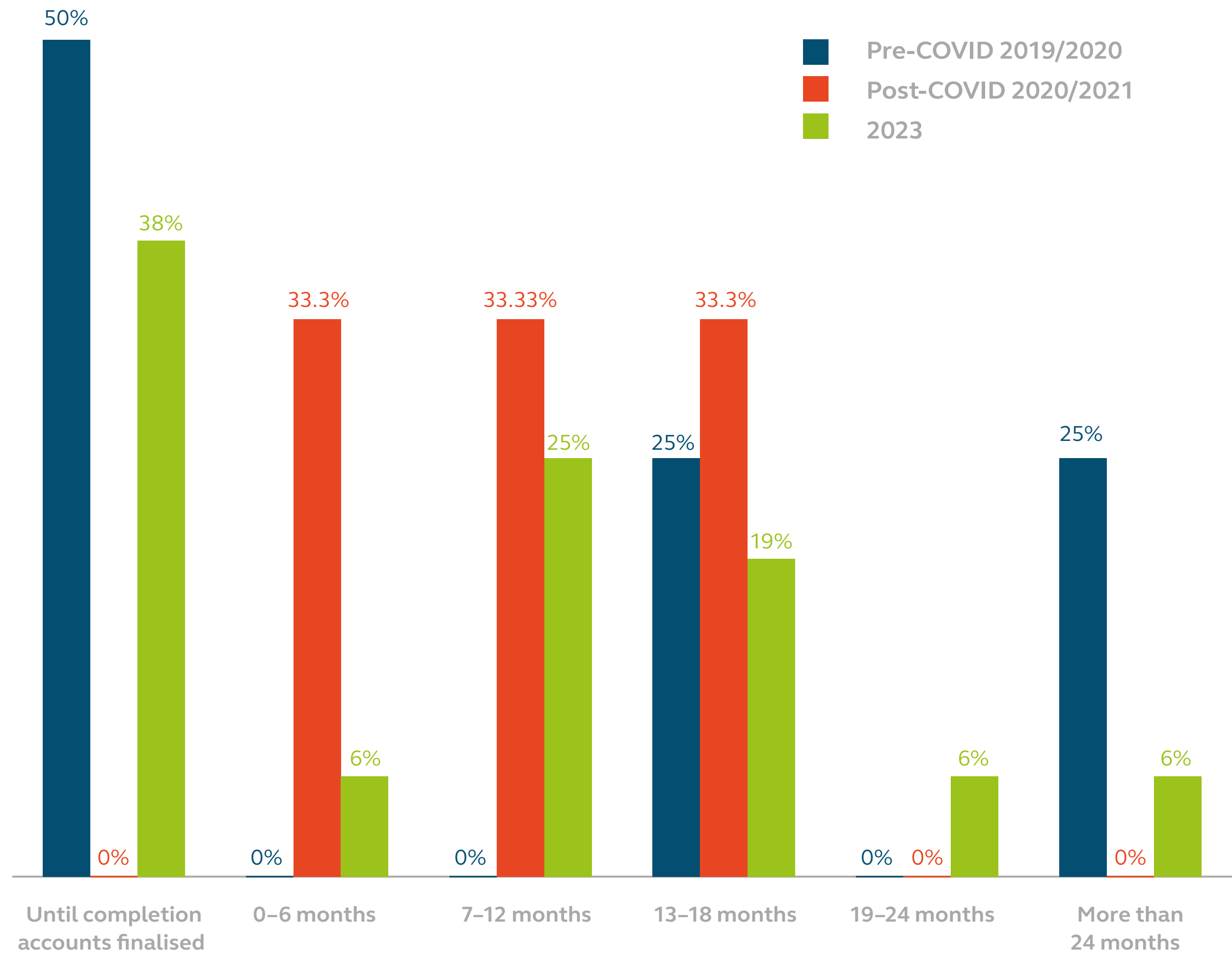
- Over half of all retentions that were in our deal sample, were for less than 5% of the purchase price which is similar to the position pre-pandemic.
- We have, however, seen an increase in the number of larger retentions and these seem to be used to address concerns regarding a specific liability, for example, potential tax charges. With concerns about continued trading in the challenging economic climate, and possibly a shift towards a buyer's market, this may be a trend which continues.



Retention – what did it cover?

- We continue to see retentions being used to cover adjustments arising under completion accounts, but also more broadly. Not only are they being used to deal with any claims under the purchase agreement but also to address particular concerns that the buyer may have. For example, we have seen a number of deals which have used retentions to deal with the risk that HMRC may have a specific tax claim against the target.
- Interestingly, we had no deals which used a retention to cover the risk of a key contract being terminated, possibly because deals are using conditionality to ensure consent to a transaction has been obtained rather than taking the risk that the contract be terminated post-completion.
- We expect buyers to continue looking for deal structures which enable them to minimise their risk and exposure given the increased scrutiny of transactions and the more challenging economic climate.

Retention – time period

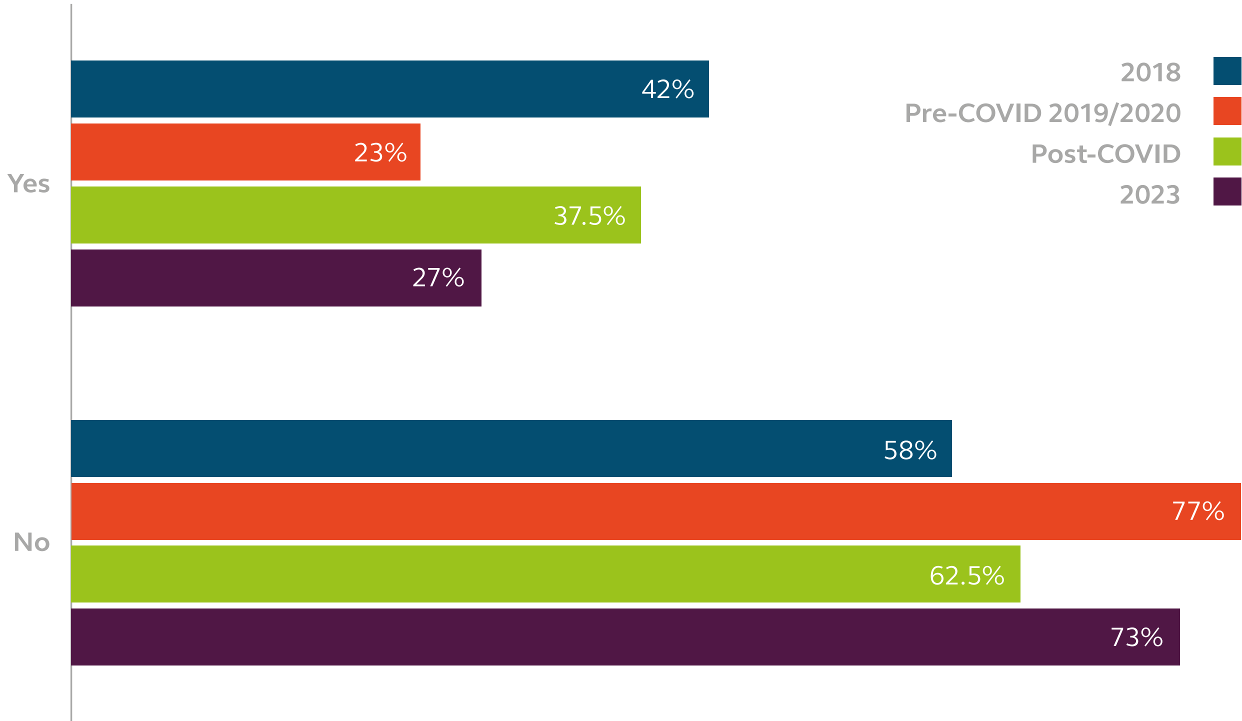


- Retention time periods continue to vary and are clearly very deal specific relating to the particular risks and concerns that the buyer wishes to address.
- Despite this, we have seen retention periods tying in with the time it takes for the completion accounts to be finalised (as we did pre-pandemic). This may suggest that sellers are unwilling to allow buyers to hold onto funds after completion accounts have been finalised.

Earn-out arrangements

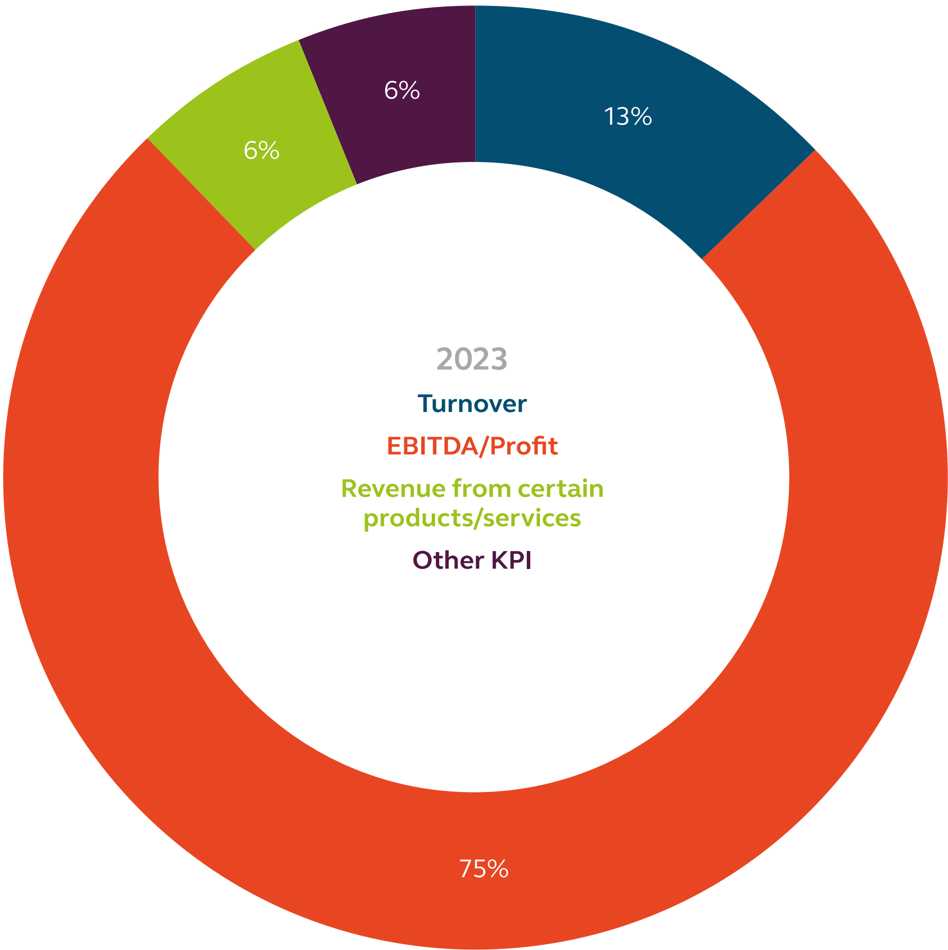
Earn-out – was an earn-out used?

- We saw a marked increase in the use of earn-outs immediately following the start of the COVID-19 pandemic. This was to be expected as valuing businesses was challenging, either because a business was seeing greater success (for example online retailers) or was suffering possibly a downturn in trading (for example businesses in the hospitality sector).
- Earn-outs can be utilised to balance the concerns of either a buyer thinking they may be paying too much for a business or sellers feeling that their business cannot demonstrate all of its value. Earn-outs allow for an agreed price to be payable at completion of the transaction, with further consideration payable in respect of the future financial performance of the business.
- We have seen a decline in the use of earn-outs in our recent analysis. However, with greater economic uncertainty, earn-outs may again be used to bridge valuation gaps. What will remain a challenge and a subject of debate between parties is agreeing on the relevant targets and metrics to be used for any earn-out.



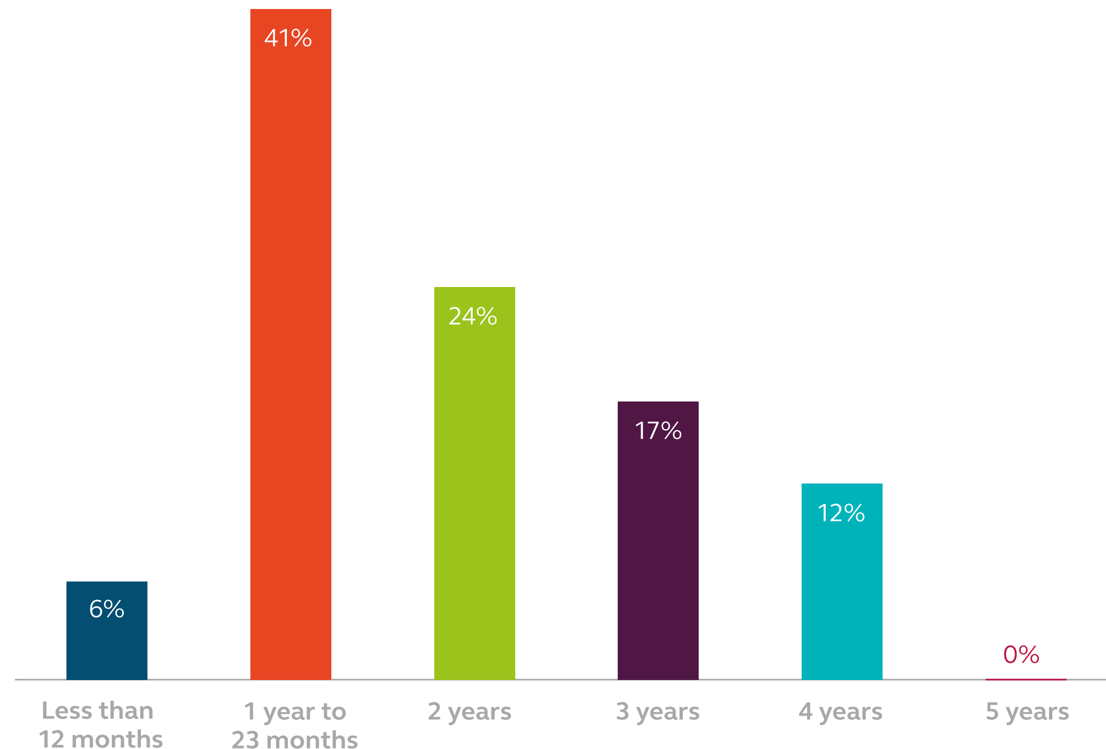
Earn-out – what did it test?

- We continue to see EBITDA or a similar measure of profit as the most common metric for earn-out calculations. Immediately after the COVID-19 pandemic it was used in 67% of all earn outs and in our recent analysis it was used on 75%.
- We have, however, seen an increase in earn-outs based on turnover. We didn't see this in any of our deals sampled for our 2021 report which suggests that other measures are being considered, possibly in sectors where EBITDA doesn't provide the seller and/or buyer with the correct measure of success.
- Other forms of KPI target (usually non-financial) continue to see limited use as they can be difficult to test and measure and therefore provide less certainty.



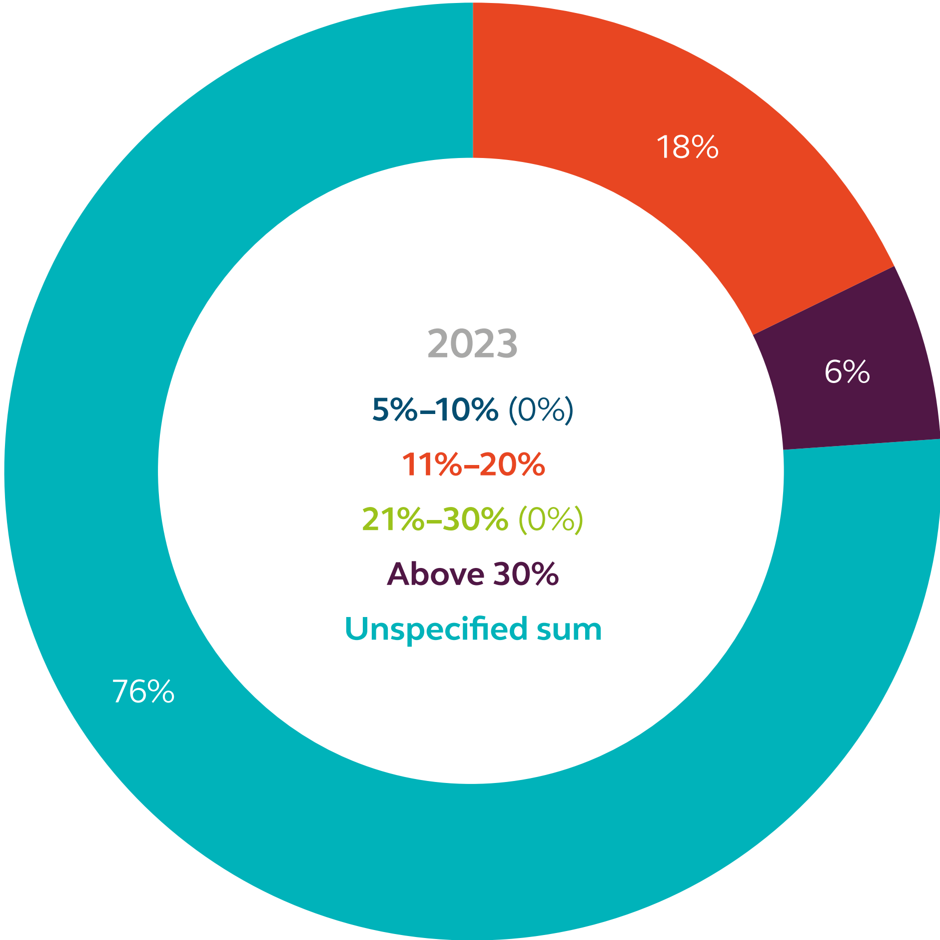
Earn-out – time period

- The length of earn-out periods has reduced over the last 24 months.
- In our 2021 M&A Market Monitor, we saw that earn-out periods had started to lengthen. Only 33.3% of all earn-out periods were for 2 years or less in the post COVID-19 sample. This may have been to provide time for sellers to recover from both the impact of the COVID-19 pandemic and the UK's transition out of the EU.
- With the more challenging political environment in the latter half of 2022, the economic uncertainty, the war in the Ukraine and the continued disruption to supply chains, long term forecasting for earn-outs can be really difficult to predict and it is therefore unsurprising that we have seen a shift to shorter time frames. This is a trend likely to continue into 2023.



Earn-out – size relative to price

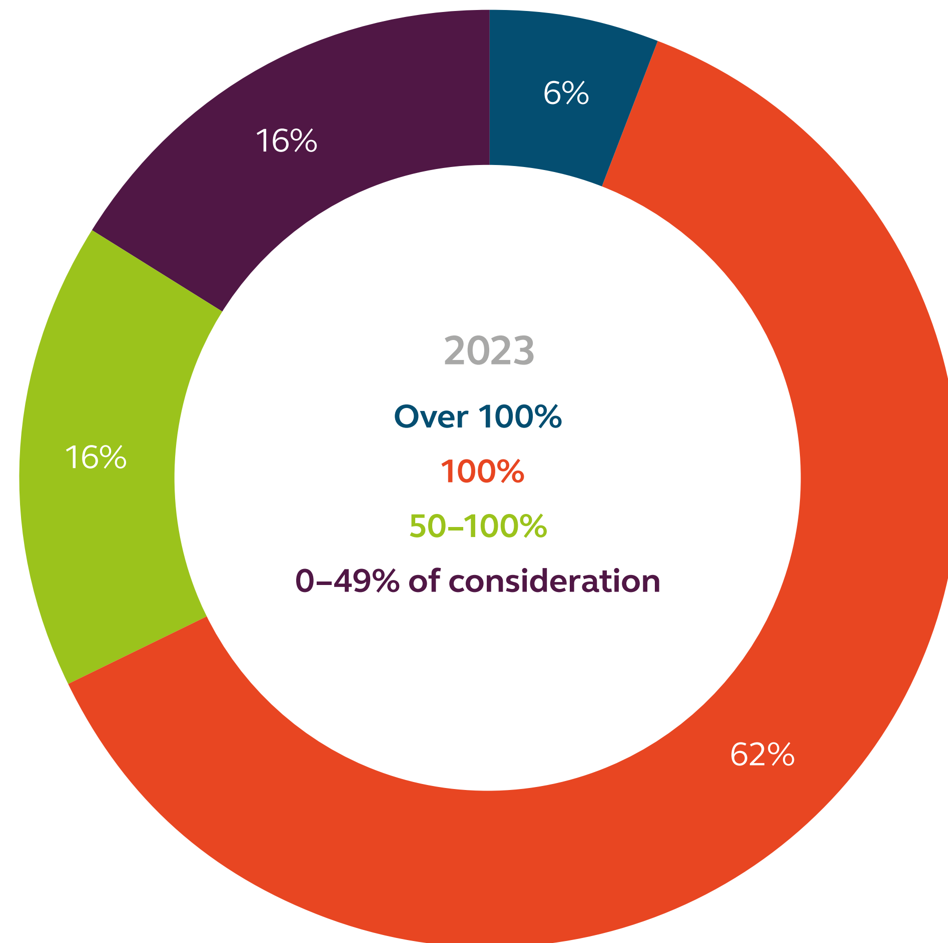
- A noticeable increase in the number of earn-outs which are unspecified as to value has continued. Unspecified sums were seen in 67% of all deals sampled immediately after the COVID-19 pandemic compared with 76% in our most recent analysis.
- Where we refer to an earn-out as being for an unspecified sum, we mean no specific amount or cap was contractually agreed. Having an unspecified sum creates risks for both the seller(s) and buyer, however, parties clearly feel such risk is acceptable to ensure that the value of the business is determined by the relevant future performance metrics.
- This return to shorter earn-out periods means that any contractual protections which a seller wants to safeguard their position during the earn-out do not need to run for such a long time. Appealing to a buyer who will not want to be restricted for too long in its future activities and functions across its wider group (including synergising the target's activities with its own), or to keep track of the earnings/profits/revenue attributable to the target business after merger.
- We would usually expect earn-outs of between 10–20% of deal value, providing a meaningful incentive for sellers whilst also ensuring they are not overly exposed to future performance.



Seller limitations on liability

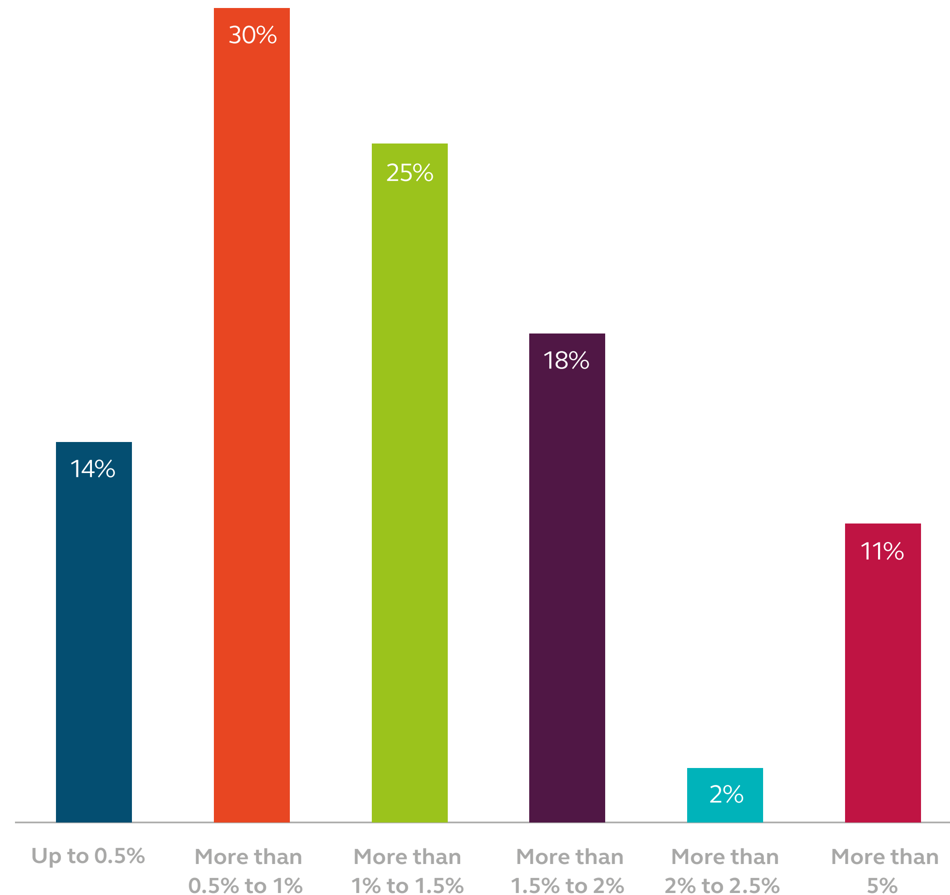
Liability – cap as percentage of purchase price

- 100% of the total purchase price (including any upwards adjustment, deferred or earn-out consideration received from time to time) remains the most commonly used liability cap.
- We have seen much lower caps on liability although these tend to coincide with the use of warranty and indemnity insurance where a buyer will only be looking for the seller to be liable in relation to anything not covered by the insurance policy.
- Transactions with a "greater than 100%" cap are unusual and reflective of very bespoke terms (often linking through to other related transactions).



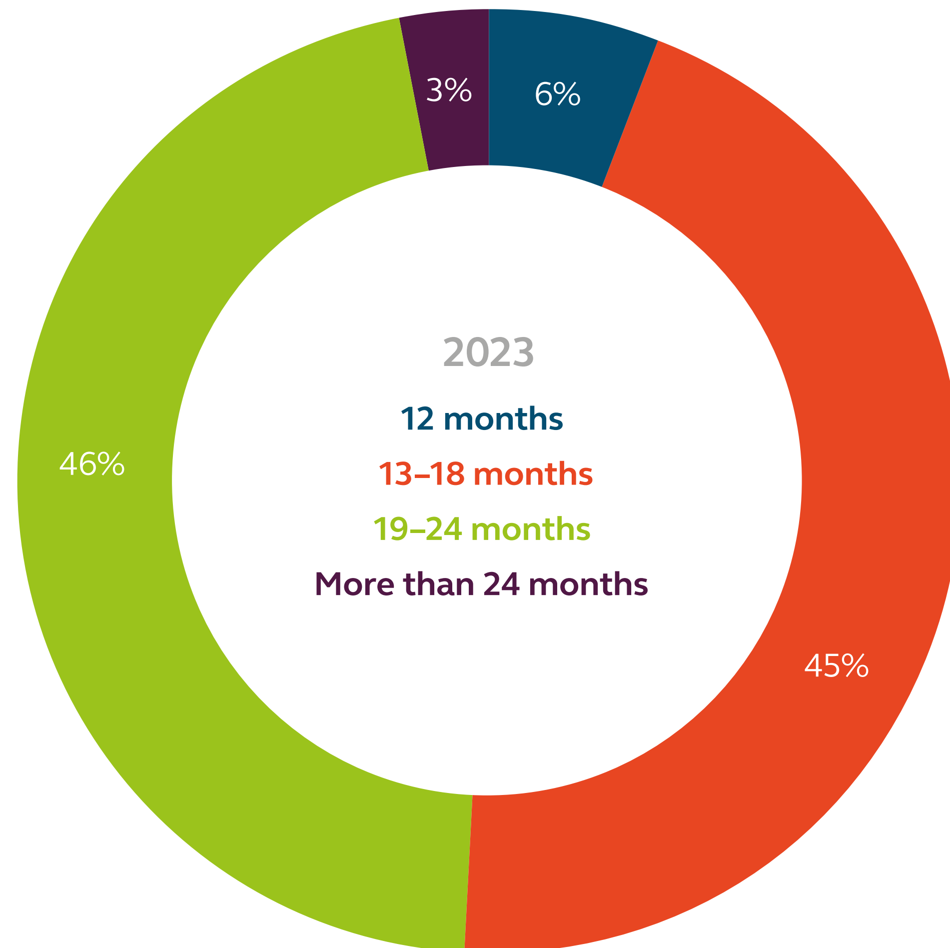
Liability – aggregate claims threshold/basket (% of deal value)

- We have seen a return to slightly larger "baskets" being agreed with most being in the region of up to 2% of deal value. This is a return to the levels that we saw back in 2014, 2016 and 2018.
- Following the COVID-19 pandemic, we had seen baskets reducing to roughly 1% of deal value which possibly indicated buyers being in a stronger bargaining position after the challenges of the pandemic.
- Deals with thresholds falling below 0.5% are generally transactions involving warranty and indemnity insurance or transactions undertaken on bespoke terms.



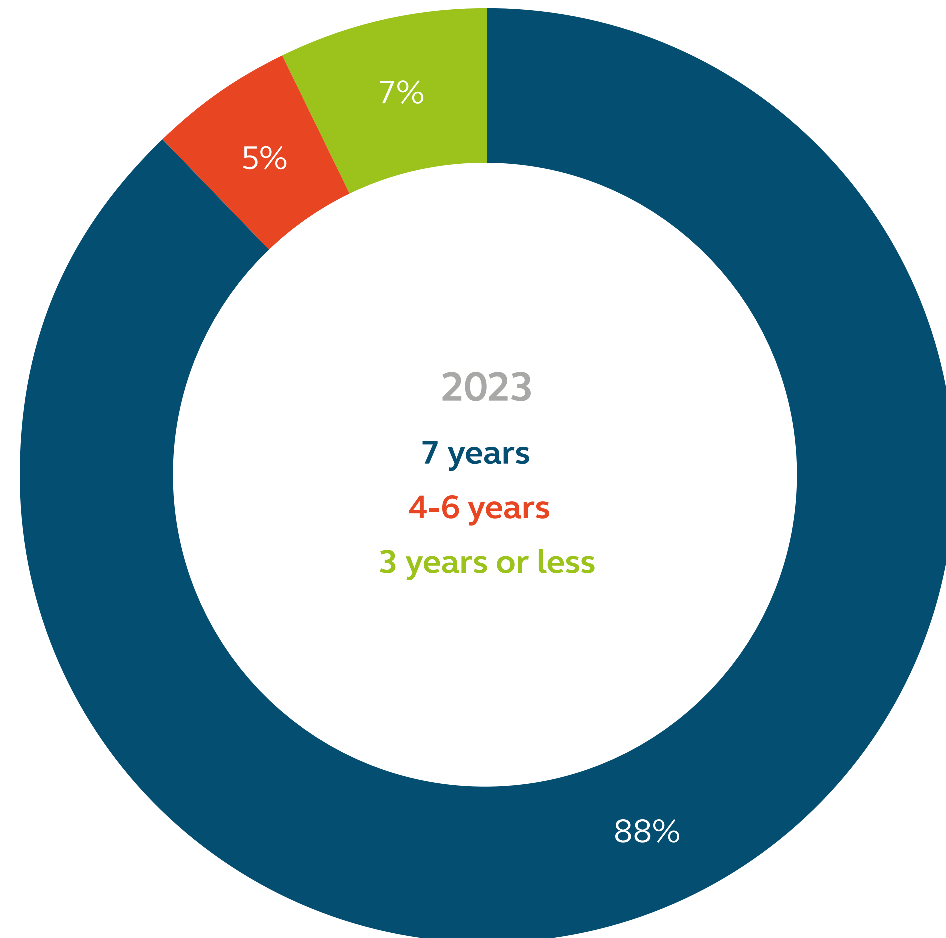
Liability – limitation period for non-tax warranty claims

- Almost all of the deals sampled had non-tax warranty claim periods of no more than two years which remains consistent with our analysis from previous years.
- Buyers usually wish to have at least one full year's accounts prepared post completion before any non-tax warranties expire.



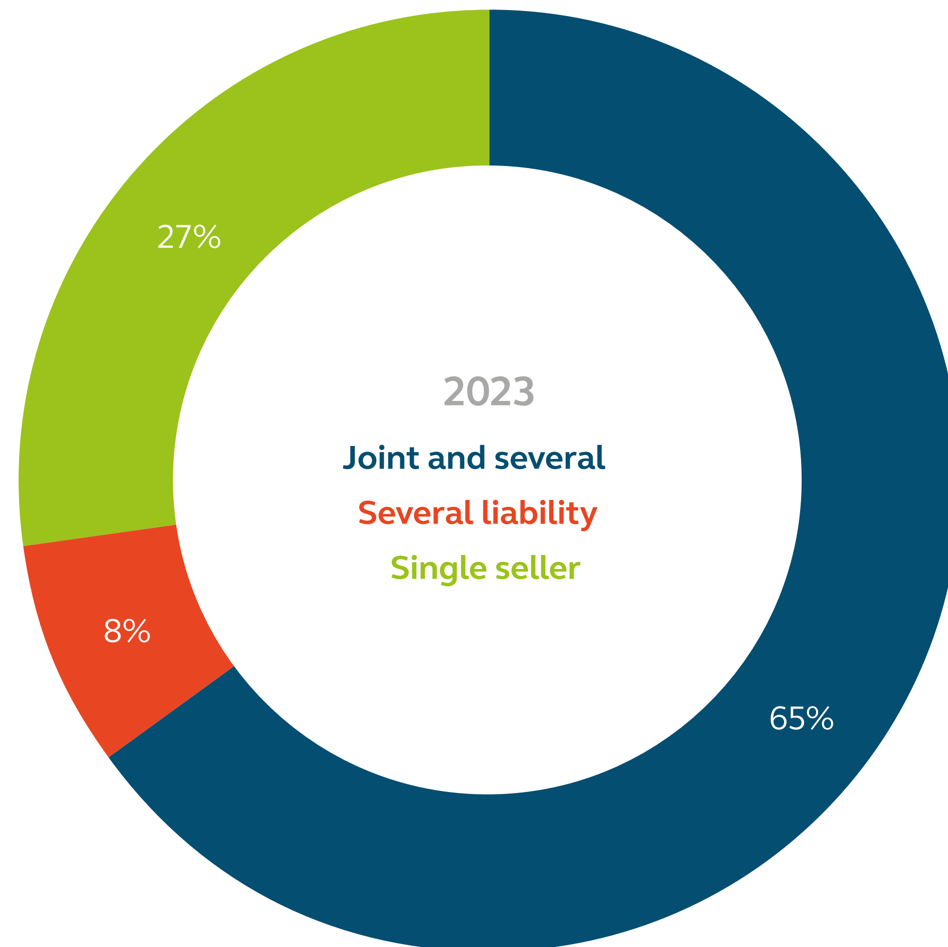
Liability – limitation period for tax claims

- Seven years continues to be the most popular limitation period for tax claims – increasing after the slight reduction post-pandemic where it was at 75% (it was 85% in 2016 and 77.5% in 2018).

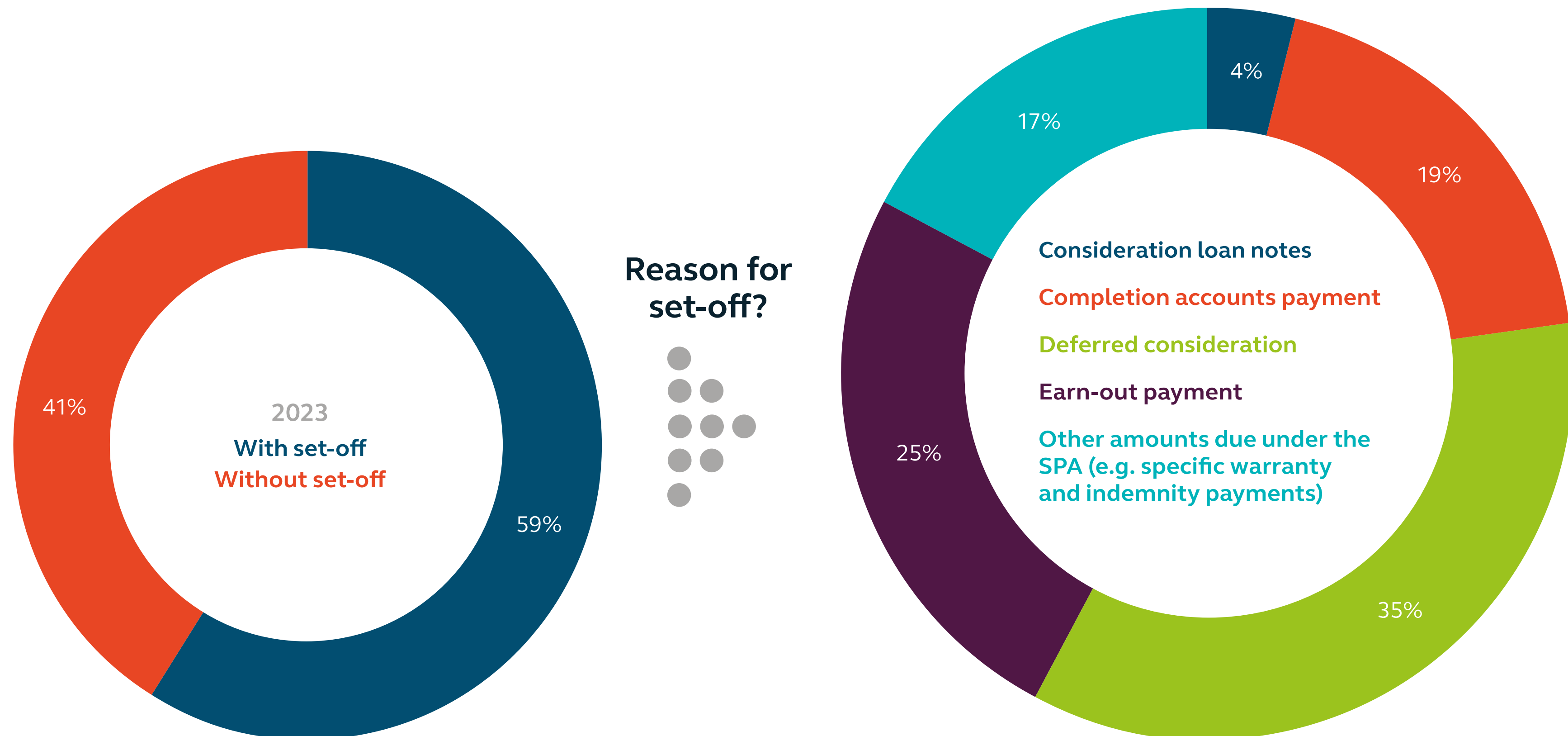


Liability – joint and several or several liability

- In transactions where there is more than one seller, we are continuing to see joint and several liability predominantly being used. Buyers remain unwilling to accept credit risk on individual sellers which could prejudice their ability to seek recovery.
- Several liability is occasionally seen and usually reflects a seller's more limited exposure in the relevant transactions, due to warranty and indemnity insurance cover and/or greater retentions.
- Historically we have seen sellers having liability on a "several and proportionate" basis but not in our current or 2021 deal samples.



Liability – contractual right of set-off



- We have seen a reduction to pre-pandemic levels on the use of contractual rights of set-off, which dovetails with a decreased use of earn-outs.
- A contractual right of set-off allows for any amounts due to a buyer to be off-set against any owed by a buyer. For example, if the buyer is due to pay some deferred consideration but has an agreed warranty claim against the sellers, the amount of consideration payable by the buyer can be reduced by the amount of the warranty claim.
- With the challenging economic climate ahead, set-off rights may well be used more frequently, particularly if we see increased use of post-completion pricing adjustments and/or deferred or "future performance" consideration against which claims can be set off.

Liability – W&I insurance used?

- Warranty and indemnity insurance continues to be an important aspect of many deals. It was used in 19% of our most recent deal sample, 25% of the post-pandemic deal sample and 13% of our pre-pandemic deal sample.
- Such insurance adds certainty to transactions amidst the uncertainty of the market. It provides a buyer with a broader set of contractual protections, which may not otherwise have been possible due to the nature of the seller (for example, private equity funds only usually willing to provide title and capacity warranties).
- As we move into a more challenging economic climate with the possibility of more distressed M&A, we may see a rise in the use of synthetic W&I insurance products where the insurer effectively provides the warranties, not the sellers under the purchase agreement.
- We expect premiums to lower where there is reduced deal activity in 2023, and for larger valuation multiples to be questioned by insurers who may be concerned about overpayment. The timeline for agreement and inception of a W&I policy is usually about 14 business days.
- Underwriters still require a comprehensive due diligence exercise to be undertaken. IP, IT and data protection are key areas of focus, as cyber attacks become more prevalent and a business' resilience needs to be assessed.
- All of the W&I policies obtained on our transactions were buy-side policies.

Liability – data room – due diligence documents generally disclosed?

- We have seen a return to the pre-pandemic position where the majority of deals have general disclosure of the data room / due diligence documents. General disclosure was only seen in 38% of the transactions in our 2021 post pandemic sample, however this was a move away from the 70% seen pre-pandemic and the 71% seen in our 2018 M&A Market Monitor.
- We continue to see extensive due diligence being undertaken on target businesses and this is only likely to increase with enhanced corporate transparency laws (particularly those proposed under the UK's Economic Crime and Corporate Transparency Bill) and the strong focus on ESG matters. Buyers seem, however, to be able to get comfortable with general disclosure, perhaps because most due diligence takes place via online data rooms which can be tracked and audited, giving buyers comfort that all documents have been reviewed by them and/or their advisors.
- Given the ever-increasing demands of due diligence on target businesses, sellers need to be mindful of the time and resource that this part of the transaction takes. Wherever possible, they should try to undertake an internal audit prior to starting any sale process to ensure that any issues are rectified to prevent them affecting pricing or timing of the transaction.

General disclosure was seen on

75%

of our 2023 deal sample

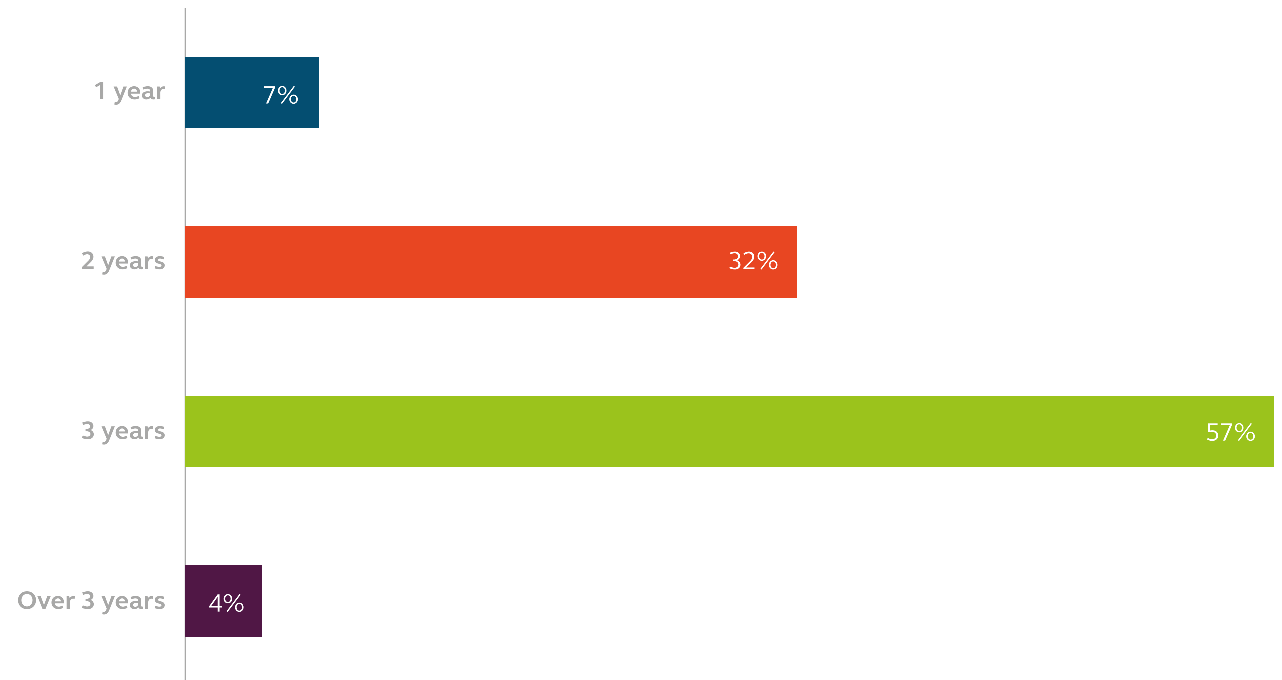
Restrictive covenants

Restrictive covenants – were they provided?

- Restrictive covenants are always a key element of the parties' negotiations and were captured in 90% of the deals sampled. They focused mainly on restrictions against competition, branding and approaching/contacting a target's employees, suppliers and customers.
- The reason for covenants not being imposed on the remaining 10% of deals sampled was due to the specific nature of the transactions, for example, where there were private equity sellers or where it was agreed to be inappropriate to restrict a seller due to the nature of their particular business.

Restrictive covenants – duration

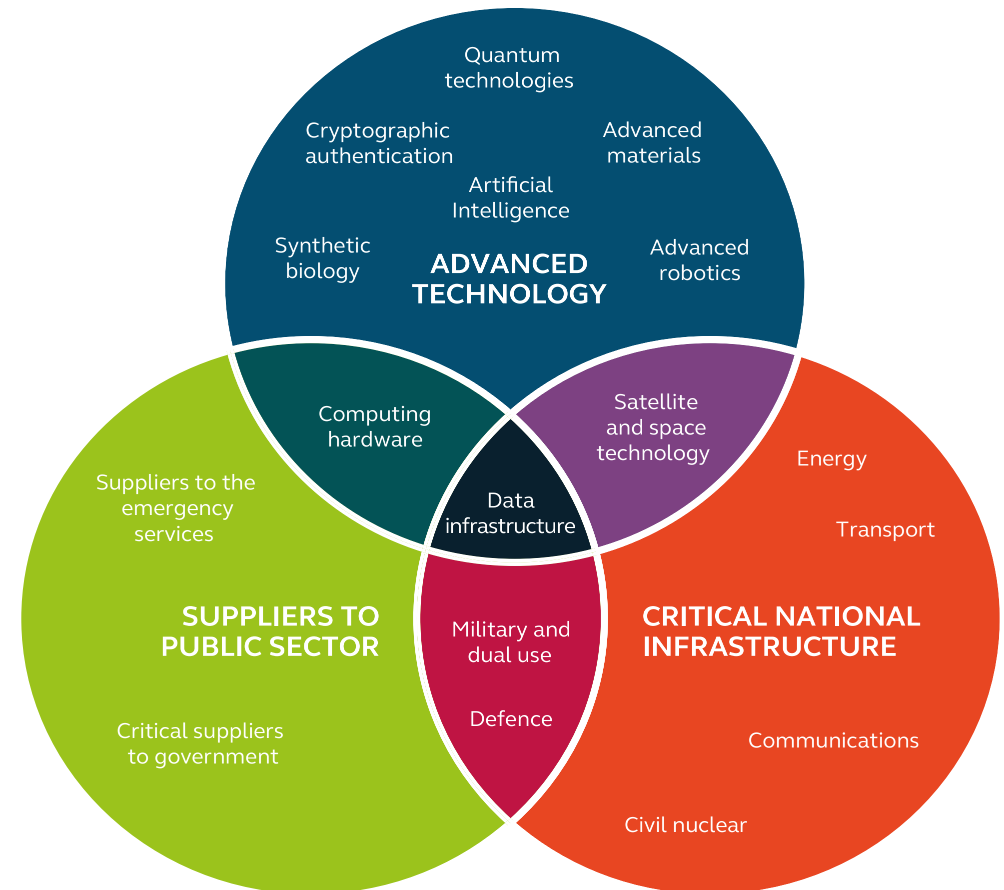
- As we have seen in previous years, the vast majority of restrictions tend to run for two or three years (89% of deals in this report, 87.5% post-COVID 2020, 100% pre-COVID 2019/2020 and 86% in 2018).
- Anything outside of the two to three year timeframe is unusual and based upon the specific circumstances of a specific transaction. In particular, we have seen deals with restrictions lasting over three years which were put in place to provide for a period of time following an earn-out.
- Restrictive covenants always need to be viewed in their context to ensure that they are proportionate and defensible and cannot be seen as anti-competitive. Being able to demonstrate the commercial rationale to support a restriction is something which should always be considered.



National Security and Investment Act 2021

National Security and Investment Act 2021

- A new national security regime came into force in the UK on 4 January 2022 pursuant to the National Security and Investment Act 2021 (**NSIA**), and this has become a significant consideration in a number of transactions.
- It was introduced with the aim of protecting the UK's national security from hostile foreign parties using ownership of, or influence over, UK businesses and assets. However, the NSIA does not specifically limit its scope to foreign buyers and investors. It applies equally to domestic parties. In certain circumstances it can also catch acquisitions of non-UK entities or assets.
- The NSIA captures a wide range of transactions and focuses on entities and assets which operate in 17 'sensitive sectors'. Whether or not a business falls within one of these sectors is something which needs to be carefully considered, especially as they are broad in scope and not purely focused on defence and military operations/assets.
- We have made mandatory NSIA notifications in respect of two of the transactions covered in our deal sample. However, we have undertaken NSIA analysis (of both sectors and transaction structure) on a number of others and it is something which is becoming a common feature in due diligence processes.
- Where transactions are caught by the regime (either by way of a voluntary or mandatory notification) we are finding that the new Investment Security Unit (**ISU**) which reviews the clearance applications is typically taking the full review period to which it is entitled to respond and make its assessment. This is something which parties need to factor into their transaction timetables. We are seeing the approval period often being dealt with as part of a split exchange and completion with the parties agreeing to the terms of the transaction subject to confirmation from the ISU that the clearance has been given (or given with conditions to which both parties are happy to comply).
- For more information on the regime, please do refer to our **Frequently Asked Questions** and dedicated **In Focus page**.



Key themes and looking to the future

Conclusion – Key themes and looking to the future

As ever, much depends on the circumstances, but emerging themes include...

Timing

Timing is an important part of all transactions and over the last 12 months we have seen increased scrutiny of transactions whether as a result of the NSIA being used to manage foreign investment, the Competition and Markets Authority considering competition aspects or transactions requiring Financial Conduct Authority approval.

Where a transaction involves the need for such approvals, we expect to see the use of conditionality/split exchange mechanics. This is something which advisers will need to spot early in order to navigate the process effectively and provide a realistic timetable for the parties.

Economy

The second half of 2022 brought with it both economic and political instability with rising interest rates, higher energy costs, supply-chain issues and continued fall out due to the war in the Ukraine. With the cost of finance and energy increasing at a time when many businesses may be having to repay loans granted during the COVID-19 pandemic, businesses will be looking to manage costs. This is likely to mean they are more selective as buyers, focusing on targets which help them adapt or consolidate their existing offering.

Valuations are likely to continue to be challenging with uncertainty around cash flow and the trend of deferred and future performance-based consideration being used to bridge the gap between buyer and seller pricing expectations may not be over yet. Businesses that can maintain stable cash flow should find it easier to demonstrate value.

Distressed sales

Periods of economic downturn tend to lead to an increase in the number of distressed sales and we anticipate seeing more of these as we move into 2023. This kind of market still creates opportunity, especially for cash rich buyers. High quality, resilient businesses will remain highly marketable, compared with distressed businesses with more risk and possibly greater deal complexity. However, there will be good deals to be had for the right assets at the right price.

Due diligence

Buyers continue to carry out extensive due diligence on target businesses, and warranty and indemnity insurers are adopting the same approach. Whilst a business response to the COVID-19 pandemic and the repayment of any COVID-19 pandemic specific loans remain a key feature, there are many other factors to consider. Consideration of the NSIA can be a due diligence workstream in its own right and parties also need to carefully navigate sanctions regulations. The introduction of the new Economic Crime and Corporate Transparency regime (which is expected to come into force in 2023) together with the new Companies House register of overseas entities has increased the scope of corporate legal due diligence, particularly where there is overseas ownership of UK property.

Where time allows, sellers should “due diligence” their businesses before beginning a sale process, so that any issues identified can be resolved in good time to avoid an impact on price and timescales.

ESG

ESG has become a key part of due diligence for all businesses, and this will continue to be a key theme in 2023. It has become more than just a compliance matter, with buyers and private equity investors keen to understand how a target’s approach to environmental, social and governance matters dovetails with their own (and that of their underlying funders). This can be just as important for sellers, especially where they may remain working for the target or the purchasing group after completion.

With buyers, investors and deal financing possibly becoming harder to come by, good ESG credentials may positively differentiate a target business.

Jon Stewart

“Sustainable finance has become increasingly mainstream, with sustainable finance instruments, particularly sustainability-linked loans (SLLs), continuing to dominate the upper end of the market. However in 2023 we will begin to see SLL products entering the mid market. Borrowers who fail to develop credible sustainability strategies could find that bank debt becomes harder to access and more expensive.”

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