SURVEY OF TRENDS IN DANISH TRANSACTIONS 2020/2021

M&A REPORT

LUNDGRENS

FOREWORD - M&A REPORT 2020/21

In March 2020 we launched the first M&A survey covering 2018 and 2019 (M&A Report 2018/19). Almost at the same time the Covid-19 pandemic started to impact all corners of the World – including the M&A market.

Many transactions stopped or were put on hold in Q1 2020 but the market started to pick up again during the course of 2020. 2021 has been one of the busiest years ever in the Danish M&A market.

These two years were also very busy for Lundgrens, and during the period we have advised on more than 90 transactions. We were involved in a number of notable and high-profile transactions and have represented Danish and international leading private equity (PE) and venture capital firms, large corporates, family owned/managed businesses and others.

In this report, we provide you with statistics and a summary of the terms of deals we have been involved in. This survey is based on more than 60 transactions selected between the transactions we have advised on during the period. In our opinion, these reflect the typical Danish M&A market. We have not included those which do not reflect customary transactions, such as distressed transactions and asset transactions.

The average value of all transactions included in the survey is approximately DKK 295 million (USD 43 million).

After having received very positive feedback on the M&A Report 2018/19 we have been looking very much forward to this report. We hope that you will be able to use this report and the analysis it contains. We would be happy to provide you with a more in-depth analysis in person, so please reach out if you would like more information on the report.

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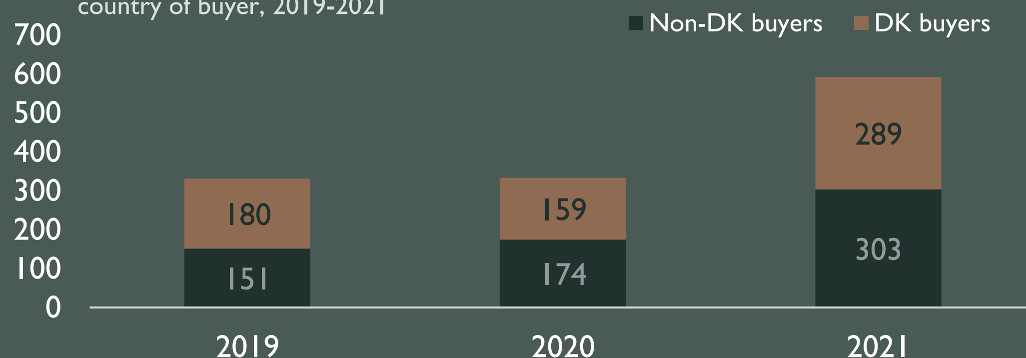
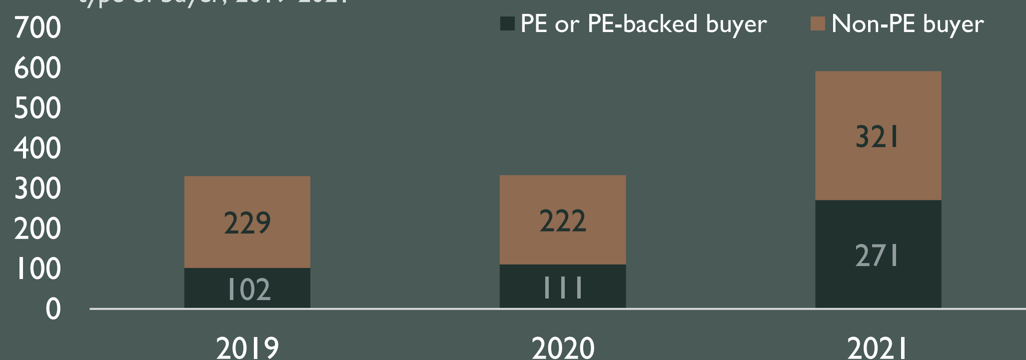
M&A INSIGHTS - 2021 IN REVIEW (BY NKP)



Source: NKP | M&A Insights (18 Mar 2022)



Source: NKP | M&A Insights (18 Mar 2022)

Record high M&A activity in 2021 driven by continued low interest rates, increasing stock market valuations, and Covid-driven (permanent) boost of certain industries through accelerated technology adoption (technology, healthcare, e-commerce, logistics)

- Continued (high) appetite among foreign investors for Danish companies due to stable political and macro-economic environment, high degree of digital nativeness, and a track record of Danish technology firms succeeding abroad
- Private equity buyers and PE-backed buyers accounted for 46% of majority sales in 2021 up from 33% in 2020 and 31% in 2019, trend driven by several factors:
  - Covid-19 has boosted certain industries and business models that is increasingly favoured by private equity, including software, e-commerce, and healthcare
  - Low interest rates since Q1-2020 have increased accessible leverage enabling PE funds to drive up valuations (without compromising expected returns) making them more competitive buyers
  - Low/negative interest rates on bonds have increased pension funds' allocation to private equity making more capital available

NKP M&A INSIGHTS

Source: NKP | M&A Insights (18 Mar 2022)

CLOSING ACCOUNTS - DOMINANT PRICING MECHANISM

- The closing accounts model is (becoming) the more dominant pricing mechanism and is used in the majority of the transactions.
- Closing accounts transactions use figures as per the closing date with adjustment after closing, while locked box transactions use historical figures and, accordingly, have a fixed price at closing.
- In most locked box transactions, the equity price is combined with an interest from the locked box date (which is often the latest accounts date).
- In comparison to the M&A Report 2018/19 the closing accounts mechanism has become more popular (up from 52%). It is difficult with certainty to conclude why that is the case. Our best guess – based on our transactions – is that sellers throughout the pandemic have continued to believe in better times ahead and therefore have been more reluctant to agree to a price model based on historical figures.

42%

Locked Box

58%

Closing Accounts

EARN-OUT MECHANISMS AND OTHER CONDITIONAL PAYMENT

- More than one third of the transactions included an earn-out or other payment conditional upon future events.
- Earn-out mechanisms are often rooted in large differences in opinions over the value of a target business, e.g., in growth companies or companies which are highly dependent on founders.
- EBITDA was the most commonly used basis for the calculation and determination of earn-out and was used in around half of the transactions which included earn-out.
- Other models included milestones based on EBIT, revenue, ARR (annual recurring revenue) and exit value for the buyer.
- Compared to the M&A Report 2018/19 there is a small increase (5%) in the transactions where an earn-out is included. We assume it is a direct result of the pandemic and the buyers' concern for the future performance of the target company.

36%

Earn-out

64%

No earn-out

SECURITY (OTHER THAN W&I INSURANCE)

- In approximately 57% of the transactions, the buyer was offered security, other than warranty and indemnity ("W&I") insurance, for warranty claims.
- Ranging from the most secure to the least secure from a buyer's perspective, such security varied between holdback, escrow, bank guarantee, parent company guarantee, collateral, equity guarantee and dividend restriction.
- The most secure, a holdback, entails that the buyer retains part of the purchase price for subsequent release, whereas the least secure, the dividend restriction, entails a restriction on the seller's ability to distribute dividends for a certain period of time following closing.
- Escrow was used in 1/4 of the transactions in which the buyer was offered this kind of security. Compared to the M&A Report 2018/19, this is a decrease from 1/3.
- The reason for the decline in use of escrow is most likely an increased scrutiny among banks with respect to KYC documentation, general reluctance to act as escrow agent, negative interest rates and increased costs to the escrow agent. Escrow entails that an agreed amount is deposited with a third-party escrow agent (typically a bank).
- The size of the security (holdback, escrow or guarantee) ranged from a few percent (often labelled to cover specific concerns) to a certain percentage equaling the cap on warranty claims.
- There is no clear conclusion as to why no security was provided in 43% of the transactions. Part of the explanation is that W&I insurance was used to mitigate risks of warranty claims, a PE fund with a strong bargaining position was acting as a seller or simply that there was no inherent risk of the seller not being able to honor warranty claims.

43%

Without security

57%

With security

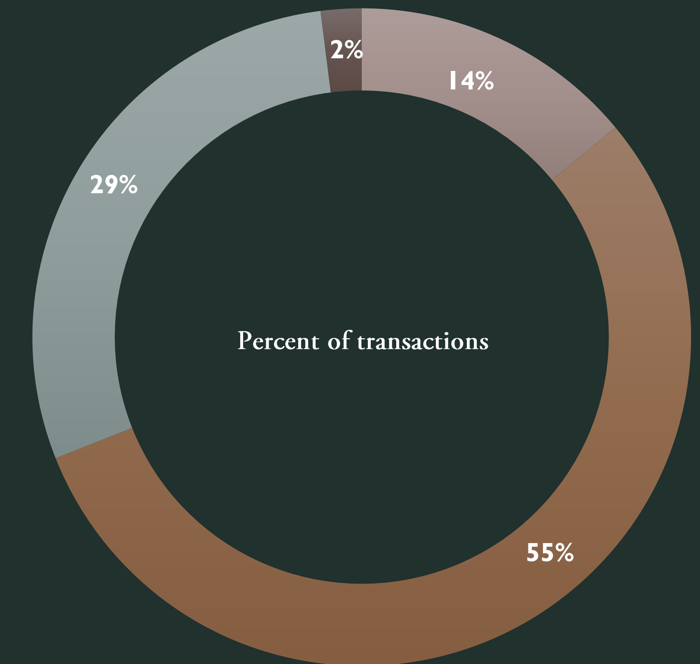
DISCLOSURE

Disclosure of data room	
Disclosure of data room (general disclosure)	85%
Non-disclosure of data room	15%
Other disclosures	
Additional information considered within buyer's knowledge	40%
Disclosure letter (specific disclosure)	6%
Anti-sandbagging	
Anti-sandbagging	60%

- The data room was considered disclosed in the vast majority of the transactions in the survey and in all transactions covered by W&I insurance. This means that a buyer is not able to raise a claim for matters included in the data room (i.e. disclosed).
- The use of disclosure letters is far from standard in Danish transactions and so, unsurprisingly, disclosure letters were only seen in a small number of the transactions included in the survey.
- Where more information than disclosed in the data room was considered within the buyer's knowledge (thus limiting the buyer's right to raise a claim), the Share Purchase Agreements (SPA) most commonly referred to buyer's actual knowledge, information provided in management presentations or the SPA and/or in few cases e-mails (to selected individuals).
- Anti-sandbagging provisions were included in the majority of the SPAs. An anti-sandbagging provision precludes the buyer from raising a claim against the seller for breach of warranties, if the buyer had knowledge of the breach at signing (an add-on to other provisions preventing the buyer from raising claims within buyer's knowledge).
- Compared to the M&A Report 2018/19 the basic principles have not changed – i.e. general disclosure (data room disclosed) and no use of disclosure letter. However, the use of additional information as disclosed has increased from 22% to 40% and anti-sandbagging has increased from 43% to 60%. These trends indicate in our view that sellers during the relevant period have had a strong(-er) negotiation position.

GENERAL WARRANTY PERIOD

- The most common warranty period for general warranties was 18 months.
- The average general warranty period was 19.1 months. This number was only to a limited extend influenced by W&I insurance covered transactions, which had an average general warranty period of 21.6 months. Excluding those transactions, the average general warranty period was 18.5 months.
- Only in 2% of the transactions, warranties were given for a period shorter than 12 months from closing. Similarly, only in 2% of the transactions, warranties were given for a period of longer than 24 months from closing. None of these transactions were covered by W&I.
- Compared to the M&A Report 2018/19 the average general warranty period have not changed significantly However, the number of transactions with a warranty period of 15 months has decreased by approximately 7% while the number of transactions with a warranty period of 18 months has increased with almost 15%.



NOTICE PERIOD FOR CLAIMS

Length of notice period	
Notice period up to 30 business days	45%
Notice period of 31 to 59 business days	12%
Notice period of 60 to 89 business days	12%
Notice period of 90-150 business days	11%
No notice period agreed	20%

- The most common notice period in which the buyer shall give notice to the seller of a matter giving rise to a claim in order to seek indemnification of such claim, is 30 business days, which was applied in 27% of the transactions.
- The average notice period was 44.1 business days after the buyer has become aware of such matter giving rise to a claim.
- In 20% of the transactions no notice period was agreed, and in 11% of the transactions the notice period was 90 business days or more.
- In most cases, failure to comply with such notice period did not preclude a claim but may have limited the size of the claim.

FUNDAMENTAL WARRANTIES

Fundamental warranties	
Warranty period for fundamental warranties of 36-59 months	8%
Warranty period for fundamental warranties of 60 months	23%
Warranty period for fundamental warranties of 72 months	4%
Warranty period for fundamental warranties of 84 months	22%
Warranty period for fundamental warranties of 120 months	2%
Warranty period for fundamental warranties equals the statute of limitation (in some with addition of a few months)	14%
Warranty period for fundamental warranties without agreed limitation	21%
No fundamental warranties singled out	6%

- Fundamental Warranties are usually defined as warranties related to the seller's authority, capacity and title to the shares, and are most commonly exempt from buyer's knowledge, and monetary thresholds such as de minimis, basket and/or cap.
- In 94% of the transactions comprising a specific set of fundamental warranties, fundamental warranties were subject to a longer warranty period than general warranties, five or seven years being equally the most common limitation. This tendency is fueled by W&I insurance covered transactions, in which fundamental warranties are commonly insured for seven years.
- Outside W&I insurance covered transactions, most commonly, fundamental warranties were subject to either 5 years or without agreed limitation. In 64% of the transactions in which fundamental warranties were singled out, and no limitation of the warranty period had been agreed, the buyer was foreign.
- Of the transactions in which a countable warranty period for fundamental warranties were set (i.e., other than period of statutory limitations or no limitation etc.), the average warranty period for fundamental warranties was 64.4 months. This number was influenced by W&I insurance covered transactions, which had an average warranty period of 75 months. Excluding the W&I covered transactions, the average warranty period was 60.9 months.
- Only in 6% of the transactions, fundamental warranties were not singled out and made subject to a longer period than the general warranty period, and none of these were covered by W&I insurance.

OTHER FUNDAMENTAL WARRANTIES

Other fundamental warranties	
IPR warranties singled out	5%
Environmental warranties singled out	11%

Warranty period	
Warranty period for other fundamental warranties of 36-59 months	22%
Warranty period for other fundamental warranties of 60-83 months	22%
Warranty period for other fundamental warranties of 84 months	12%
Warranty period for other fundamental warranties equals the statute of limitations plus a few months	22%
Warranty period for other fundamental warranties not limited in time	22%

- In some transactions fundamental warranties relate to and/or include other warranties than the usual, which the buyer deem crucial to the business or the case, such as environmental, Intellectual Property Rights ("IPR") etc., and wish to single out from the general warranties.
- This was only the case in 16% of the transactions of which 11% had singled out environmental warranties, and 5% had singled out warranties related to IPR.
- In those transactions where environmental and/or IPR warranties were singled out from the general warranties, the warranty period ranged from 36 months to no agreed limitation, however, no warranty period was dominant.

TAX WARRANTIES

Tax warranties	
Warranty period for tax warranties shorter than 84 months but longer than general warranties	5%
Warranty period for tax warranties of 84 months	7%
Warranty period for tax warranties equals the statute of limitation	4%
Warranty period for tax warranties equals the statute of limitation with an additional period of a few months	64%
Warranty period for tax warranties not singled out from general warranties	20%

Additional period to statute limitation	
No additional period to statute	5%
Less than 3 months or 60 business days	11%
3 months or 60 business days	71%
More than 3 months or 60 business days	13%

- There was a clear tendency towards singling out tax warranties from general warranties. This was the case in 80% of the transactions.
- In those transactions where tax warranties were singled out from the general warranties, most commonly the statute of limitation with an additional period of a few whole months or between 20-90 business days, was applied as warranty period. This was the case in 64% of the transactions. Out of these 64% transactions applying statute of limitation with an additional period of a few months, 71% applied the statute of limitation plus 3 months.
- A seven-year limitation for tax warranties was only applied in cases covered by W&I insurance, and overall, in 90% of the transactions covered by W&I insurance, the tax warranties were singled out and made subject to a longer warranty period.

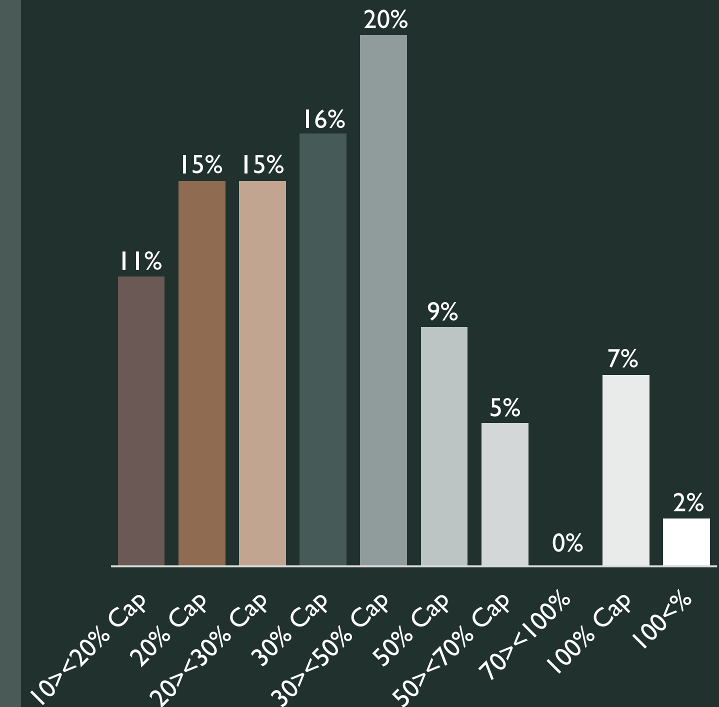
TYPE OF LOSS COVERED BY SELLER

Type of loss	
Only direct losses	42 %
Direct and reasonably foreseeable indirect losses	36 %
Direct and indirect losses	12 %
Reference to Danish law	10 %

- Most commonly, both direct and reasonably foreseeable indirect losses were claimable by the buyer against the seller. It is our experience that, historically, most sellers only covered direct losses suffered by the buyer.
- In all transactions involving W&I insurance, direct and reasonably foreseeable indirect losses were covered. Excluding cases with W&I insurance, coverage for direct losses only was still the prevailing scheme.
- Compared to the M&A Report 2018/19 the division between direct losses and direct reasonably foreseeable losses has also tipped in favour of only direct losses being covered, whereas direct and reasonably foreseeable indirect losses was more commonly covered in the M&A Report 2018/2019.

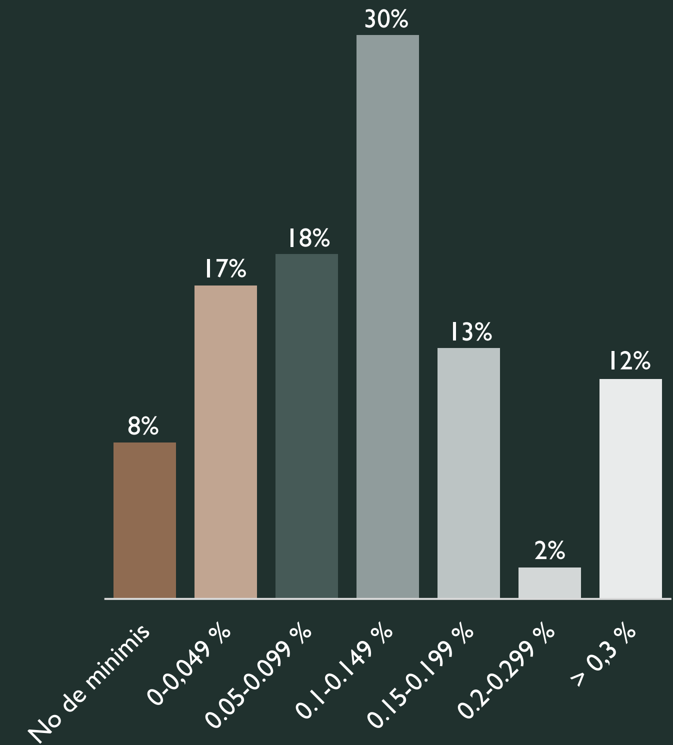
CAP

- A maximum (cap) on the seller's liability was included in all transactions.
- 45% of the transactions had a cap between (and including) 30% and 50%, with 30% being the most frequently used cap.
- The average cap was 38%, which is close to identical to the average cap in the M&A Report 2018/19. Excluding the transactions with a cap of 100% or above, which we believe are based on specific and special circumstances, the average cap is 31%.
- There was a slight tendency that the higher the enterprise value was, the lower the percentage.
- The cap in W&I insurance covered transactions was generally on the same level as the cap in other transactions, with the exemption that a cap equivalent to the purchase price was not used in any W&I insurance covered transaction.
- The cap did not apply to breaches of the fundamental warranties in almost all transactions, and in a vast majority of the transactions the general cap did not apply to breaches of the tax warranties, but liability for breach of such warranties was still limited to a maximum of the purchase price.



DE MINIMIS

- A de minimis threshold for protection against liability for minor losses was used in almost all transactions.
- The majority of all de minimis thresholds agreed were between 0.1-0.15% of the purchase price, with a majority of these centered around 0.1%. There was, however, a large spread in the de minimis thresholds applied.
- There was a general tendency that the de minimis threshold percentage was higher on transactions with a lower enterprise value compared to transactions with a higher enterprise value.
- There was a clear tendency that the de minimis thresholds in W&I insurance covered transactions were lower than in non-W&I insurance covered transactions.
- The survey showed that in almost all transactions the de minimis threshold did not apply to breaches of the fundamental warranties, and in a vast majority of the transactions the de minimis threshold did not apply to breaches of the tax warranties.



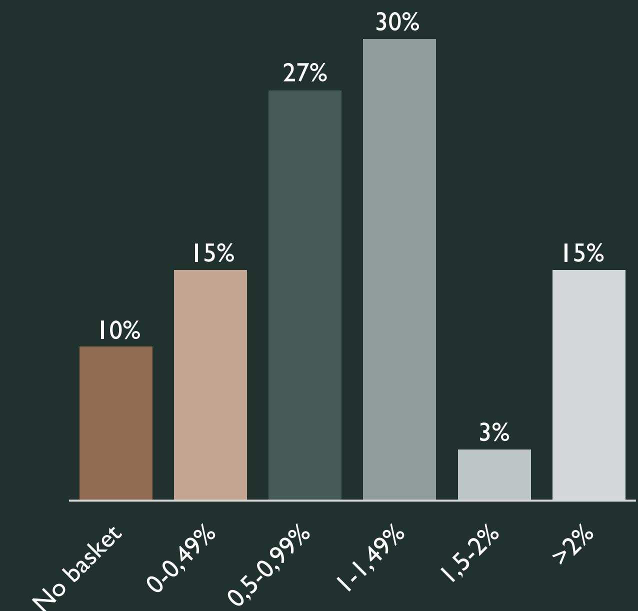
BASKET

- Almost all transactions contained a basket limiting the buyer's right to raise a claim against the seller unless the aggregate of all losses exceeded a certain threshold.
- The most commonly used basket was between 0.5% and 1.5% of the purchase price, with a majority of these centered around 1%. However, as was the case with the de minimis threshold, there was a rather large spread in the percentages.
- The basket as a percentage of the purchase price was lower on transactions with a high enterprise value compared to transactions with a low enterprise value.
- There was a tendency that the basket in transactions covered by W&I insurance was lower than in transactions not covered by W&I insurance.
- The most common type of basket by far was a tipping basket (83%), i.e., once the aggregate losses exceed the basket, the full amount will be recoverable.
- Non-tipping baskets (i.e., the basket works as a deductible) were used in only 17% of all transactions, which is significantly lower than in the M&A Report 2018/19.
- The survey showed that in almost all transactions the basket threshold did not apply to breaches of the fundamental warranties, and in a vast majority of the transactions the basket threshold did not apply to breaches of the tax warranties.

TIPPING VS. NON-TIPPING

83%	17%
Tipping	Non-tipping

PERCENT OF TRANSACTIONS



W&I

- W&I insurance coverage for breaches of the seller's warranties was used in 17% of all transactions. All of these involved a PE fund either as buyer or seller indicating that PE funds have a big appetite for W&I insurance whereas W&I insurance is less common in transactions involving corporates only.
- The reasons for this are:
  - When the PE fund is acting as a seller, a W&I insurance may facilitate a clean exit for the PE fund which enables the fund to close down with no liability resting with the PE fund for breaches of warranties.
  - When the PE fund is acting as a buyer, a W&I insurance may facilitate more favourable deal terms as it enables the PE fund to offer terms for the seller without usual security to honor warranty claims and minimizes risk of disruption in the event of warranty claims where the seller is reinvesting in the target with the PE fund.
- Our survey shows that, in most transactions, the seller would remain liable for breaches of the fundamental warranties if and to the extent the W&I insurance would not cover such breach (for whatever reason). Furthermore, W&I insurance does not cover in the event of fraud or willful misconduct by the seller.
- The sellers also provided specific indemnities (i.e. indemnities for specific matters which the parties are aware of and therefore can not get coverage for under a regular W&I insurance) in a large part of the W&I insurance covered transactions.
- W&I insurance generally does not cover breach of warranties which is discovered between signing and closing. Therefore, the risk and consequence of such breach must still be negotiated between the buyer and the seller.

17%

With W&I insurance

83%

Without W&I insurance

NON-COMPETE AND NON-SOLICITATION

Non-compete	
With non-compete	83%
Without non-compete	17%

Duration	
12 months	13%
18 months	2%
24 months	25%
36 months	60%

Liquidated damages in DKK	
No liquidated damages	18%
<500,000	50%
500,001 – 1,000,000	17%
1,000,001 – 1,500,000	5%
>1,500,000	10%

Non-solicitation	
With non-solicitation	54%
Without non-solicitation	46%

- More than 4 out of 5 of all transactions in the survey contained non-compete clauses restricting the sellers - and ultimate owners where relevant - from competing with the targets' business for a period after closing.
- The most commonly used period for non-compete clauses was by far 36 months after closing.
- Of the agreements containing non-compete clauses, 82% had liquidated damages for breaches of the non-compete clause. The vast majority of liquidated damages were DKK 500,000 or lower, with DKK 500,000 being the most popular amount.
- Clauses restricting the seller from soliciting employees and/or customers were included in roughly half of the transactions.
- Compared to the M&A Report 2018/19 we note a substantial increase in the use of non-compete provision (up from 63% to 83%). The duration of the restrictions has not changed significantly while the liquidated damages seem to decrease with transactions either being without liquidate damages, or with damages limited to DKK500,000 or lower increasing from 46% to 68%. It seems that buyers have generally been insisting on the restrictive covenants at such to be included but have agreed to smaller penalties.

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