2024 M&A Outlook:

Building on Dynamic Dealmaking and Resilience from 2023, and Capitalizing on Emerging Developments

Charles Katz, Drew Pollekoff, Erik Belenky and Zev Beeber

K&S King & Spalding

If dealmakers build on successes from the past year and capitalize on emerging M&A catalysts, there is room for cautious optimism about the next year.

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INTRODUCTION

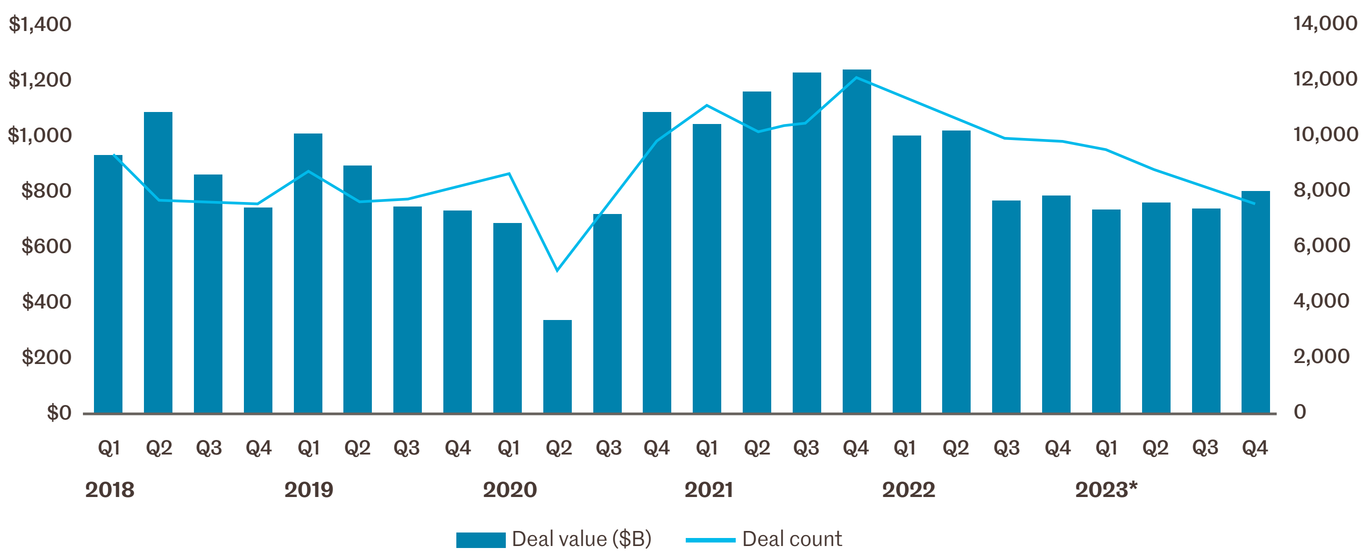
Last year, we recapped that coming off record-setting levels in 2021, mergers and acquisitions (M&A) deal activity cooled in the second half of 2022. A number of headwinds that precipitated the 2022 decline – including, among others, steadily rising interest rates and the higher cost of financing, sticky inflation, divergent valuation expectations, geopolitical turmoil, heightened regulatory scrutiny, and increased economic uncertainty – endured and further contributed to subdued dealmaking during most of 2023. We observed buyers and sellers continuing to approach dealmaking with a more selective and cautious tone. Deals generally took longer to negotiate and execute, and persistent valuation gaps, amplified by the increased cost of capital and volatility in the equity markets, caused many transactions to derail.

Although global M&A activity in 2023 declined by 23% year-over-year in deal value, according to Mergermarket data, the number of deals dropped by a more modest 16%, reflecting an emphasis on smaller transactions.

Overall volume, which was largely in line with and resemblant of pre-pandemic levels, progressively improved throughout the year and began to show signs of a rebound in the fourth quarter. A steady flow of divestitures, private equity (PE) add-ons and growth equity transactions prevailed throughout the year, and we witnessed savvy dealmakers deploy creative transaction structures and other innovative tactics to navigate and adapt to challenging market conditions.

Ongoing headwinds, geopolitical tensions and lingering economic uncertainty make prognostications for 2024 difficult. However, stabilizing interest rates (at least in the U.S.), cooling inflation, waning recession fears and rallying public equity markets headline a more conducive macroeconomic backdrop. With historical fundamentals and key drivers of M&A remaining intact, emerging levers may spur an uptick in activity, including in the PE space, which was notably muted in 2023.

M&A Activity by Quarter



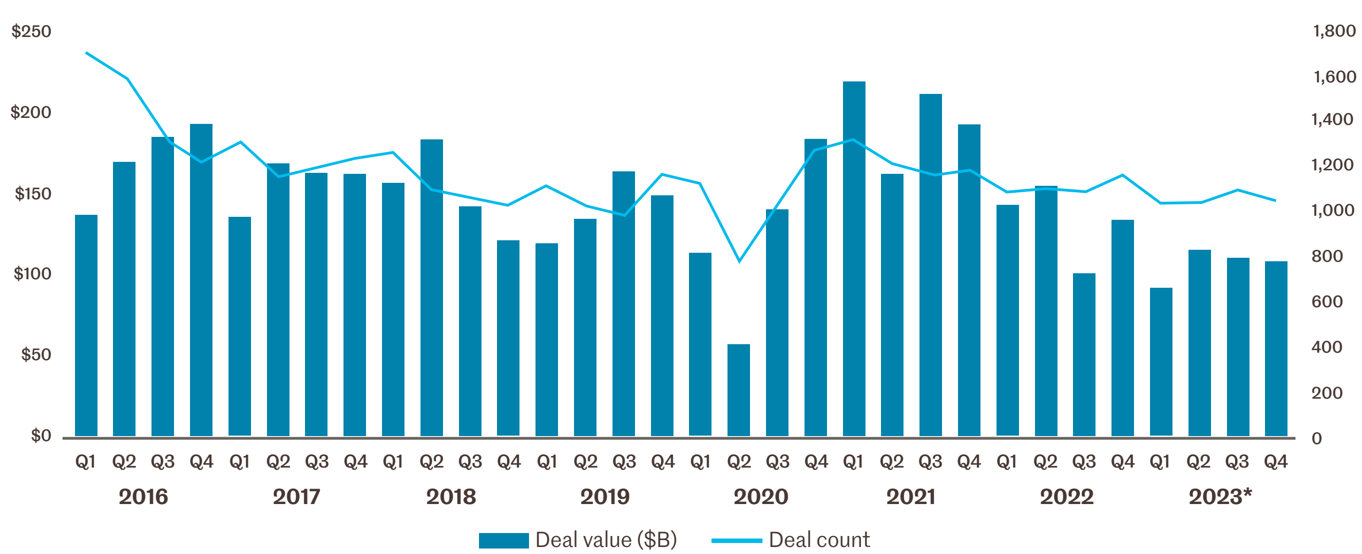
Source: PitchBook, *2023 Annual Global M&A Report*

ADHERING TO WINNING TRANSACTIONS

Carve-outs and Spinoffs: Amid challenging market conditions, divestitures, carve-outs, separations, spinoffs and joint ventures proved to be popular transaction structures to unlock value. With acquisitions having outpaced divestitures by roughly four times over the prior two years, according to reports from PwC, we entered 2023 with a myriad of corporate assets that were likely to make strong candidates for divesture. Carve-outs and spinoffs were strategically pursued by companies and management teams to deleverage, optimize and simplify operations and concentrate on core business lines against a cloudier economic backdrop. Dealmakers often engaged in complex structuring, such as carve-outs in which the seller retained a stake after closing through joint venture or other long-term commercial arrangements. These transactions delivered shareholder value and helped companies achieve capital efficiency by monetizing noncore assets and/or underperforming units, strengthening balance sheets, and reducing operational risk. We expect these types of transactions to remain front of mind, particularly as rebounding equity markets may present more attractive asset valuations for sellers yet remain at relatively opportunistic levels for buyers.

Emphasis on Smaller Transactions. In light of recent market dynamics, we have seen a shift in dealmaking toward smaller deals. Sponsors are adapting to the prevailing higher interest rate environment and the constraints of the financing markets by opting for smaller-scale add-on deals and all-cash growth equity transactions and by purchasing smaller stakes in targets. These targeted, modest transactions not only forgo or limit the need for significant acquisition debt financing, but they also limit financial downside, aligning deal activity with a more cautious approach to risk management and emphasizing operational efficiency. Sponsors are increasingly pursuing add-on acquisitions as part of a "buy-and-build" strategy to scale existing portfolio companies and as a means to leverage their operational expertise.

Carve-Outs by Quarter



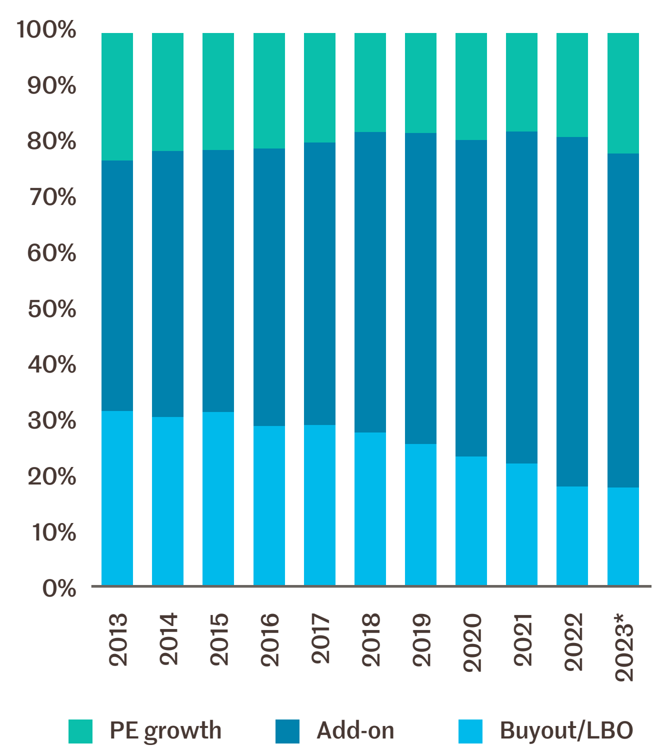
Source: PitchBook, *2023 Annual Global M&A Report*

Unlike leveraged buyouts (LBOs) or platform acquisitions, the financing of add-ons is more feasible due to the smaller dollar size of such transactions and the ability to leverage the existing credit facilities of the acquiring PE-backed platform company. Indeed, add-on acquisitions accounted for 75.9% of PE buyouts in 2023, according to PitchBook data, representing the second-highest rate since 2008, and all but a handful of these transactions were valued under $1 billion. For the first time, growth equity transactions accounted for a greater share (21.5%) of all PE activity than did LBOs (18.9%) (see Figure 1). Minority investments – up 4% in 2023, which is particularly notable in the context of the overall decline in M&A volume – further enable sponsors to avoid refinancing the target's debt at high interest rates while helping companies pull from a new revenue source.

In what seems like an annual refrain, sponsors are sitting on record levels of "dry powder" with a mandate to deploy funds wisely in the wake of economic uncertainty. Similarly, corporations are sitting on large cash balance sheets and need to achieve growth. Given these circumstances and the ongoing constraints in the financing market, we expect add-on acquisitions, growth equity transactions and minority investments (on the sponsor side), and targeted, smaller deals (generally) – which are easier to justify and execute and more practical in the current environment – to remain a continued priority for both financial and strategic buyers.

As discussed in further detail below, the specter of heightened antitrust scrutiny continues to influence dealmaking trends. Companies are increasingly pursuing divestitures as a means to preemptively alleviate potential antitrust concerns, further contributing to the popularity of these transactions. Likewise, stricter antitrust enforcement may be playing a role in the shift toward smaller deals, which are inherently less likely to invite scrutiny or review, and may avoid reporting requirements under the Hart-Scott-Rodino (HSR) Act. Barring an unlikely shift in antitrust policy ahead of the 2024 U.S. presidential election – such activity, in fact, may be as fierce as ever during this "contract year" – companies will continue to consider these types of transactions to minimize or address regulatory risks.

Figure 1 –Growth and Add-On Share of PE Deal Count

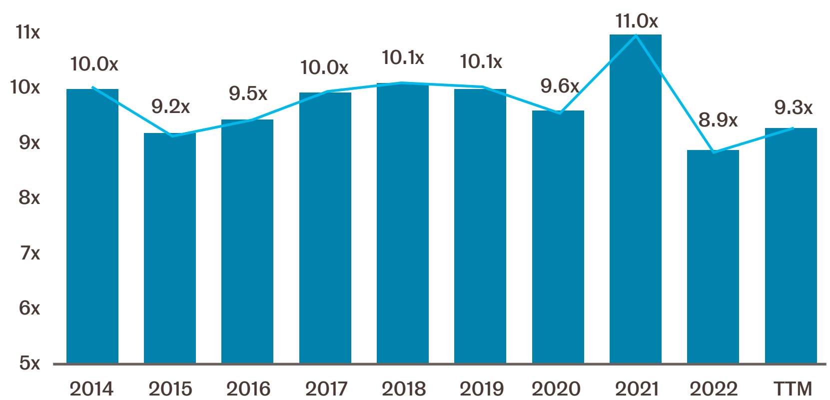


Source: PitchBook, *2023 Annual US PE Breakdown*

DYNAMIC DEALMAKING

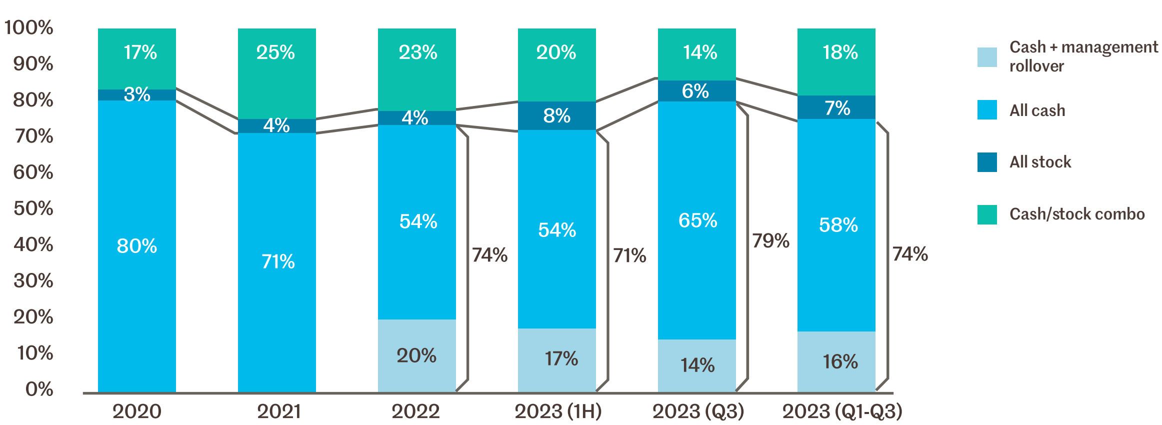
Valuation-Related Deal Mechanics: To offset gaps in expectations and valuations, astute dealmakers continued to opt for structured transactions. In the case of private targets, buyers and sellers utilized earnouts and contingent payment mechanics based on the fulfillment of post-closing financial or performance milestones in M&A transactions. Through Q3 2023, the prevalence of earnouts increased 50% over the prior year (i.e., 32% of deals featured earnout provisions in 2023, compared with 21% in 2022), according to data from SRS Acquiom. Rollovers (i.e., seller equity in the business after closing) have been incorporated in transactions more frequently and at higher equity percentages. For public targets, contingent value rights (CVRs) were employed not infrequently, particularly in health care deals, as a way to bridge valuation gaps. Collectively, these mechanisms reduce a buyer's financial cash burden at the time of closing, potentially allowing a buyer to forgo costly, conventional acquisition debt financing. They further serve to align post-closing incentives between buyers and sellers. Sellers agreeing to such deal structures communicate confidence in the business, thereby narrowing perceived gaps in business value. Persistent market dynamics – including lingering valuation disparities, compressed (albeit stabilizing) transaction multiples and higher costs of capital – will prompt buyers and sellers to continue assessing and deploying creative structures and tools to overcome mismatched expectations in negotiations and facilitate dealmaking (see Figures 2 and 3).

Figure 2 – Global M&A EV/EBITDA Multiples



Source: PitchBook, *2023 Annual Global M&A Report*

Figure 3 – Closing Consideration Trends

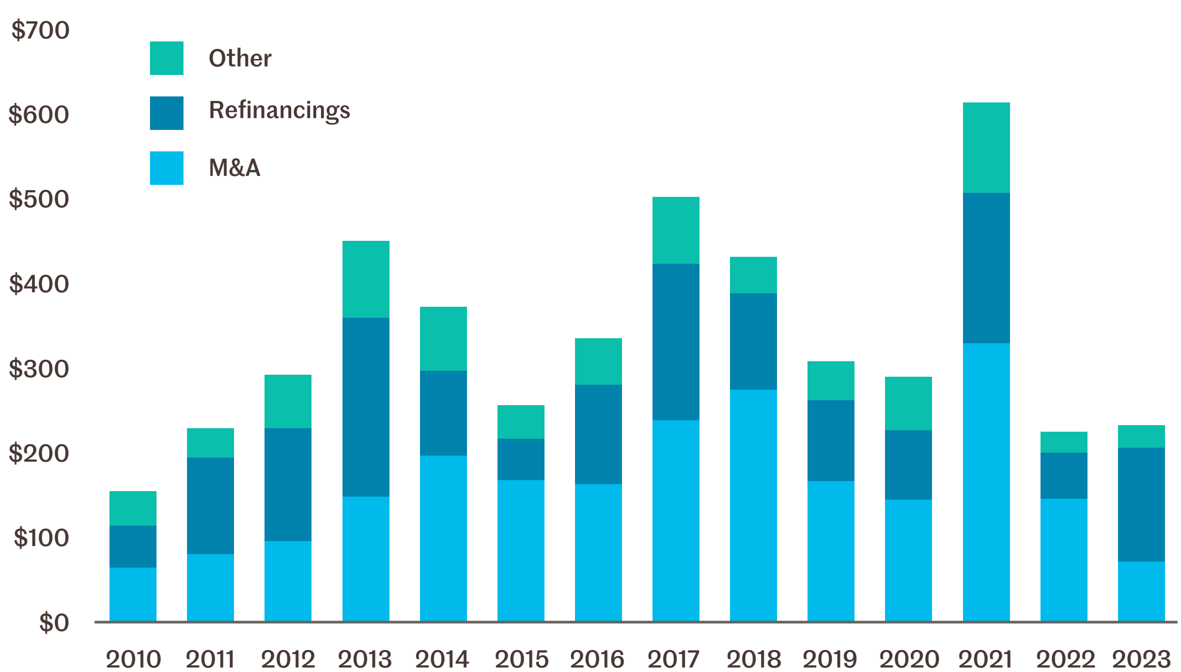


Source: SRS Acquiom 2023 M&A Deal Terms: Three Trends to Watch

Innovative Financing Tactics: The financing gap remained a pain point. According to PitchBook reports, last year's total institutional loan issuance of $233.5 billion was only marginally higher than the 2022 total of $225.3 billion, both of which paled in comparison with the prior 10-year annual average of $380 billion (see Figure 4). Of last year's total institutional loan issuance, M&A accounted for a meager 30%. Although J.P. Morgan and Barclays forecast significant increases in total loan volume for 2024, with estimates of $375 billion and $320-350 billion, respectively, refinancings will likely constitute the bulk of such growth.

Dealmakers are increasingly making use of alternative financing arrangements and pursuing innovative tactics to overcome the financing gap. In line with prior years' trends, buyers have benefited from greater access to private credit funds, sovereign wealth funds and other nontraditional sources of direct lending. Sponsors have continued to display resilience as they adapt to the choppy financing markets, transforming from buyout shops to alternative asset managers and diversifying their product offerings to expand into private credit and other capital solutions. In the context of sponsor-driven M&A transactions, PE funds are providing greater upfront sponsorship for deals via equity contributions, in some cases even funding pure equity deals. Average leverage levels for new LBOs declined to 5.9x from 7.1x in the prior year, and the average level of equity contribution for large LBOs reached 52% in 2023, an all-time high. This trend in equity contributions is notable in the context of recent signals from the Federal Reserve regarding rate cuts for 2024 and beyond; sponsors are facilitating dealmaking now by putting up more cash with the plan to later increase leverage or pursue refinancing under less costly conditions.

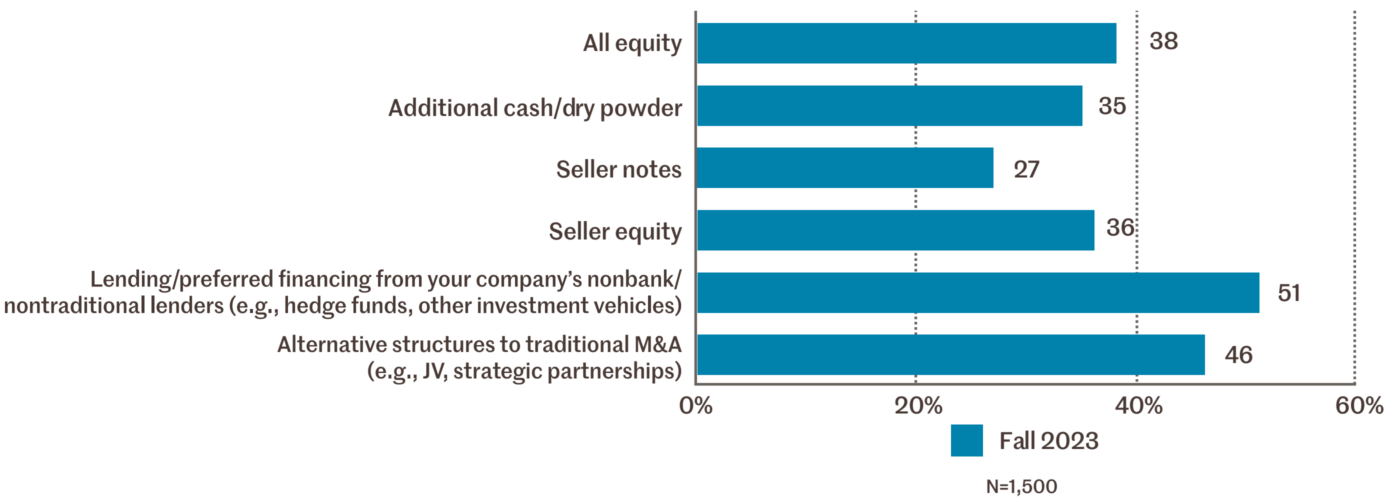
Figure 4 – U.S. Leveraged Loan Value



Source: PitchBook | LCD, "[2024 US Leveraged Loan Outlook: Strong returns, improved issuance likely](#)," December 17, 2023

Joint ventures, clubbing deals and consortium arrangements – with sponsors teaming up with other sponsors and, in some cases, strategic buyers or even activists – were also creative methods for alleviating financing limitations. Not only do these arrangements reduce the amount of funding needed to execute transactions, but they also may improve access to financing by leveraging a consortium's enhanced bargaining power to negotiate more favorable terms with lenders. Additionally, parties are utilizing seller notes and other forms of seller financing to bypass strained negotiations, with sellers agreeing to deferred payment schedules to provide buyers with a longer time horizon to iron out their financing. With PE-driven minority investments becoming more commonplace, we have seen sponsors execute creative minority investment structures (or acquisitions of less than all of a target company) where they negotiate call options to acquire a majority (or the remaining) stake in the target company. Figure 5 shows relevant findings from a recent Deloitte survey regarding the use of alternative financing vehicles.

Figure 5 – Use of Alternative Financing Vehicles in Past Year or Likely Use in the Next Year



Source: Deloitte, *2024 M&A Trends Survey*

CAPITALIZING ON KEY DEAL DRIVERS

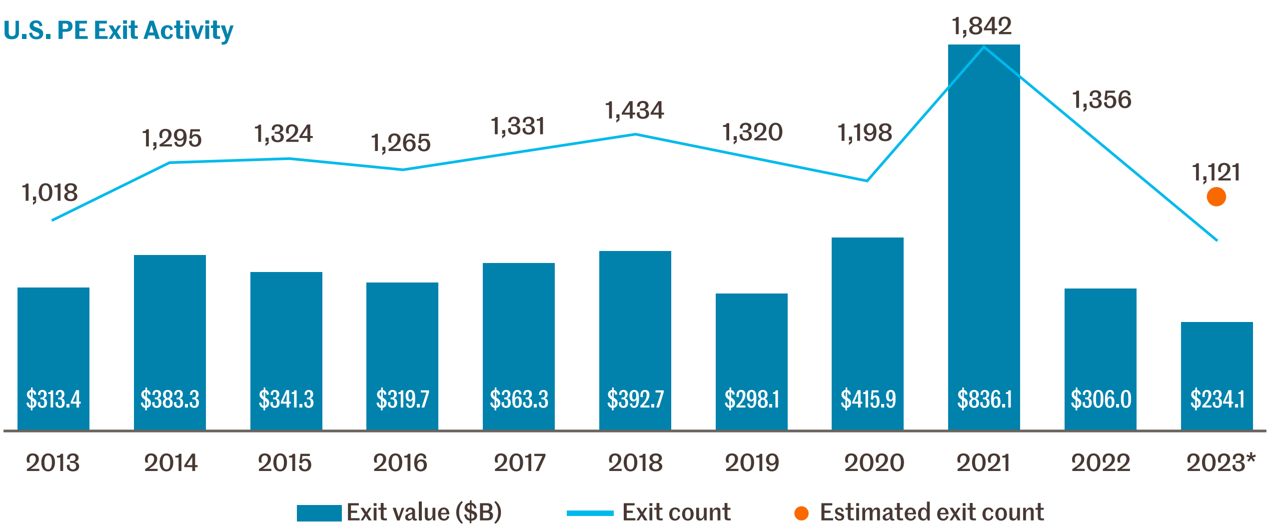
Sponsor Activity: Sponsor activity, which was largely subdued throughout 2023 – with total U.S. PE deal value down 29.5% on the year and hitting its lowest point since 2017 outside the pandemic-induced 2020 levels – seems primed for an uptick in 2024.

PE exit activity declined dramatically (with total U.S. sponsor exit value dipping 33.4% below pre-pandemic averages, and global PE exit value shrinking to $574.2 billion, its lowest point in a decade, according to PitchBook), as sponsors grappling with prolonged inflation and unattractive valuation trends have opted to hold on to assets longer, waiting for market conditions to improve. Indeed, the median holding period for U.S. PE investments hit 6.4 years, the first time since 2015 that figure has exceeded the six-year mark.

However, sponsors are now feeling the pressure to monetize portfolio companies, exit positions, and generate liquidity for and/or return capital to their limited partners. Distributions to paid-in capital have been at historically low rates, and investors – who have been experiencing net drawdowns since 2018 with limited capital return from sponsors – are becoming reluctant and/or too constrained to invest more capital as a result, creating a persistent headwind for fundraising. Furthermore, the slowed exit market is giving way to an impending "maturity wall" that PE sellers are facing for deals made five to seven years ago in better economic conditions, which are beginning to reach their natural exit timelines. Although persistent valuation gaps between buyers and sellers will narrow, with the adjustment process around pricing expectations not yet completed, PE sellers may ultimately need to accept lower exit valuations to align with buyers due to these market pressures and forces. Consequently, many expect sponsor exit activity to be at the forefront of an M&A rebound in 2024.

At the same time, with dry powder accumulating and once again hitting record levels (totaling $2.59 trillion globally and approximately $1 trillion for the U.S. market), there will be continued pressure from limited partners for PE funds to deploy capital (see Figure 6). We expect stabilizing interest rates and inflation, converging valuation expectations, and the gradual reopening of the initial public offering (IPO) market. These generally are positive for M&A transactions in that they provide more incentive for targets, whether or not they are sponsor-backed, to pursue strategic options and run dual-track processes. They also give sponsors another pathway to exit investments to fuel additional momentum for sponsors to recognize and act on opportunities in 2024.

U.S. PE Exit Activity

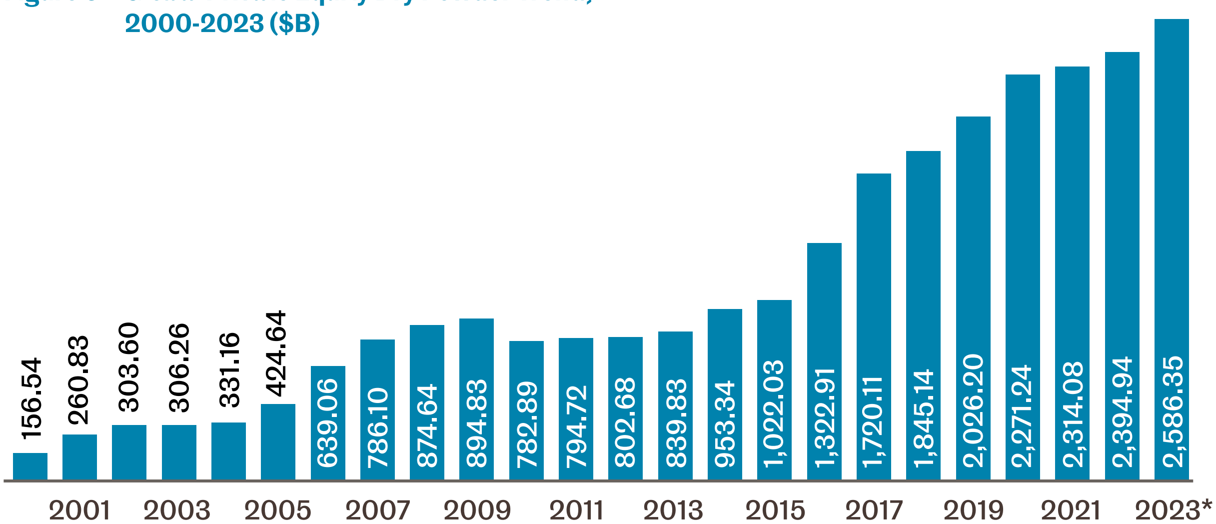


Source: PitchBook, *2023 Annual US PE Breakdown*

Technology: Technology has been and will remain a key catalyst in the dealmaking environment. After accounting for 27% of deal value in 2023, many are expecting that the technology sector will see a continued spike in M&A activity in 2024, driven by the emphasis companies are placing on their digitization strategies. The prominence of and demand for artificial intelligence (AI) and other emerging technology-based solutions and capabilities are at an all-time high. For many businesses – which may lack the skills or time horizon to develop these capabilities on their own – it is more economically efficient and feasible to buy rather than build such technology, fueling M&A and investment activity. AI-driven M&A, which has largely been confined to the technology sector until now, is beginning to expand into and drive activity across other industries, and businesses are generally recognizing the need to embrace technological innovation and digital transformation to remain competitive and keep up with global trends. In this regard, many expect to see amplified activity, in particular in the renewable energy (including clean technology) and health care (including digital health and health care technology) sectors. PE firms and other M&A players themselves are embracing AI as a tool for identifying potential acquisition targets, assisting in investment decisions and automating tasks to improve efficiency of internal deal processes.

The cybersecurity space is also poised for a surge in dealmaking opportunities in an ever-increasingly digital world. Given the hike in cyberattacks and threats, the increasing complexity of safeguarding sensitive data (especially with the rise in AI) and stricter regulatory compliance requirements, it is imperative for companies across all industries to continue prioritizing and investing in cybersecurity solutions and technologies.

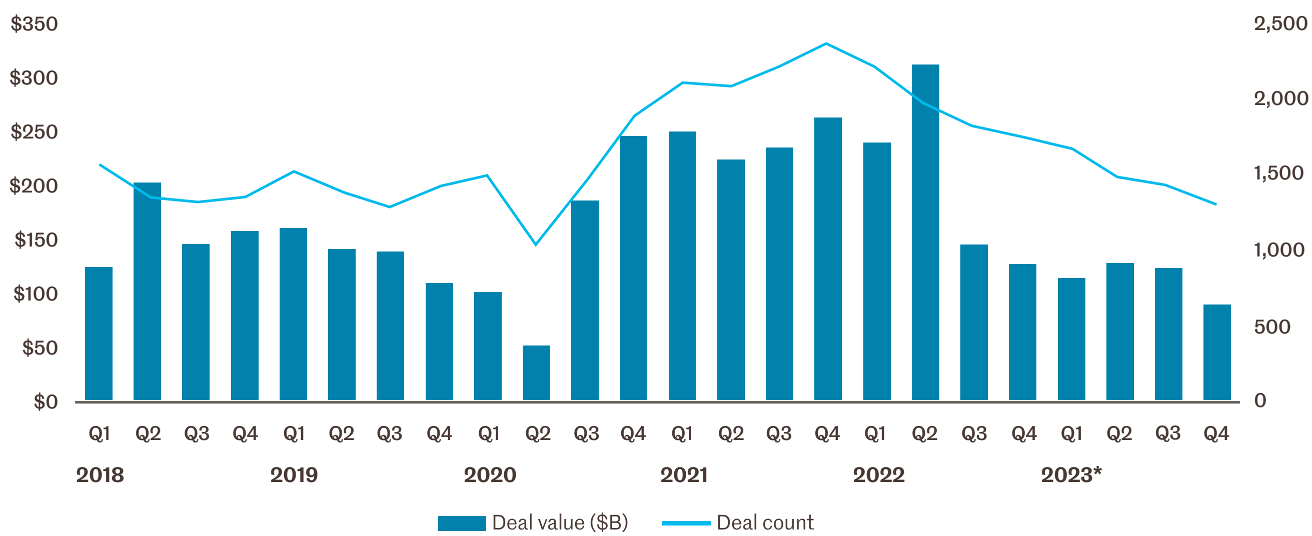
Figure 6 – Global Private Equity Dry Powder Trend, 2000-2023 ($B)



Source: S&P Global Market Intelligence, [Private equity firms face pressure as dry powder hits record $2.59 trillion], December 13, 2023

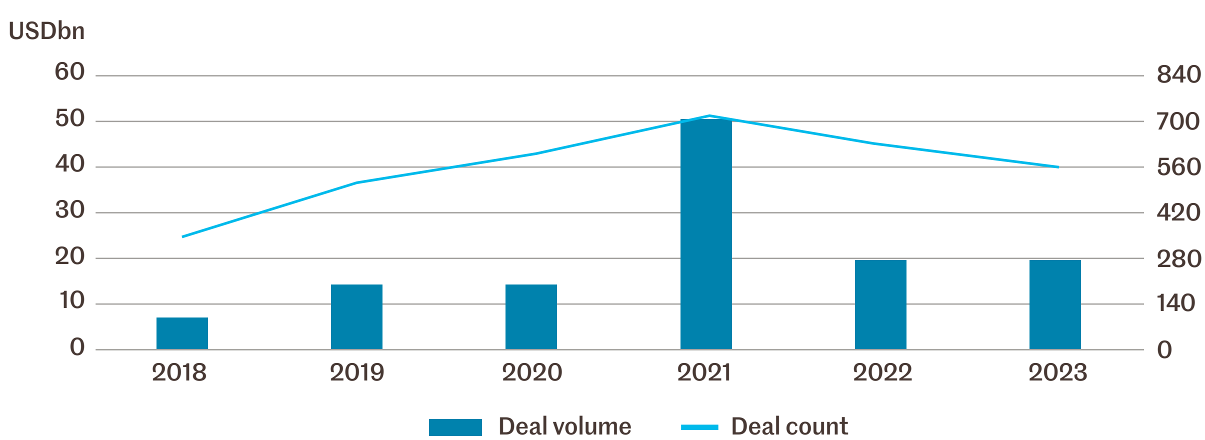
Shareholder Activism: We saw elevated levels of shareholder activism in 2023, including a rise in the number of new players and the number of new campaigns (see Figures 7 and 8). With a 9% increase in global campaigns and a 14% increase in the U.S. (increasingly focused on smaller companies), we also saw a record number of unique activists launching campaigns, up 21% from the prior year, and roughly twice as many "first-timers" as the five-year average (i.e., 77 versus 44). Equity market volatility has resulted in an opportunity for shareholder activists, who continue to focus on M&A as a solution to undervaluation amid macroeconomic uncertainty. Despite the slowdown in M&A activity, the percentage of campaigns with an M&A-related thesis in 2023 remained consistent with historical averages. M&A-focused activism may experience an uptick in 2024 as financial markets improve and last year's first-timers get more comfortable initiating campaigns.

IT M&A Activity by Quarter



Source: PitchBook, *2023 Annual Global M&A Report*

Global AI M&A



Source: Mergermarket, [Artificial intelligence takes over the world, but dealmakers warn of need for deeper due diligence – DealTech], January 17, 2024

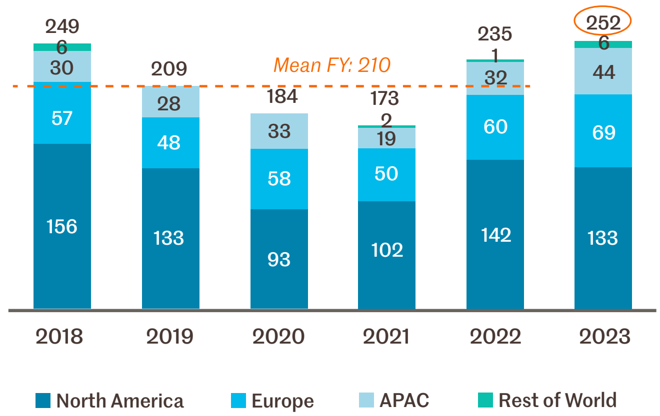
Additional Drivers: Other drivers of M&A activity and trends may support a more optimistic dealmaking environment in 2024. These include a gradual reemergence of cross-border M&A transactions, catalyzed by globalization-related growth strategies, the reopening of international borders and renewed accessibility to international markets, as well as lackluster (albeit slightly thawing) IPO markets that will continue to push M&A-related exit processes. Furthermore, there will likely be a continued focus on using M&A to pursue strategic environmental, social and governance (ESG) initiatives, including energy transition, decarbonization, the circular economy and social impact, with heightened regulatory scrutiny of ESG practices and strong demand for technology or services that touch on ESG issues (see Figure 9).

MITIGATING HEIGHTENED REGULATORY SCRUTINY

Regulatory Posture: Aggressive antitrust regulatory enforcement remains an ongoing challenge for dealmaking. Last year, we noted that the U.S. Department of Justice (DOJ) and the Federal Trade Commission (FTC) were taking increasingly active positions and arguing novel theories of competitive harm and antitrust doctrine to intervene in transactions that previously would have cleared the initial waiting periods. We also noted that regulators were broadening the scope of their merger review in order to regulate more deals and expanding the parameters by which they could classify a transaction as anticompetitive. These actions augured a year of intense deal scrutiny, and despite the agencies suffering repeated defeats when relying on novel theories of competitive harm, 2024 promises to be another year of active enforcement.

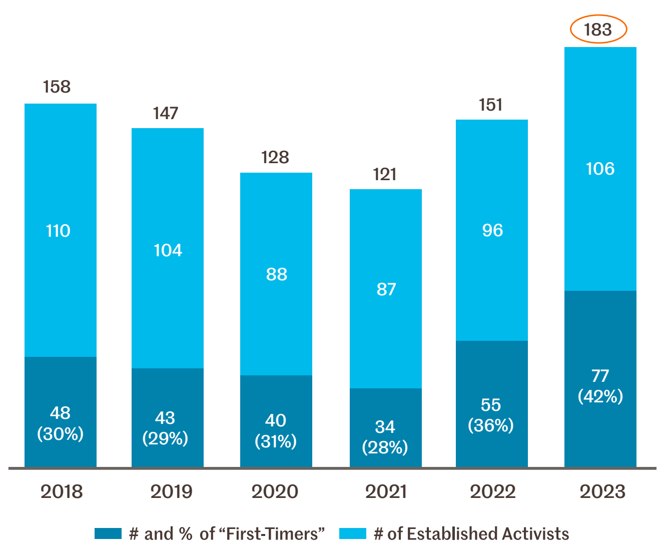
2023 Merger Guidelines: In addition to aggressive enforcement, the DOJ and the FTC have pursued an effort to slow down M&A activity through the adoption of new merger guidelines, which were adopted on December 18, 2023. Previously updated in 2010, the guidelines represent a set of principles and policies that outline the agencies' approach to merger regulation.

Figure 7 – Global Campaign Activity



Source: Lazard, *Annual Review of Shareholder Activism 2023*

Figure 8 – Number of Investors Launching Activist Campaigns



Source: Lazard, *Annual Review of Shareholder Activism 2023*

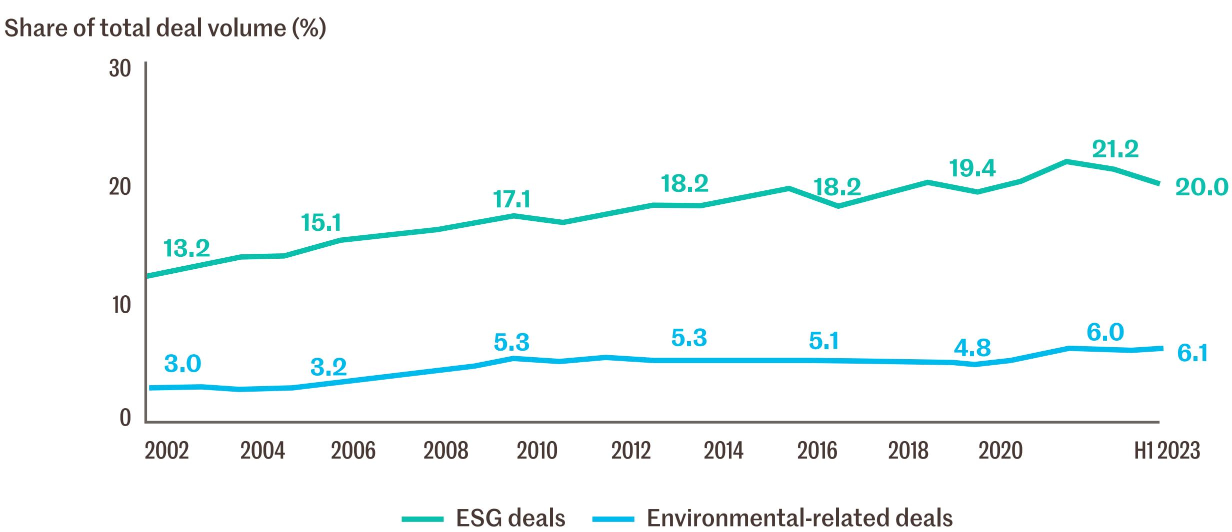
Although the guidelines lack the force of law, courts often refer to them for direction when deciding merger challenges, and it behooves companies to understand the key changes to the guidelines.

As a general matter, the 2023 guidelines cement the agencies' ambitious objective of preventing anticompetitive merger practices by "arrest[ing] anticompetitive tendencies in their incipiency." With this new, explicit commitment to prevention, the agencies may be signaling an intent to bring challenges earlier in a transaction's life cycle. And perhaps with this in mind, the guidelines significantly lower the thresholds for finding a merger to be presumptively anticompetitive, meaning that more mergers could be challenged under antitrust laws than previously was possible. The guidelines now specify that any merger producing a firm with more than 30% market share in any relevant market and an even minor increase in Herfindahl-Hirschman Index (HHI) concentration is presumptively in violation of antitrust laws. For contrast, the 2010 policy gave no presumption with respect to market share, stating only that market share is "useful to the extent it illuminates the merger's likely competitive effects."

The updated guidelines also articulate variously broad, novel and vague legal theories for findings of competition and determinations of anticompetitive effect. For example, the guidelines provide that a merger can cause competitive harm independent of market share analysis if the agencies can broadly show existing competition between the merging parties. Moreover, the guidelines now suggest that the agencies may consider the anticompetitive impact of a merger on the labor market (e.g., via lower wages, reduced benefits, worse workplace conditions).

Finally, the new guidelines, agency rhetoric and enforcement trends highlight a unique risk to PE firms by introducing a broad, novel theory of anticompetitive effect based on "serial acquisitions." The serial acquisitions theory involves scrutinizing a series of acquisitions by a company and evaluating the cumulative harm; even if an individual acquisition might otherwise appear uncontroversial or was not independently required to be reported under the HSR Act, the agencies may take issue with it upon review of the buyer's history. This focus could impact

Figure 9 – The Share of ESG and Environmental-Related Deals Has Grown Continuously

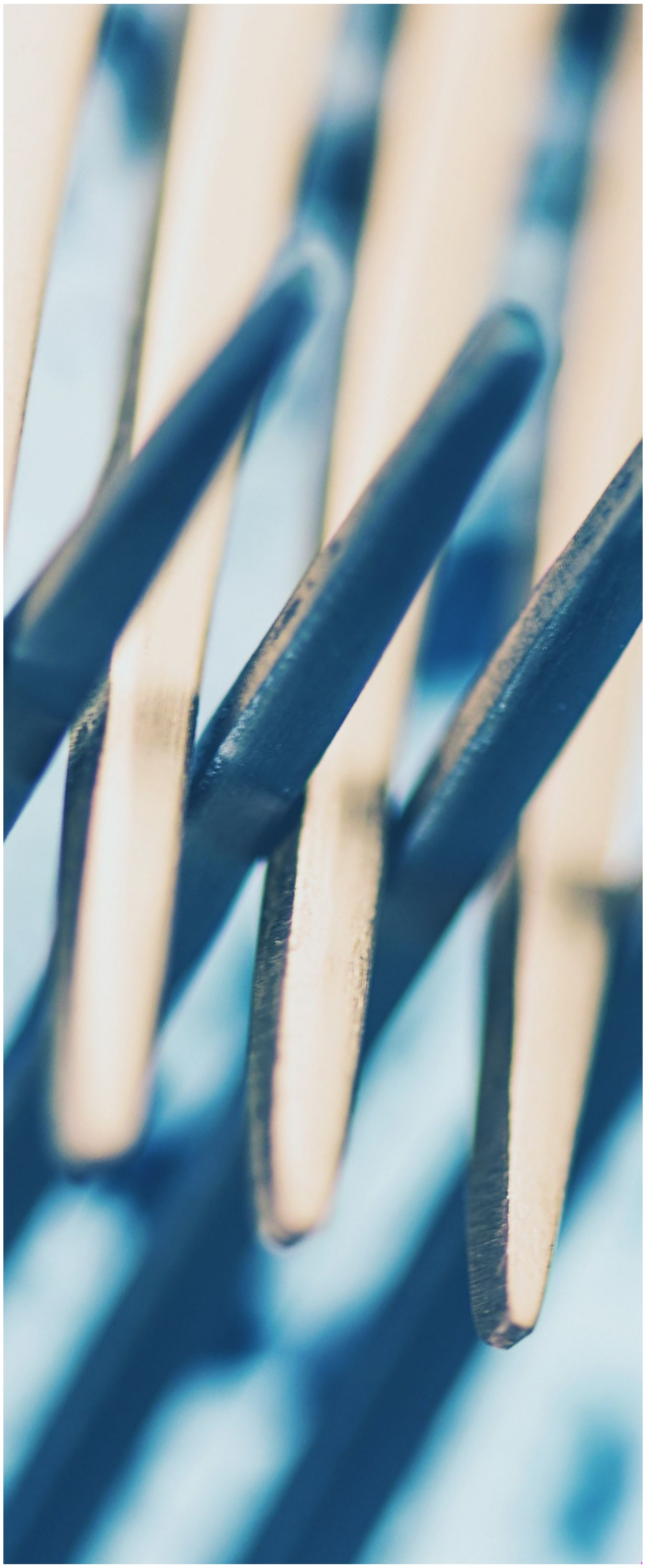


Source: Refinitiv; BCG analysis, M&A Outlook Looking Up After Bottoming Out

PE firms that rely even in part on roll-up strategy, as the agencies have already demonstrated a willingness to target such firms based on the theory. In a lawsuit filed in September 2023, the FTC alleged that the PE firm Welsh, Carson, Anderson & Stowe had violated antitrust law through its acquisition and consolidation of more than a dozen anesthesia practices in Texas. The case remains pending at this time, but the theory itself (coupled with proposed changes to the HSR premerger notification form) should prompt PE firms to closely assess their acquisition strategies, including ways to articulate the procompetitive effects of any roll-ups.

Mitigation Tactics: Heightened antitrust scrutiny has prolonged deal timelines and caused a number of delayed, abandoned and blocked transactions. Some dealmakers have felt a resulting chilling effect, deterring the consideration of transformative mergers and subduing big-ticket transactions, particularly in certain sectors. Elevated levels of recent enforcement and the ambitious policies of the 2023 Merger Guidelines suggest that antitrust regulation will remain fierce this year. In fact, it is possible that the Biden administration will double down on its regulatory action against the deal market as it looks to make a statement heading into the November election. With the significant risks posed to transactions, buyers and sellers must continue to consider antitrust risks, implications and mitigation strategies through all phases of the transaction.

At the outset, dealmakers need to conduct comprehensive regulatory risk assessments in the diligence phase, factor in lengthier deal timelines in structuring and planning transactions, and ultimately account for the ramifications of a prolonged, terminated or abandoned transaction, as well as unpredictable regulatory outcomes, in their decision-making processes and negotiation strategies. Dealmakers may continue pursuing types of transactions that are less likely to trigger regulatory scrutiny (including, as discussed above, smaller transactions) and deploying various structuring tactics in their arsenal, such as “fix-it-first” strategies. As previously discussed, utilizing divestitures and carve-outs on the front end has shown some success in preemptively alleviating potential antirust tensions.



It will be paramount for dealmakers to continue to focus on the regulatory provisions in acquisition agreements as a risk-allocation tool in navigating the current antitrust environment. For example, we have seen parties increasingly prioritizing and featuring the following deal terms, protections and mechanisms in negotiations:

- longer outside dates and robust terms regarding outside date extension rights
- reverse termination fees triggered by the failure to obtain regulatory approval
- "ticking fee" mechanisms – i.e., payments directly in exchange for or an increase in the reverse termination fee on extensions to the outside date – to compensate for delays
- expansive formulations of customary closing conditions to capture developments in antitrust enforcement (including to address receipt of warning letters and/or entry into timing agreements)
- the scope of "efforts" generally required to obtain regulatory approval, and the level of divestitures or other remedies that can be imposed on the buyer
- the scope of interim operating covenants in light of lengthier interim periods and potential gun-jumping concerns

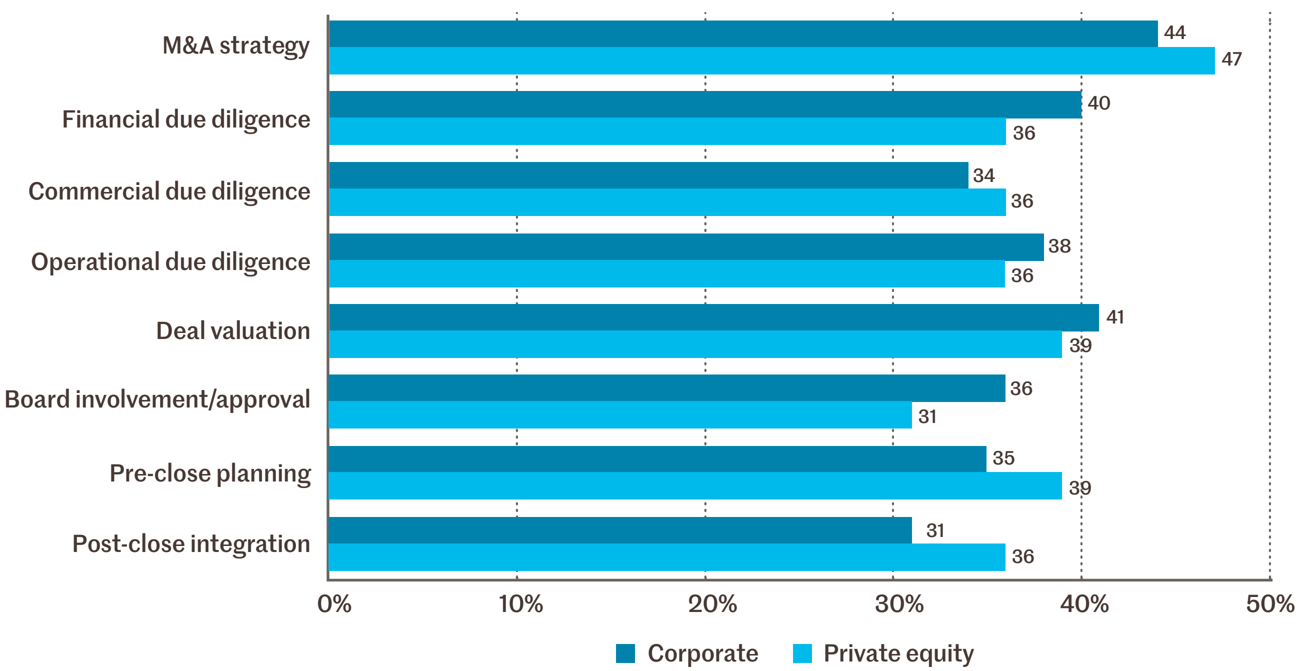
Parties should continue to look beyond the signing and negotiate for the real and significant potential for litigation, determining upfront which party controls – or to what extent the parties share control over – the regulatory strategy and whether there is an affirmative commitment to litigate in order to obtain regulatory approvals or defend challenges from the agencies and potential "tolling" of the outside date pending litigation.

DOTTING THE I'S: CONDUCTING ROBUST DUE DILIGENCE

Economic Incentives: Early indicators suggest that gradual improvements in the economic environment surrounding M&A are coming. Even so, dealmakers saw benefits from more robust due diligence last year, and they will likely want to carry those practices forward for various reasons. As alluded to above, dealmakers have strong incentives to evaluate antitrust and general regulatory risks from the earliest deal stages. Buyers will leverage due diligence reviews for their ongoing regulatory assessment strategies, deciding earlier in the diligence process whether and at what price point they should pursue an acquisition based on its regulatory risk profile.

Current financial conditions also make it logical for parties to conduct robust due diligence as a general matter. In a recent Deloitte survey of 1,500 practitioners, corporate and PE dealmakers indicated financial, commercial and operational due diligence to be among the most important drivers of successful M&A. As buyers contend with steep valuation gaps and the challenges that they pose to negotiations, due diligence offers buyers an opportunity to better steer negotiations, using financial performance data and assessments of operational risks and liabilities to drive consensus about a target's value (see Figure 10).

Figure 10 – Elements Important for Achieving a Successful M&A Deal

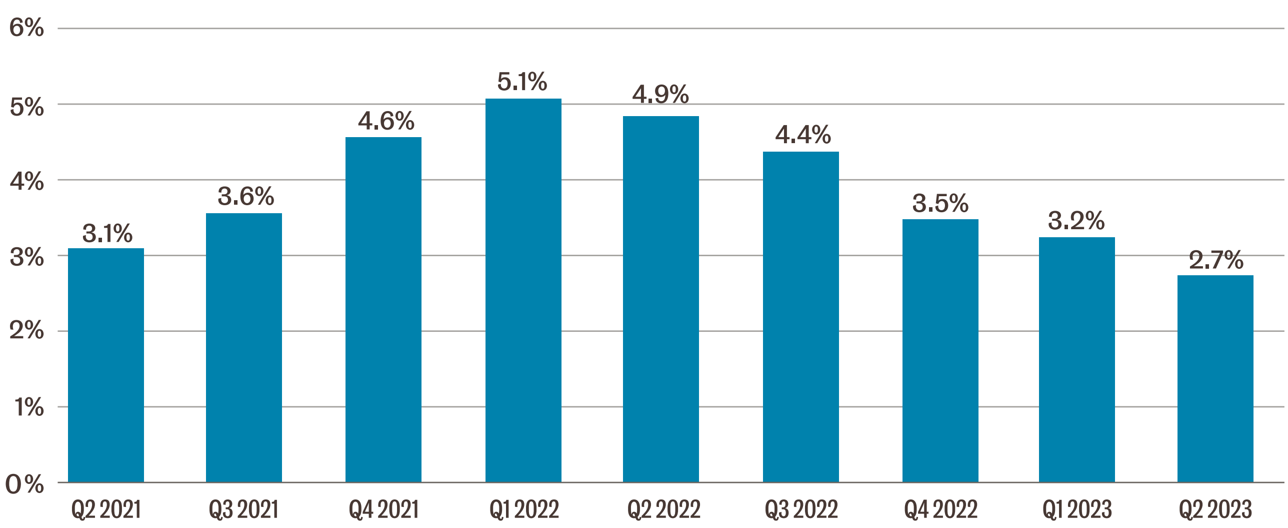


Source: Deloitte, *2024 M&A Trends Survey*

RWI: Representations and warranties insurance (RWI) remains a staple in private target M&A transactions and continues to become more accessible, affordable and pervasive in the market for deals of all sizes. The macroeconomic backdrop emphasizes the importance of the product, as buyers increasingly push for broader packages of representations and warranties as a means to obtain post-closing coverage for unknown risks and liabilities, and sellers continue to posture to minimize post-closing exposure and maximize certainty of proceeds at closing. Strong demand for the product and fierce competition among insurers (including as a result of a number of new entrants in the market) have allowed buyers to access RWI with very favorable terms and prices. In recent years, premiums/rates have dropped well below 3% to the 1.9% to 2.5% range (see Figure 11), and retentions (deductibles) – i.e., the amount of loss the insured must bear in the event of a claim before the policy limit kicks in – have decreased from 1% of the purchase price to 0.75% on average and, in many cases, as low as 0.5%.

At the same time, there has been a notable uptick in RWI claims activity in recent years, with Euclid Transactional reporting July 2023 as setting its single-month record for most claims received. This surge in claims activity included a number of very significant dollar-figure claims that were filed in 2023, a trend not only inevitably arising out of tighter economic conditions but also being driven by the lower retentions. With insurers continuing to legitimize and stand behind the product by responding to and paying out claims, RWI will continue to become even more ubiquitous in dealmaking. The rise in claims activity has caused and will continue to cause heightened focus of RWI insurers on the diligence performed by buyers during the RWI underwriting process.

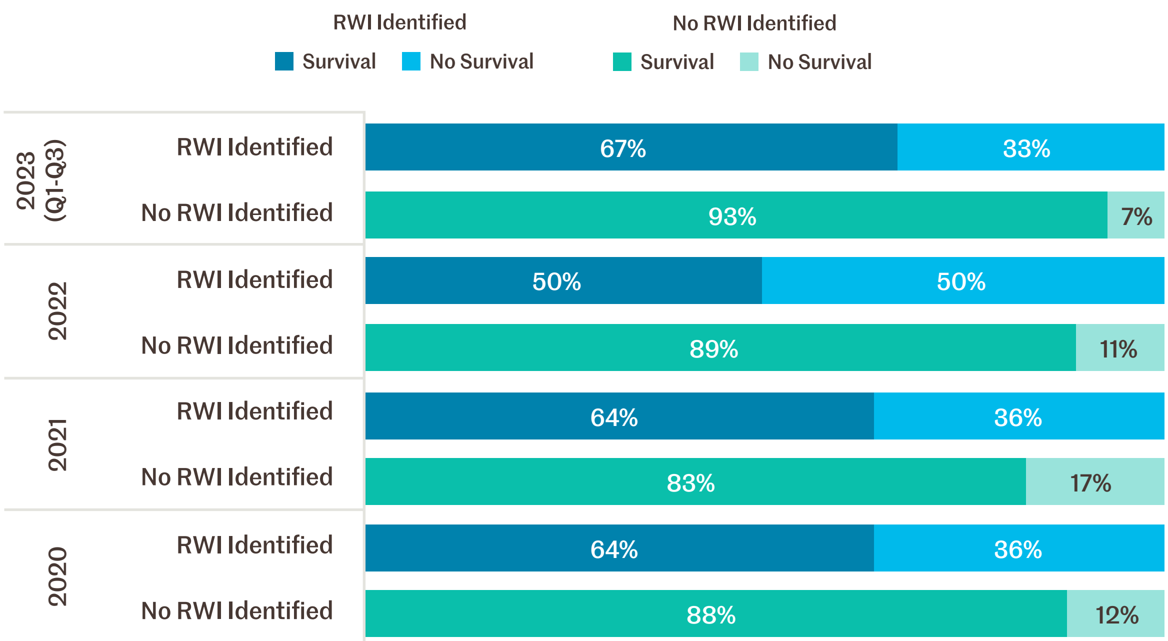
Figure 11 – Average Rate as a Percentage of Limit by Inception Quarter



Source: Woodruff Sawyer, *Looking Ahead to 2024*

While RWI continues to prove to be an effective means of addressing the post-closing risk allocation between buyers and sellers, we are seeing fewer no-survival, or walk-away, deals in this market, with parties utilizing deal escrows (including special escrows) and indemnity provisions more frequently. Within RWI-identified transactions, there has been a notable increase in the number of hybrid recourse constructs, with 67% of such deals through the end of Q3 2023 featuring survival of representations and warranties (up from 50% in 2022) (see Figure 12). Consistent with tighter economic conditions in which buyers are placing greater emphasis on and conducting more robust due diligence processes and insisting on adequate post-closing coverage for risks and liabilities, the trend observed in RWI-backed deals may also be a product of the corresponding heightened focus on diligence in the RWI underwriting process – i.e., leading to more diligence-based exclusions from policy coverage and buyers insisting on special indemnities to cover such gaps.

Figure 12 – Survival (or Not) of Sellers' General Representations and Warranties



Source: SRS Acquiom 2023 M&A Deal Terms: Three Trends to Watch

CONCLUSION

Although it is tempting to view 2023 M&A from a glass-half-empty perspective, dealmakers can identify specific areas of success, deploying creative deal structures and demonstrating resilience in adapting to financial and regulatory pressures. There is room for cautious optimism about the next year. As a number of PE and well-capitalized strategic buyers sit on record levels of dry powder or substantial cash reserves and the Federal Reserve signals rate cuts, the high costs of financing may not be as alarming as previously thought. Other contributing factors to the difficult financing market and challenging negotiating environment – inflation, slowing demand, high input costs, compressed valuations, volatility in the equity markets and widely divergent valuation expectations – are also stabilizing somewhat. Sponsors will face too much pressure to continue sitting on the sidelines.

If dealmakers build on successes from the past year and capitalize on emerging M&A catalysts in a friendlier dealmaking environment, they should be able to turn lemons into lemonade. Dealmakers can manage persistent headwinds from the political and financial arenas by doubling down on what has worked – prioritizing targeted and smaller acquisitions; aligning buyer and seller incentives with earnouts, rollovers and similar mechanisms; deploying alternative financing structures; leveraging strategies to mitigate regulatory headaches; and perfecting the fundamentals of due diligence and deal execution. November will be a pivotal month, but we expect savvy dealmakers to continue finding compelling opportunities to unlock value and growth in 2024 and beyond.

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Contacts

Charles Katz
Partner
+1 703 245 1005
ckatz@kslaw.com

Drew Pollekoff
Partner
+1 703 245 1013
dpollekoff@kslaw.com

Erik Belenky
Partner
+44 20 7551 7540
ebelenky@kslaw.com

Zev Beeber
Associate
+1 703 245 1026
zbeeber@kslaw.com

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