

2020

BALTIC PRIVATE M&A DEAL POINTS STUDY

ESTVCA / ESTONIAN PRIVATE EQUITY
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The sixth edition of the Baltic Private M&A Deal Points Study is conducted under auspices of:

- Estonian Private Equity and Venture Capital Association
- Latvian Private Equity & Venture Capital Association, and
- Lithuanian Private Equity and Venture Capital Association

Together with contributions from the following Baltic M&A law firms and alliances:

- SORAINEN
- COBALT
- ELLEX
- EVERSLEDs SUTHERLAND
- TGS BALTIC
- PRIMUS DERLING and WALLESS

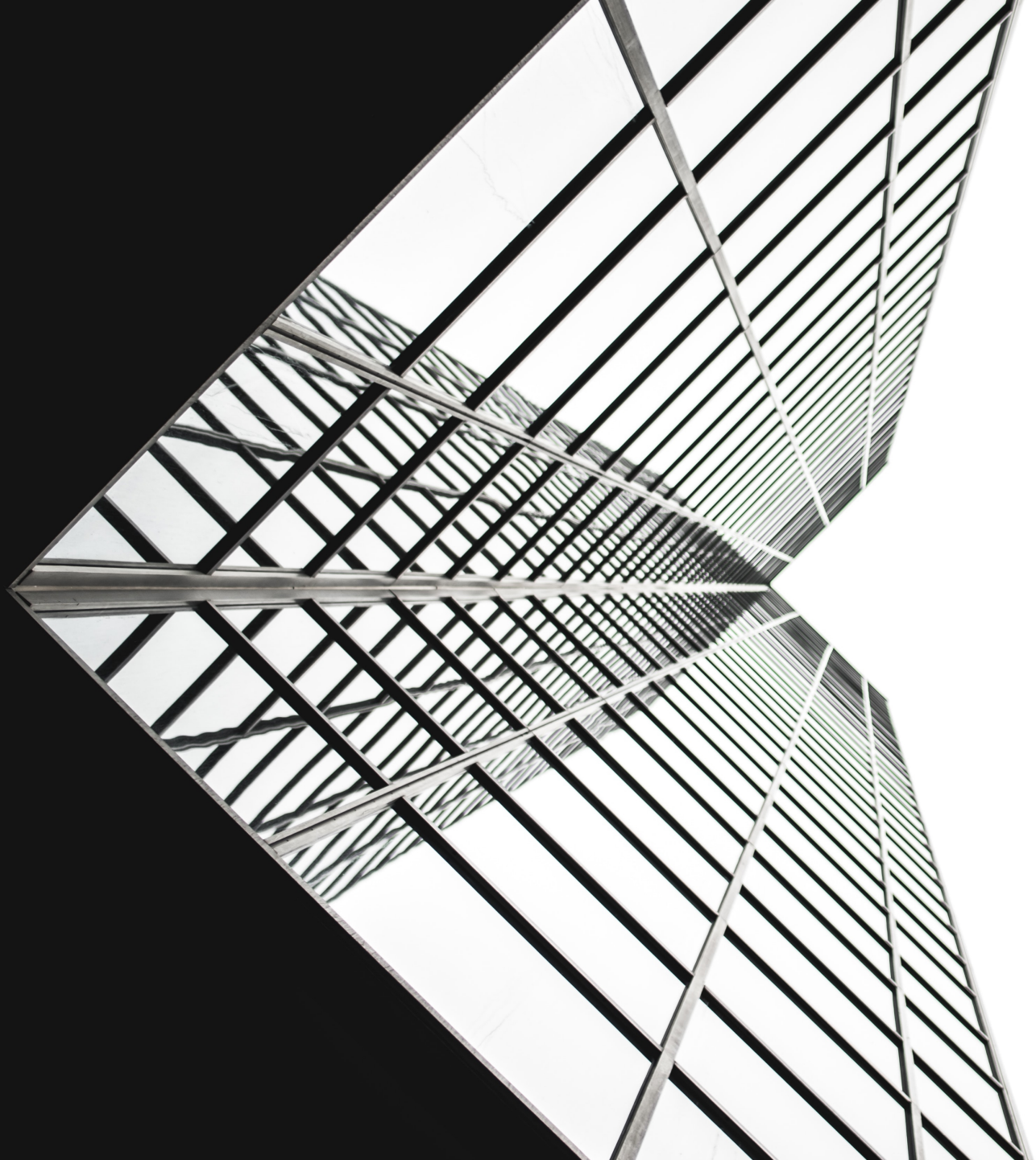
Transactions Analysed

- The study analyses 122 private M&A transactions completed during the period January 2018 – March 2020.
- This 2020 study compares the results to similar 2018 and 2016 studies.
- The transactions included in the survey have the following characteristics:
 - The survey covered M&A transactions, i.e. acquisition or merger of businesses via share or asset transactions, corporate statutory mergers or in any other way, however, excluding fundraisings and joint ventures which did not trigger transfer of control.
 - Only Baltic transactions were studied, i.e. M&A transactions involving targets operating in one or more of the Baltic States: Estonia, Latvia and Lithuania.
 - Transactions had a deal value over EUR 1 million and were completed during the period January 2018 – March 2020.
 - The study focuses on private M&A transactions, i.e. excluding takeovers of public listed companies.
- No additional limitations applied as to deal value, the nature of the parties or the target or the sale procedure of the transaction.

Content

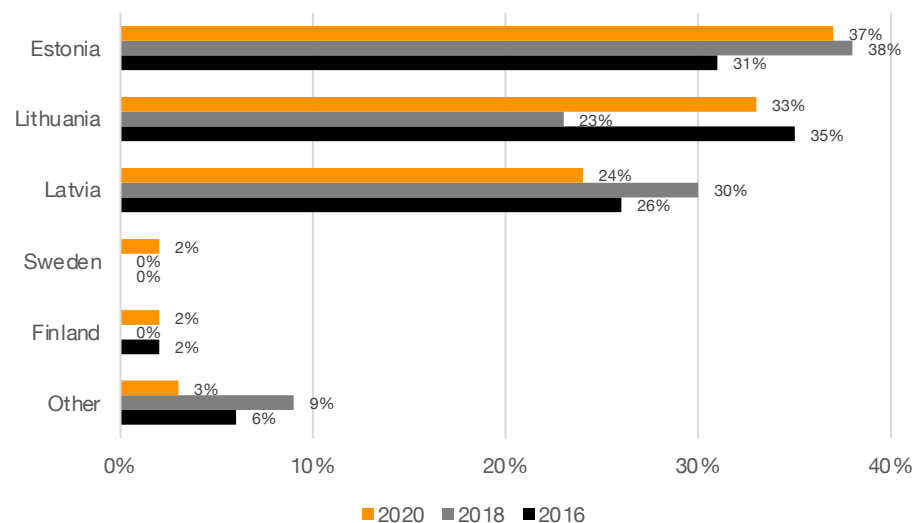
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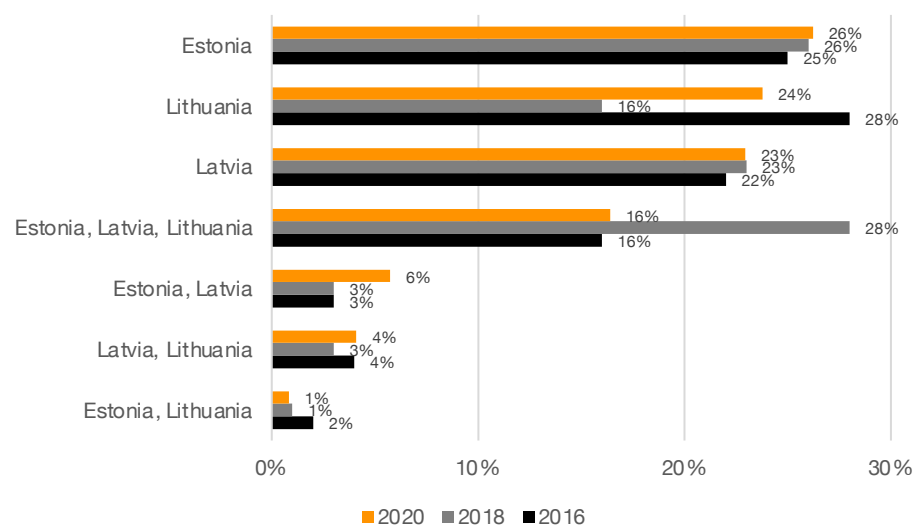
The Parties

Country of the Target's Head Office



Targets in the submitted transactions were predominantly Baltic, with Estonia providing 37% of them (similarly to 2018).

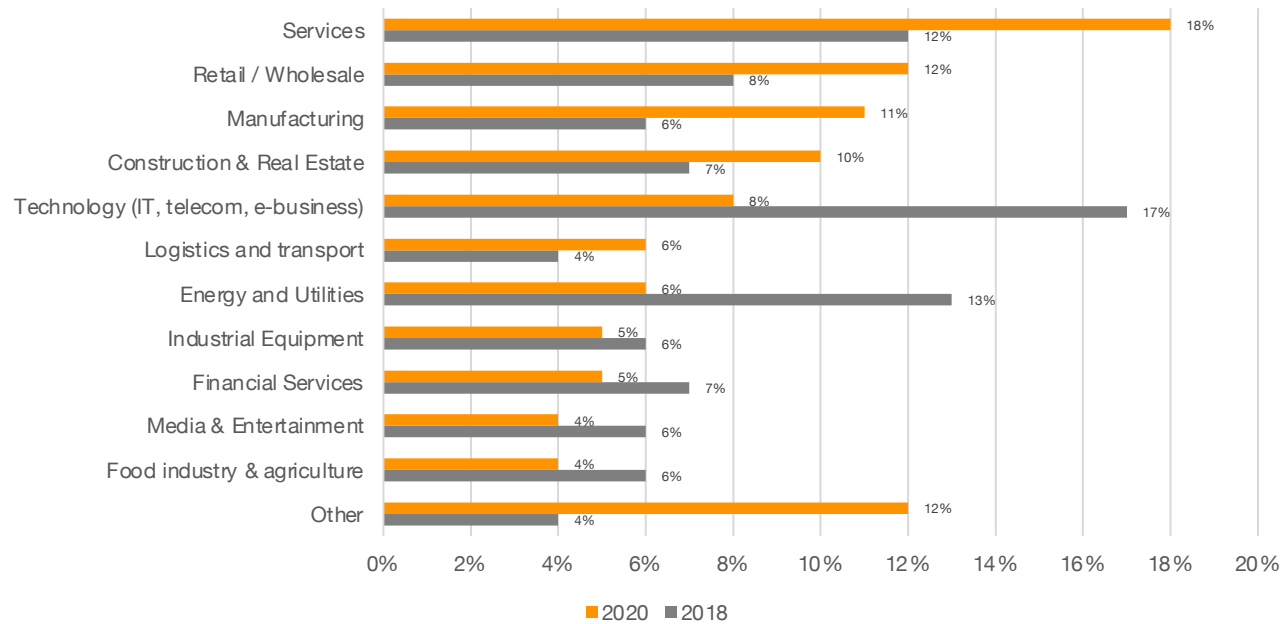
Baltic States where the Target operates



Similarly to previous periods, a majority of the Targets operate in only one Baltic country. However, the share of pan-Baltic targets has dropped from 28% in 2018 to 16% in 2020 study.

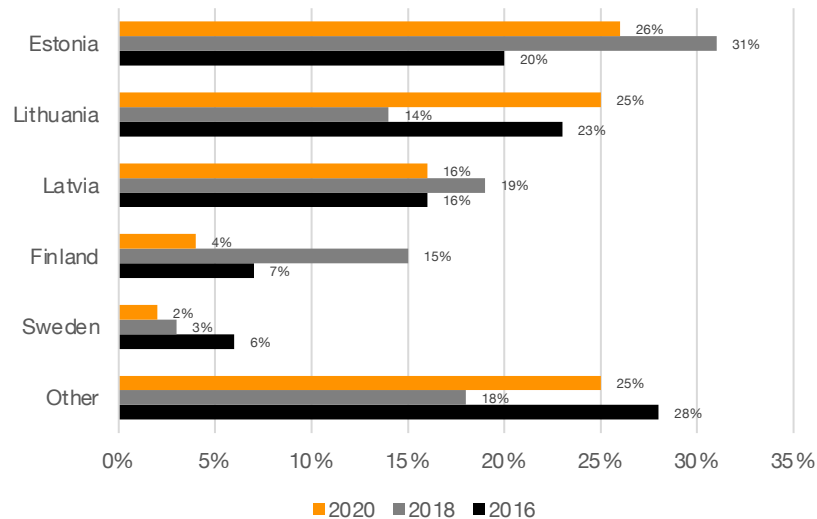
Targets' geographical focus outside the Baltics include Sweden, Finland, Poland and Germany among others.

Target's main sectors



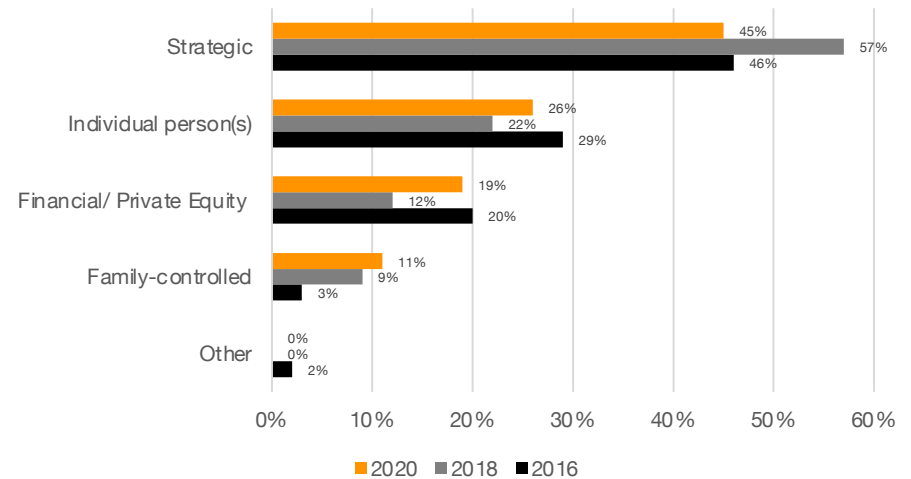
In terms of targets main industries, the share of technology sector has dropped from 17% on 2018 to only 8% in 2020 study. The most active sectors in terms of M&A during the period covered in this study are services, retail wholesale, manufacturing and construction & real estate.

Country of the Seller



Compared to the previous studies, the local Baltic sellers are now clearly dominating, whereas the most active sellers are from Estonia and Lithuania.

Nature of the Seller

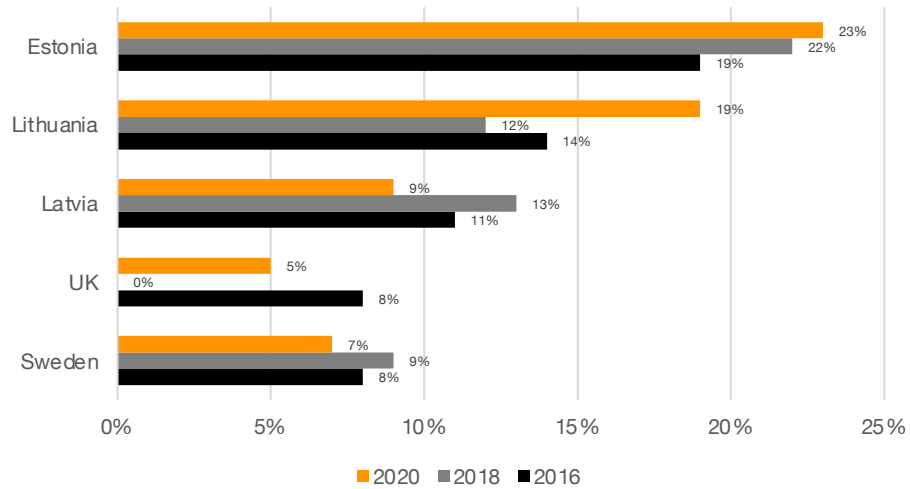


Exits by strategic investors have somewhat decreased compared to 2018 study, however, the share of private equity and individual exits have increased back to the level of 2016 study.

Private equity exits have increased compared to 2018, making up a total of 19% of the transactions this year.

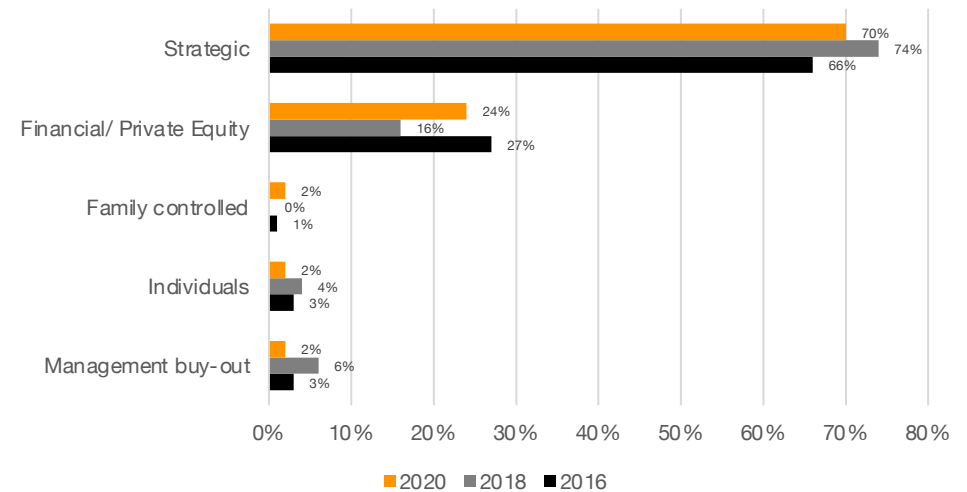
Interestingly, the sale of family-controlled businesses keeps growing.

Country of the Buyer's group head office



Similarly to previous years, Estonians continue to be the most active buyers within the Baltics. UK and Swedish buyers stand out as major foreign investors from outside the Baltics.

Nature of the Buyer



The proportion of the strategic buyer has slightly decreased, but still comprises more than 2/3 of all transactions.

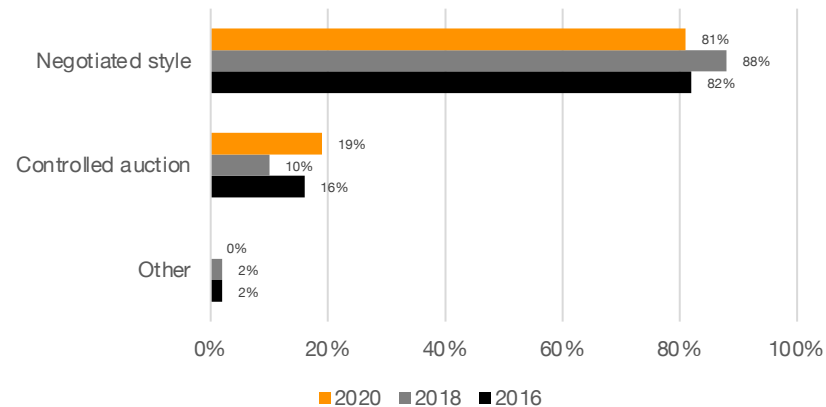
Financial and private equity buyers continue to represent around 1/4 of the M&A investors.



Sales Process and Form of Transaction

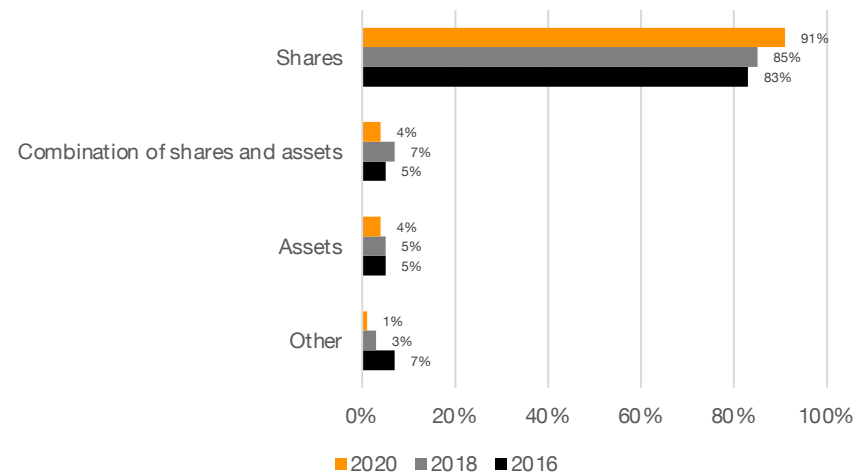
General Transaction Characteristics

Nature of the Sales Process



Compared to previous years, controlled auctions have become more popular while the proportion of negotiated sales remains very high (81%).

Form of Transactions



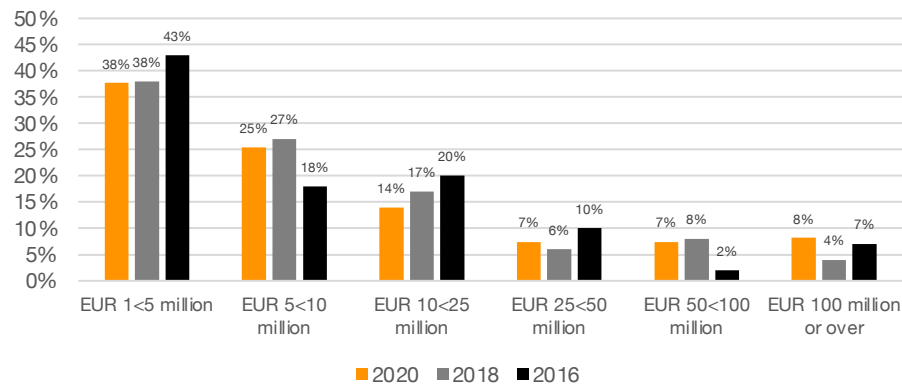
As in all previous studies, most transactions in the Baltics are share deals.



Transaction Value and Payment

General Transaction Characteristics

Transaction Value

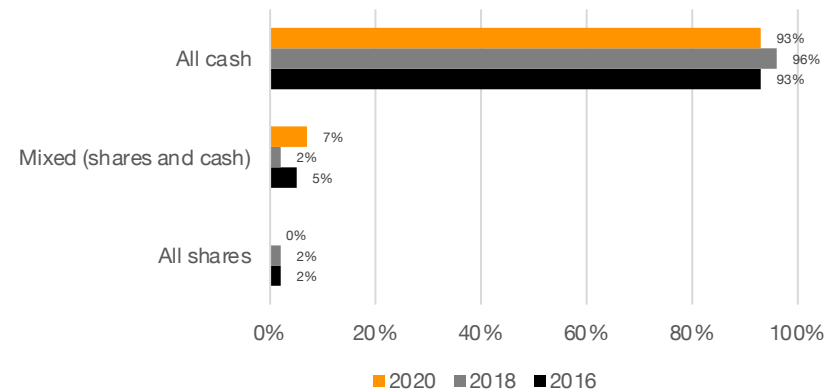


The value of a typical Baltic M&A transaction remains below EUR 10 million.

Notably, the share of megadeals (over EUR 100 million) has increased to 8%.

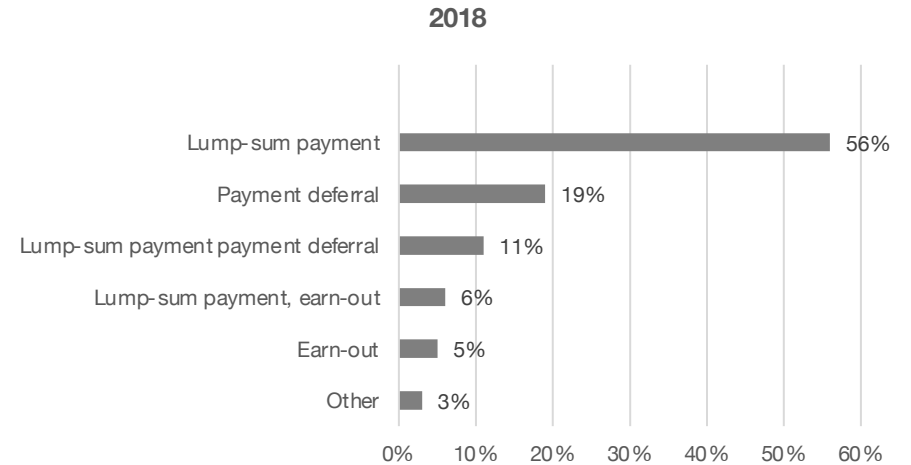
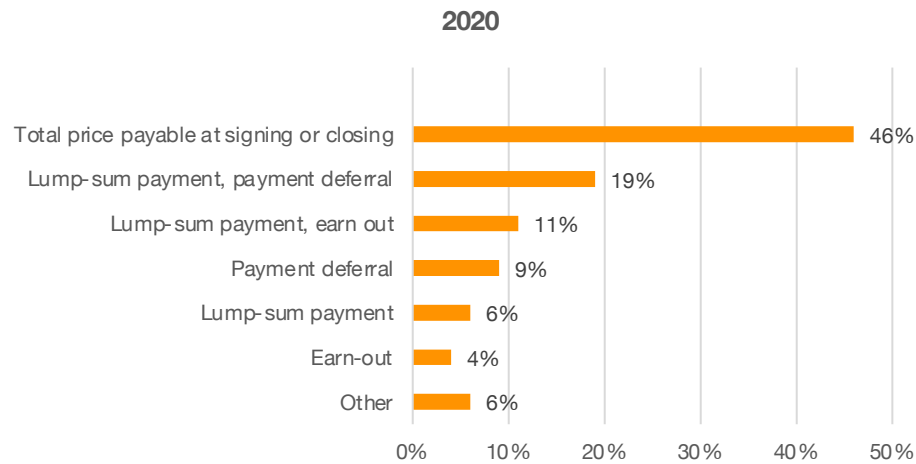
**In this and subsequent graphs: “<” means less than the figure following the symbol, i.e. “EUR 1<5 million” means EUR 1 million or more but less than EUR 5 million (excluding EUR 5 million) and “EUR 5<10 million means EUR 5 million or more but less than EUR 10 million (excluding EUR 10 million, etc)*

Form of Consideration



Similar to previous studies, almost all transactions involve cash as consideration.

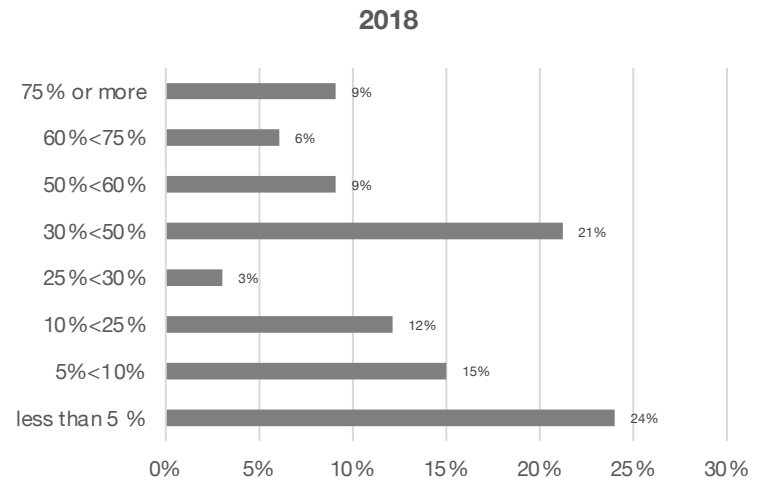
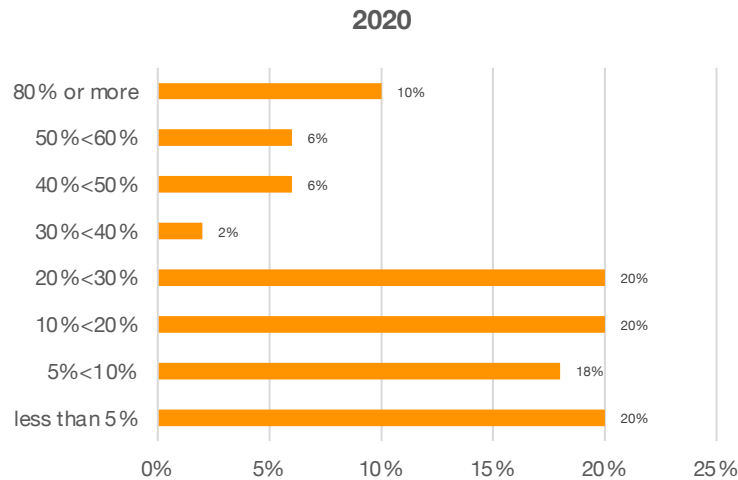
Payment Terms



This year, we introduced a new choice as an answer - "Total price payable at signing or closing", which turns out to be by far the most common among all choices.

** multiple choices were allowed in the survey*

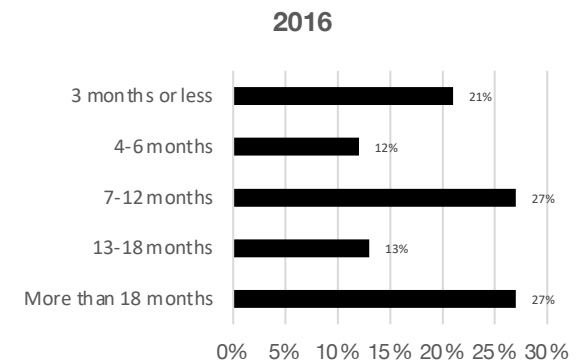
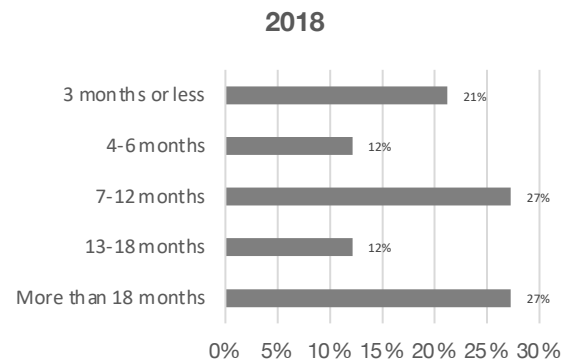
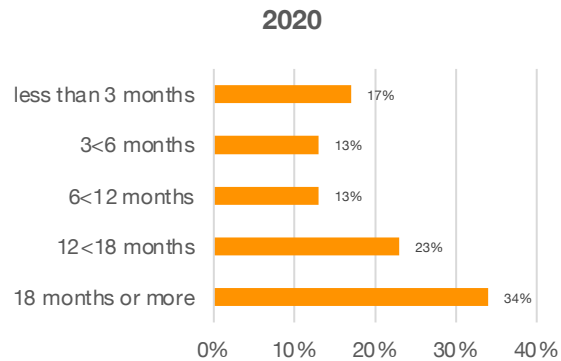
Percentage of price deferred (if deferred)



There is no certain trend as regards to the percentage of price deferred. However, in vast majority of cases (78%), it remained under 30%.

**In this and subsequent graphs: "<" means less than the figure following the symbol, i.e. "10%<20%" means 10% or more but less than 20% (excluding 20%) and "30%<40%" means 30% or more but less than 40% (excluding 40%, etc.)*

Length of deferral

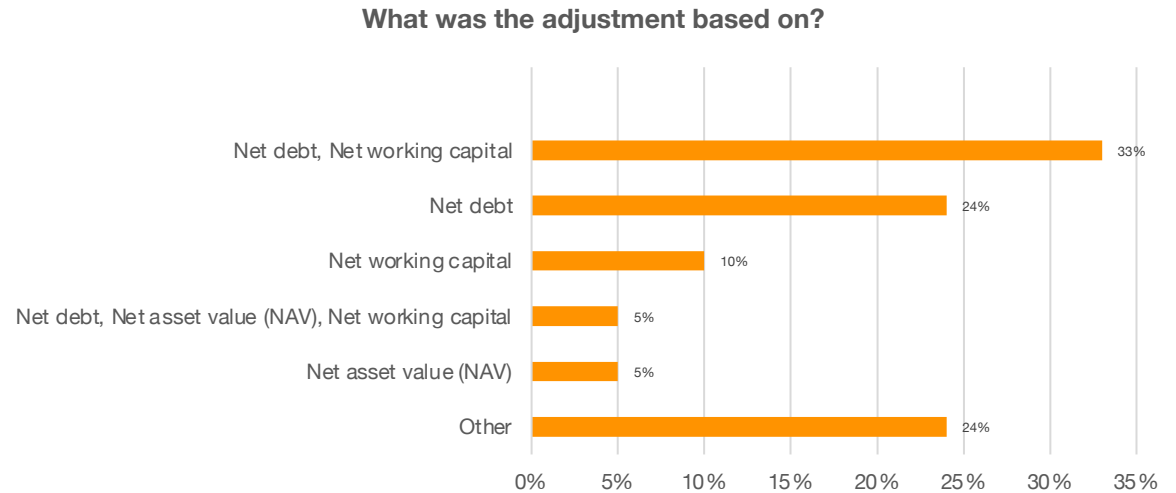
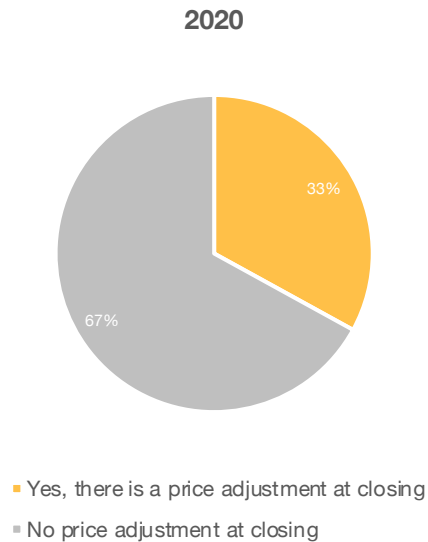


Deferral periods have stayed roughly the same as in the previous studies.

If part of the purchase price is deferred, the length of the deferral has increased compared to previous studies.

**In this and subsequent graphs: "<" means less than the figure following the symbol, i.e. "3<6 months" means 3 or more months but less than 6 months (excluding 6 months) and "6<12 months means 6 months or more but less than 12 months (excluding 12 months, etc.)*

Price adjustment at Closing

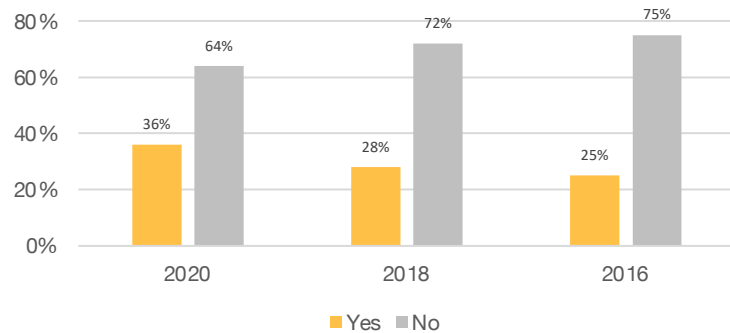


Likewise previous studies, the price has been subject to adjustment at closing only in 1/3 of the transactions.

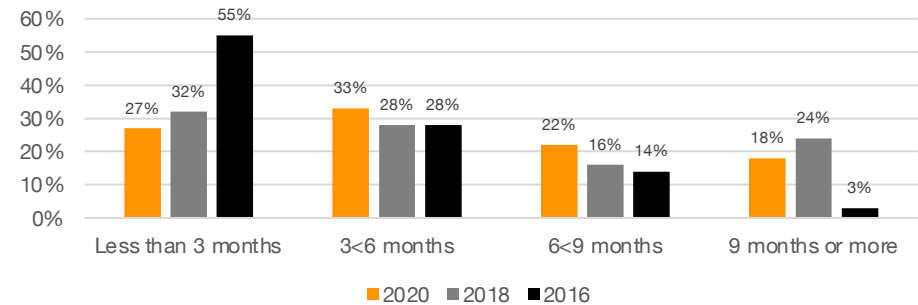
Over half of the price adjustments are based on Net debt and/or Net working capital.

Locked Box Mechanism

Usage of Locked Box mechanism



Time between the locked box date and the closing date

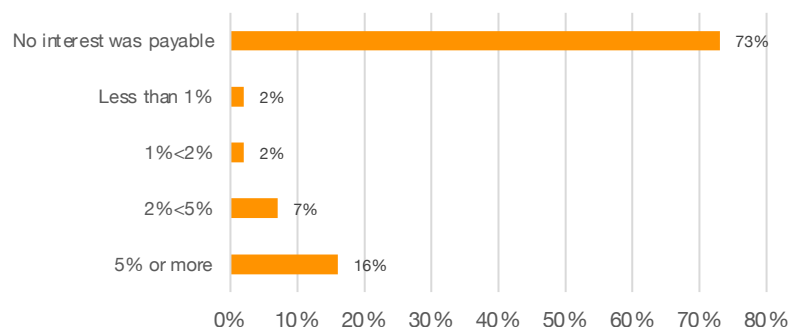


Similarly to previous studies, the locked box mechanism was used in less than half of the transactions. However, its usage is clearly on the rise, having grown by 11% compared to the 2016 study results.

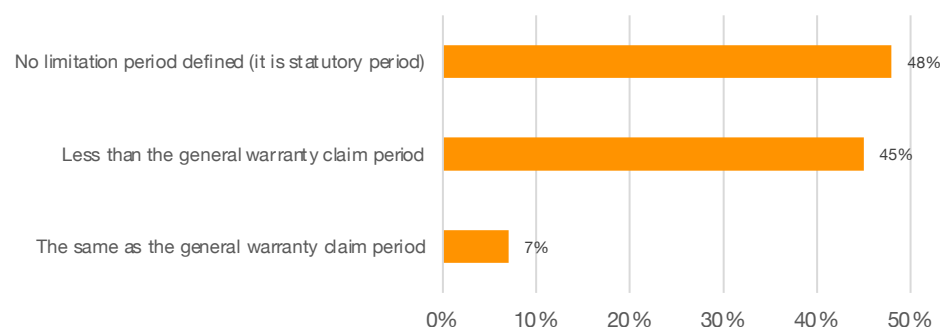
The time between the locked box date and the closing date seems to be rather evenly distributed across 9 months period.

Locked Box Mechanism

Annual rate of interest paid from the locked box date to the closing date



Time period when leakage can be claimed by the Buyer



In vast majority of cases, no interest was payable from the locked box date.

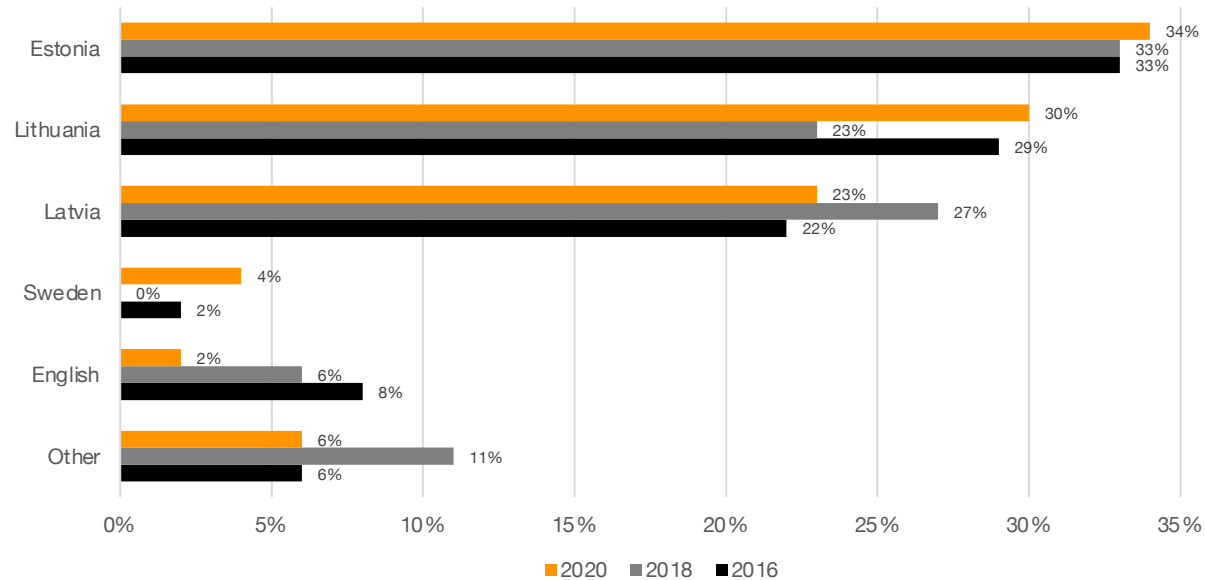
Additionally, we introduced a new question on when leakage can be claimed by the Buyer. For nearly half of the cases it was less than the general warranty period and in the other half of cases, the limitation period was not defined.



Governing Law and Dispute Resolution

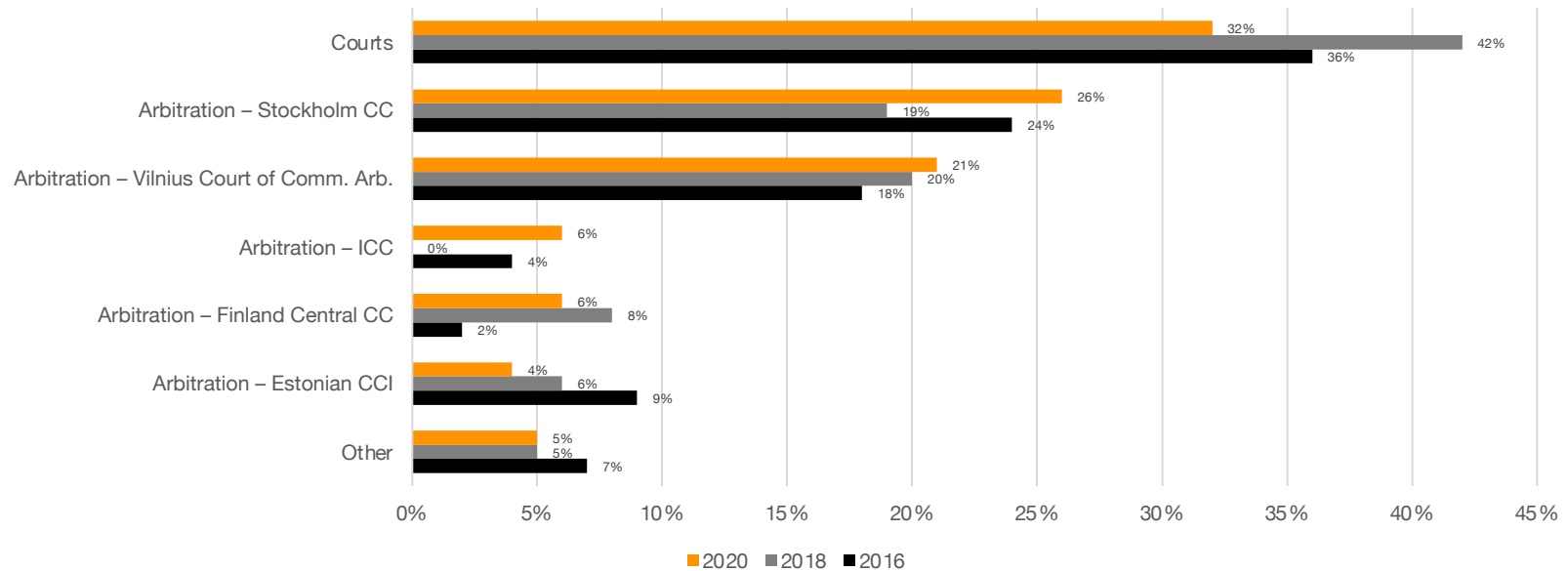
General Transaction Characteristics

Transaction Governing Law



Similarly to previous studies, most Baltic M&A transactions are governed by the local laws of the Baltic countries.

Dispute Resolution Mechanism

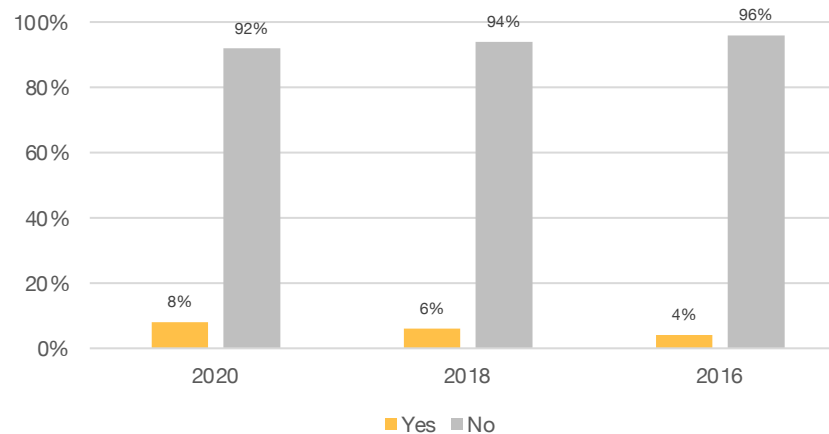


Arbitration continues to be the most popular form of dispute resolution, with the number of occasions where courts have been used as a dispute settlement venue decreasing by 10% compared to 2018 study.

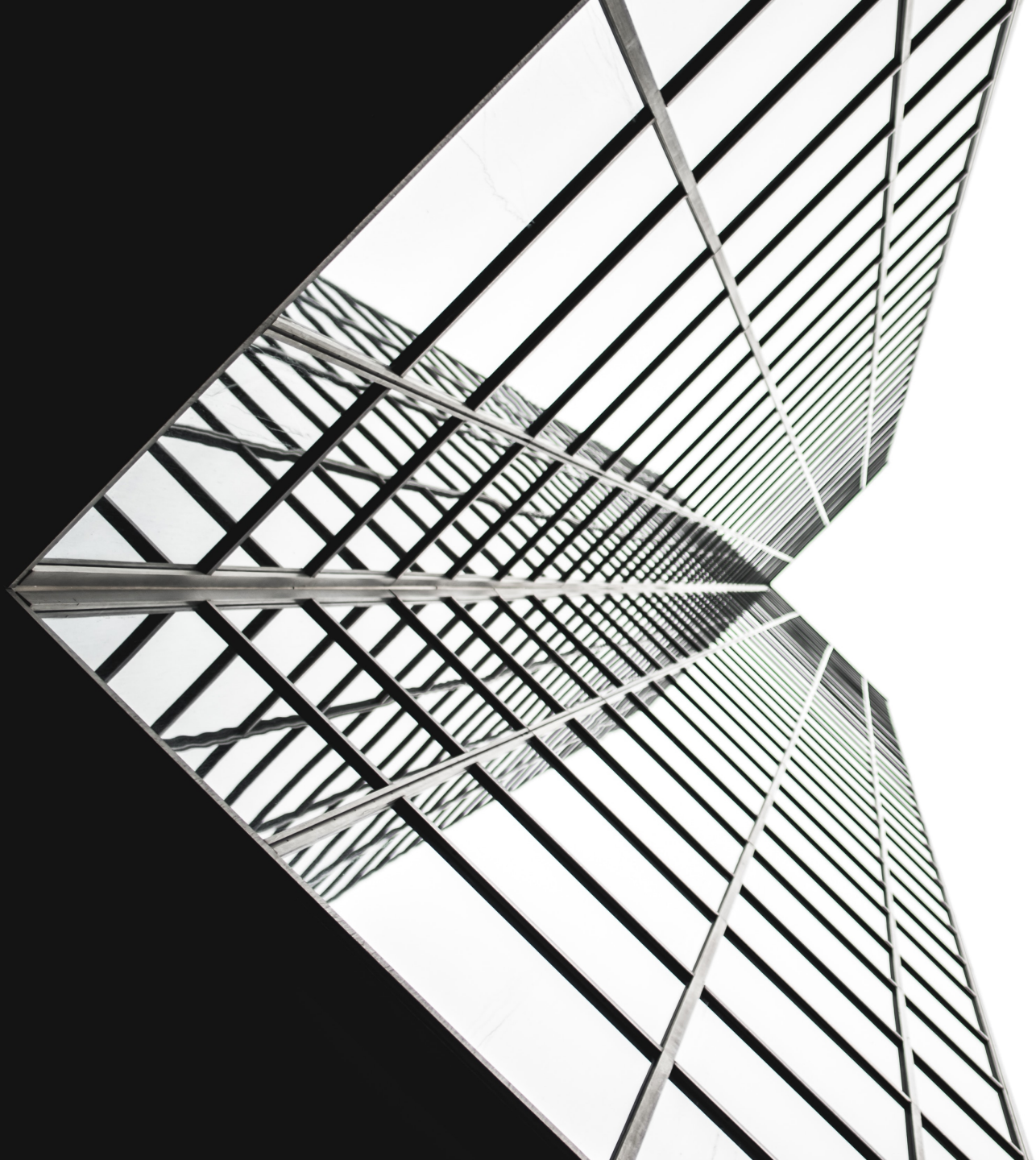
Vilnius Court of Commercial Arbitration continues to be the most reliable arbitration institution within the Baltic countries and Stockholm Chamber of Commerce is the preferred choice outside Baltics.

Dispute Resolution: Existence of Disputes

Did the transaction give rise to any disputes?

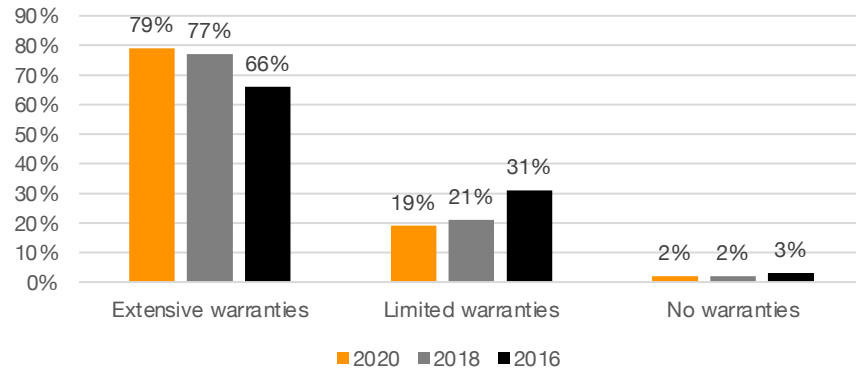


The occurrence of M&A disputes continues to be rare, but keeps rising steadily throughout the years, with the number of disputes having now doubled compared to 2016 study.



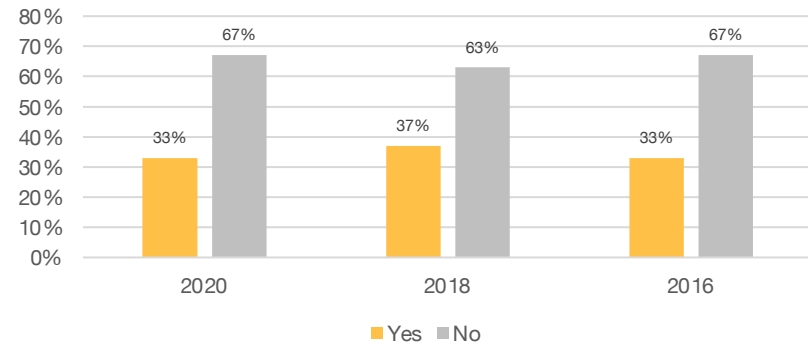
Warranties

Seller's Warranties



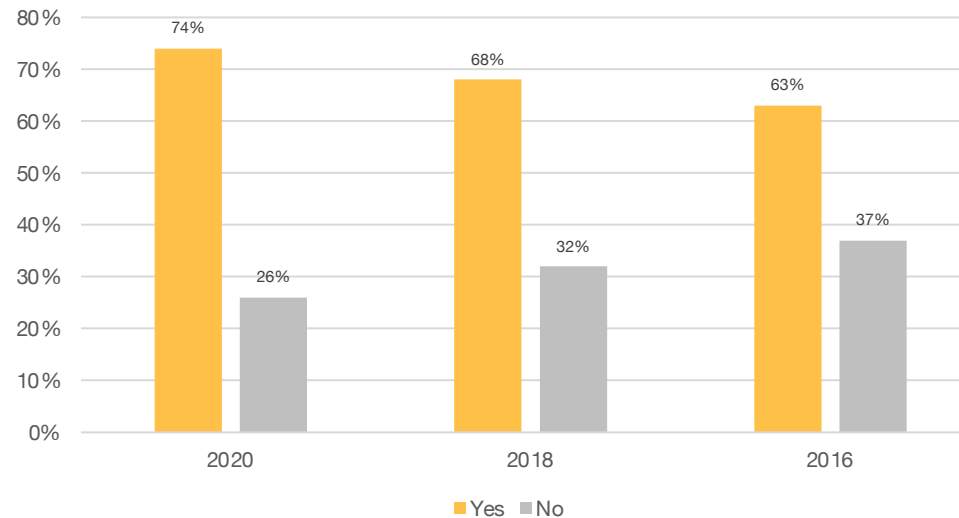
The trend of including extensive list of warranties continues to increase.

Disclosure Letter



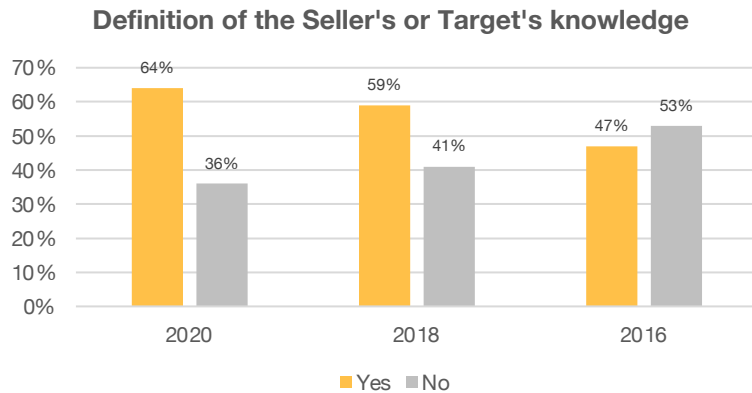
The proportion of transactions using a disclosure letter has slightly decreased compared to the previous surveys.

Due Diligence Disclosures Considered General Qualification to Warranties



The trend of viewing due diligence as a deemed disclosure has continued and now makes up nearly $\frac{3}{4}$ of the transactions.

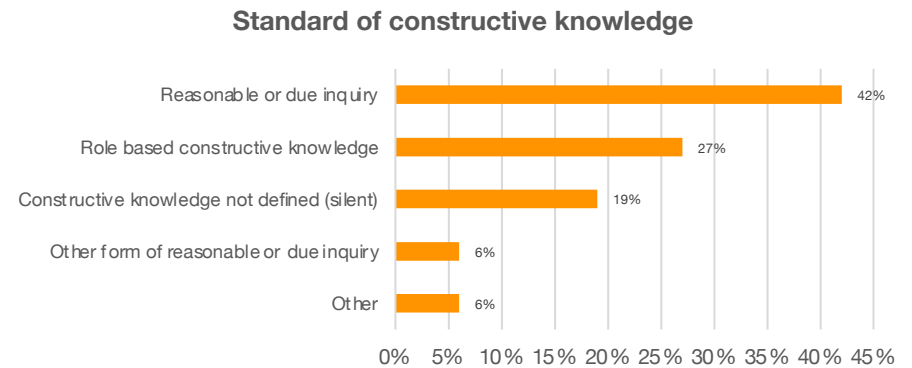
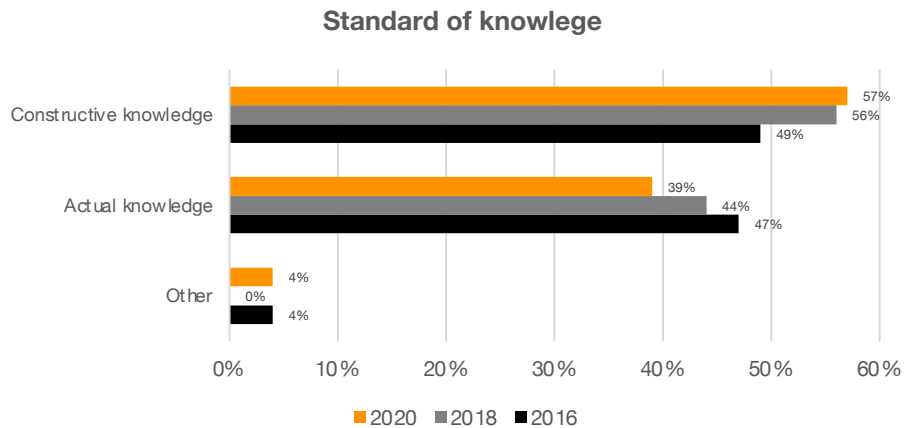
Standard of Knowledge



The Seller's/Target's knowledge is defined in more than half of transactions, additionally the % of such transactions is clearly increasing when looking at the data from the previous studies.

In case knowledge is defined, in nearly half of the cases it includes both Seller's and Target's knowledgeable persons, and almost equally it includes only the Seller's knowledgeable persons.

Standard of Knowledge



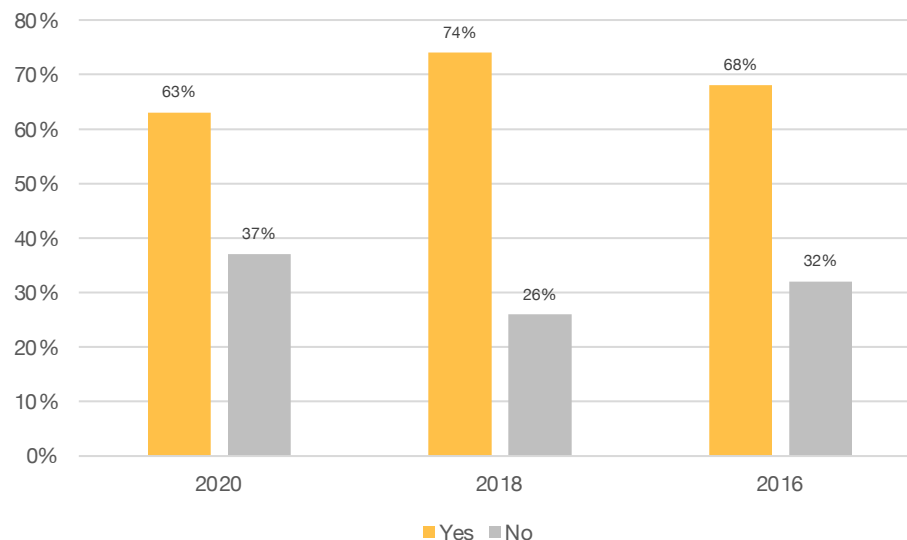
The usage of constructive knowledge continues to keep increasing.

If constructive knowledge is used, reasonable or due inquiry standard applies in nearly half of the cases.

* *Actual knowledge* - meaning that the standard refers to what the party giving the warranty does know in fact - i.e. “actually knows”

** *Constructive knowledge* - meaning that the standard refers to some defined knowledge level that the party giving the warranty “should know” (due to role or after due inquiry), regardless of whether the party in fact knows or not

No Undisclosed Liabilities Warranty

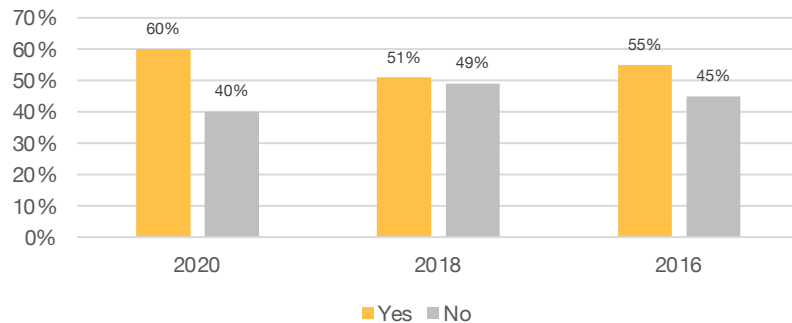


The proportion of deals using the *no undisclosed liabilities* warranty has decreased significantly compared to 2018 study but is still used in 2/3 of the transactions.

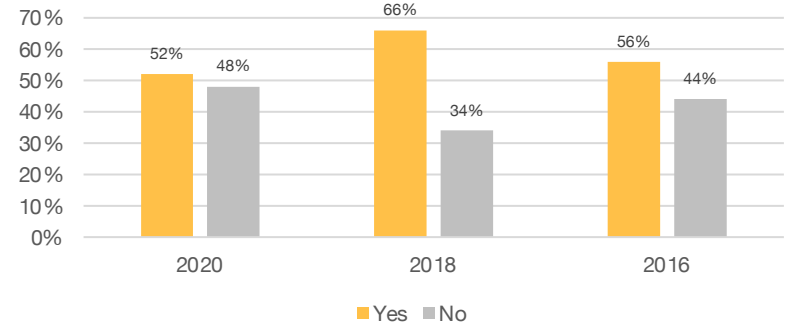
**No Undisclosed Liabilities Warranty - under such clause the Seller represents and warrants that the Target has no liabilities or obligations of any nature, except those in the balance sheet or otherwise explicitly disclosed to the Buyer. This aims to assure the Buyer that it has been informed of all potential liabilities of the Target.*

Full Disclosure Warranty

Full disclosure warranty by the Seller or Target



Is the Seller's warranty knowledge qualified?



The *full disclosure* warranty continues to be used in majority of transactions, making up more than ½ of the total transactions in 2020 and having increased by 9% compared to 2018.

The proportion of *full disclosure* warranty that is knowledge qualified has decreased compared to previous studies but the knowledge qualifier is still used in slightly more than half of the transactions.

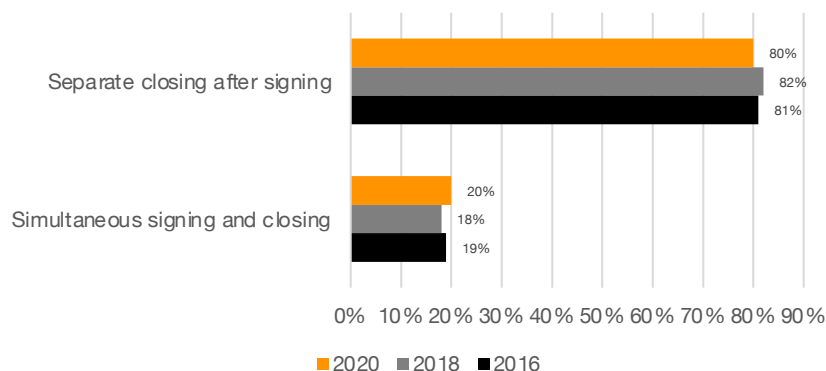
**Full Disclosure Warranty - a warranty that tends to ensure that the Seller has told to the Buyer everything that the Buyer should know about the Target, and that all statements made are true and not misleading*



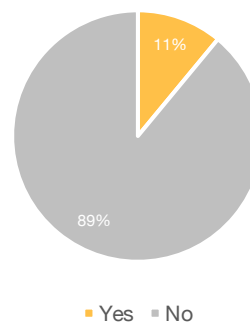
Closing and Conditions Precedent

Timing of Signing and Closing

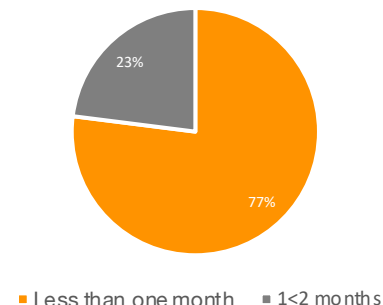
Does the signing of the agreement and the transaction closing happen on the same day?



Were Signing or closing process delayed by AML rules?



If yes, for how long?

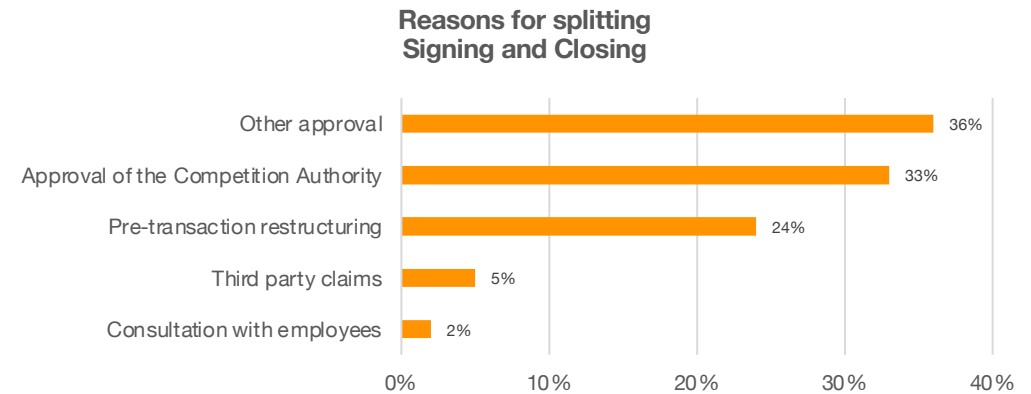
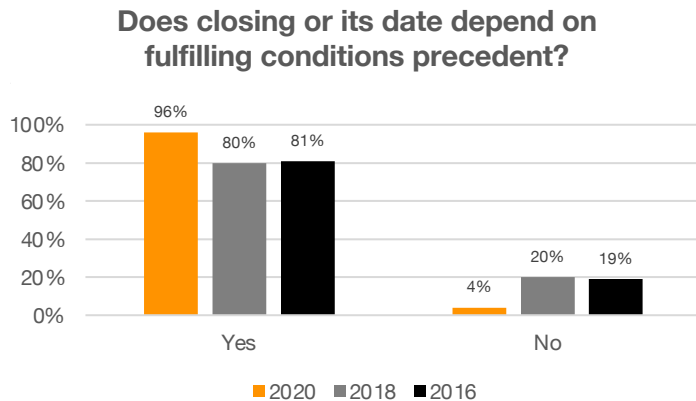


Similarly to previous studies, closing is deferred in vast majority of the transactions.

In the light of additional AML regulation coming to force, we introduced new questions on the topic. In most of the cases, signing or closing process were not delayed by AML rules.

However, if the process was delayed, the delay did not last over a month in most of the cases.

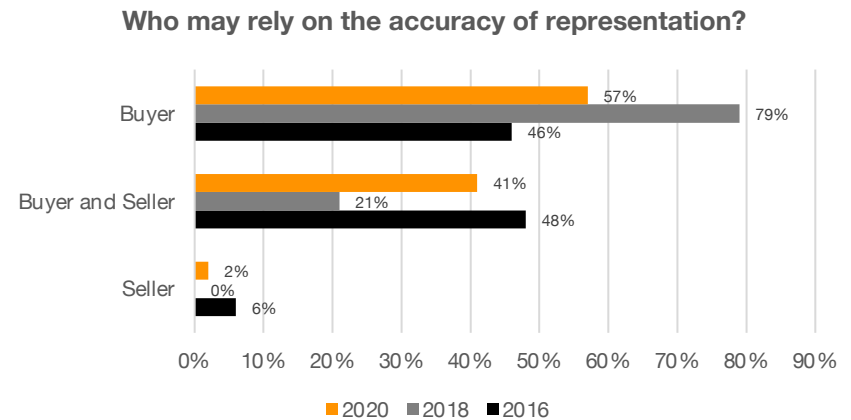
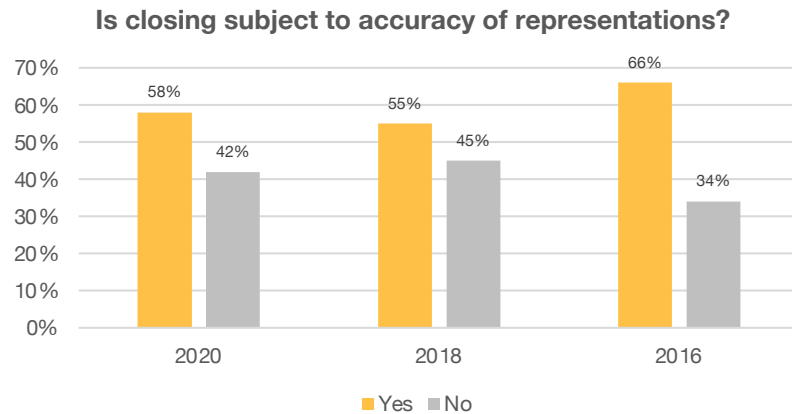
Conditions precedent



For nearly all of the transactions, the closing depended on fulfilment of conditions precedent. Previously this was the case for approximately 4/5 of the transactions.

The main reasons for splitting signing and closing was the need to obtain merger clearance or other approval or to carry out pre-transaction restructuring.

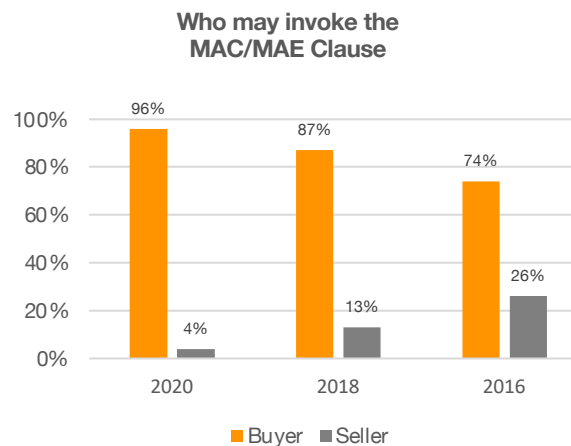
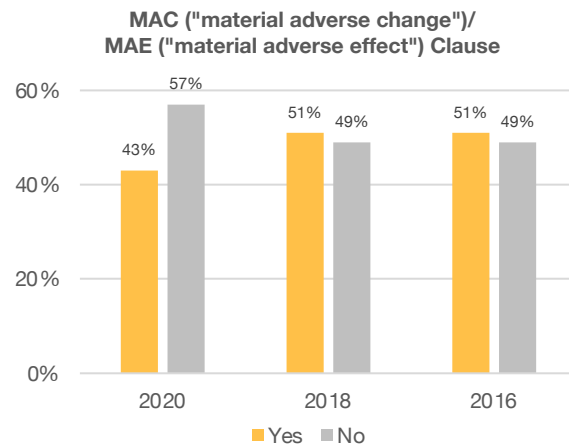
Closing



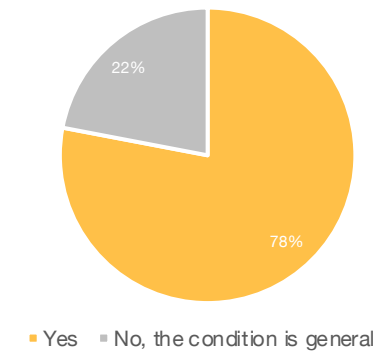
Similarly to previous studies, in most transactions closing is subject to accuracy of representations.

Unlike in 2018 study, the opportunity of relying on the accuracy of representation was divided almost equally between Buyer and Seller as it was the case in 2016 study.

MAC / MAE Clause



Does the clause include a specific amount?



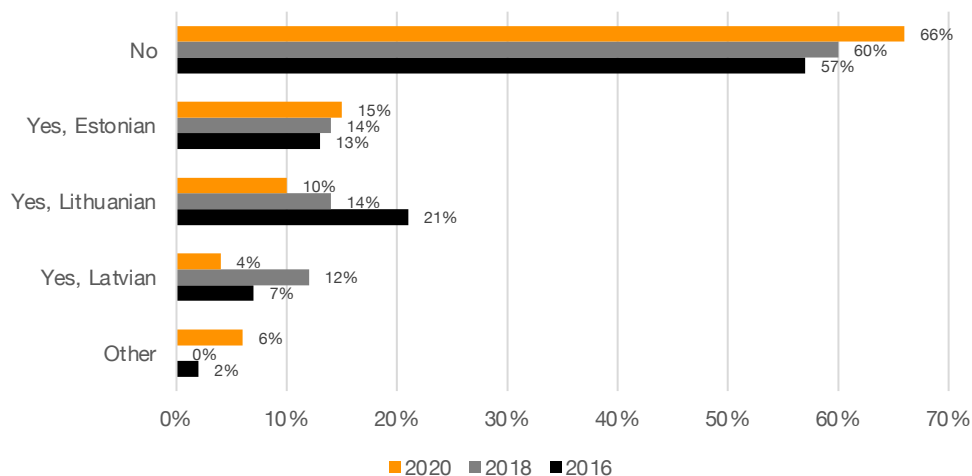
MAC clauses, which make closing conditional upon nothing material changing for the worse were used in less than half of the deals. Compared to previous years, the trend of using the clause is declining.

The buyer continues to be the main party who may invoke the MAC/MAE clause while the seller's right to invoke has constantly been decreasing.

In more than ¾ of the deals, the MAC clause is defined through a specific value threshold.

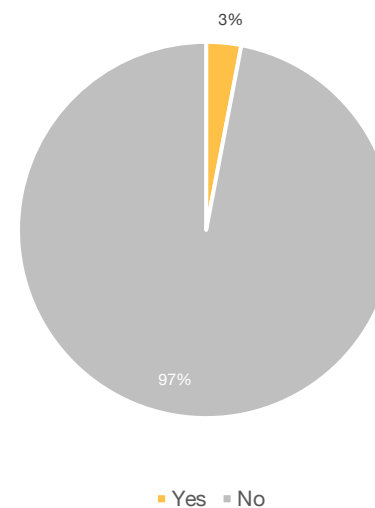
Competition Clearance

Did the transaction require approval by the competition authorities?



The number of deals not requiring approval by the competition authorities have steadily been increasing since 2016, with 2/3 of the deals not needing such approval in 2020 study.

Hell or High Water Clause

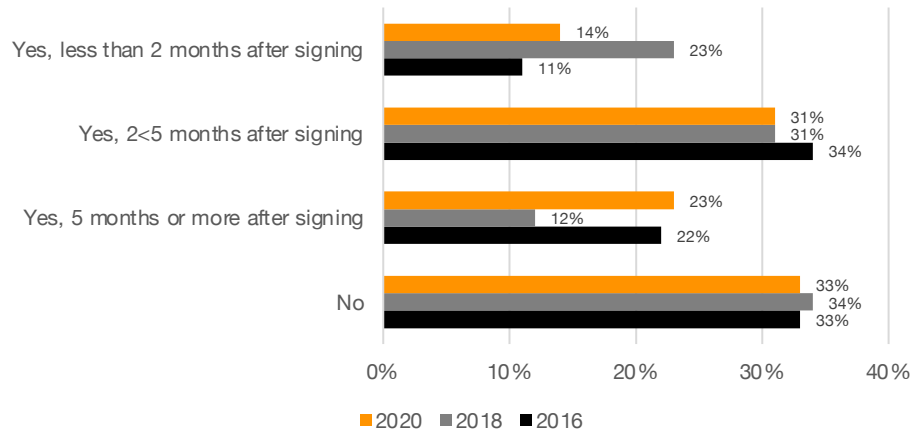


We introduced a new question to the study. Hell or High Water Clause was rarely used in the analysed transactions.

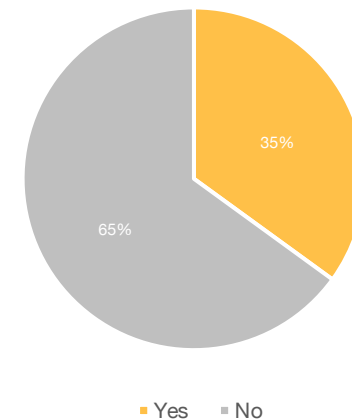
**Hell or High Water Clause - a buyer's commitment to take any and all actions necessary (which may include divestitures and/or an obligation to litigate) to obtain approval from competition authorities*

Long-Stop Date

Was a long-stop date used and, if yes, how long was the period?



Is there break fee or exit penalty?



Use of a long-stop date has remained quite similar across all studies and remain at level of 2/3 of the analysed transactions.

2-5 months continues to be the most popular long stop period.

35% of transactions analysed imposed a break fee or exit penalty (compared to 25% in 2018 and 41% in 2016).

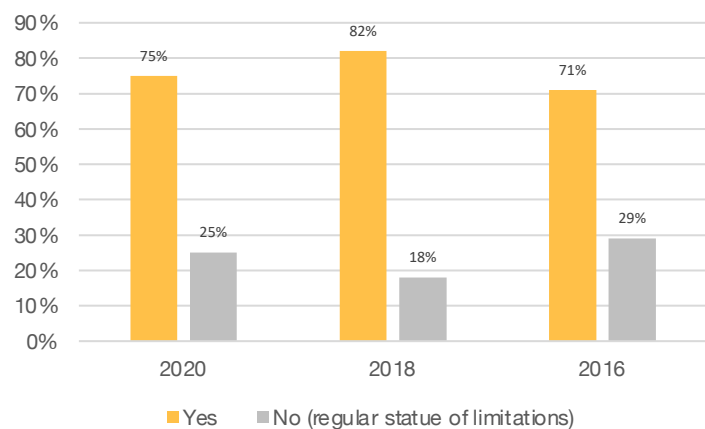
** Long-Stop Date - we refer here to a time limit to fulfil the conditions precedent, if it lapses the parties have no obligation to close or perfect the transaction and they can abandon it (in the jargon “walk” or “walk out”)*



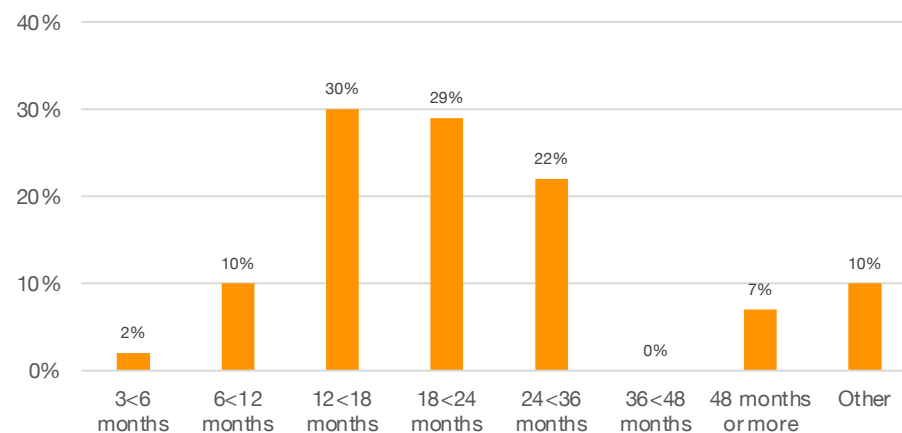
Liability and Indemnification

Survival of Warranties

Limitation period of warranties



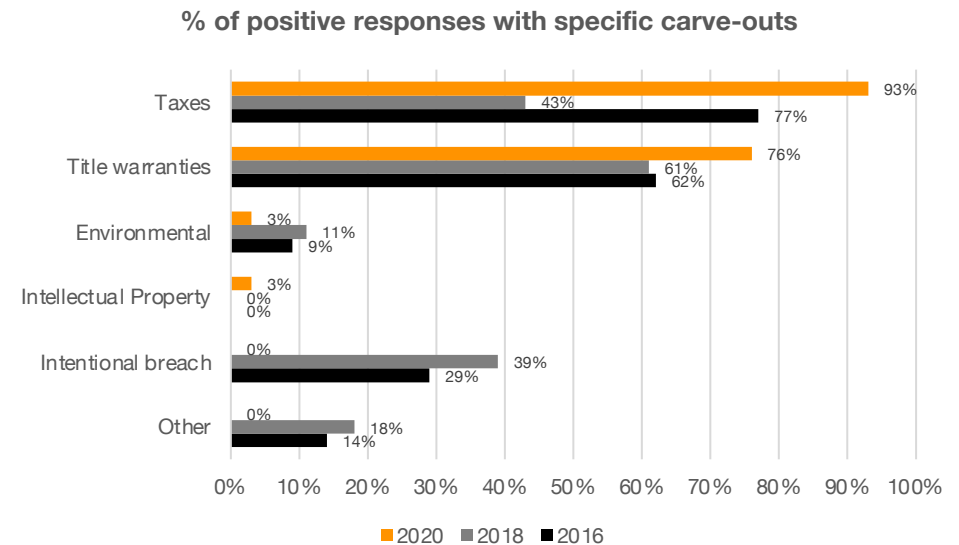
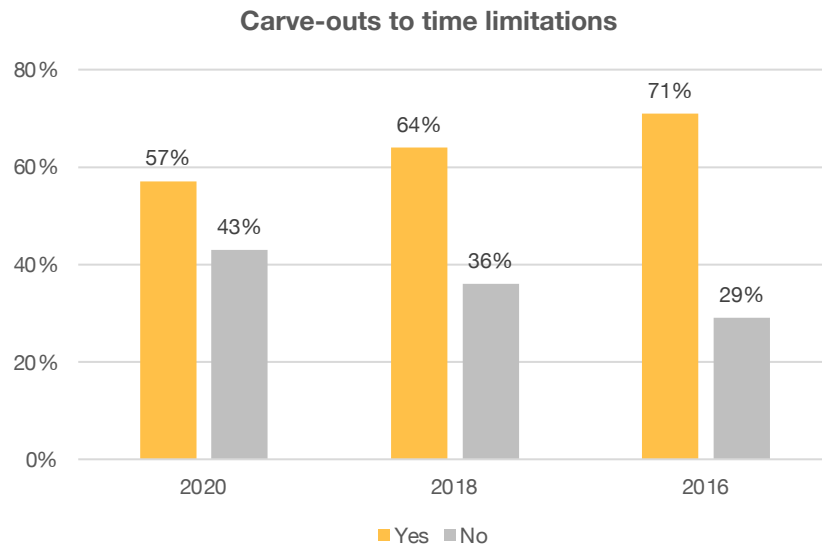
Survival period of warranties



Explicit general limitation periods for warranties were set in $\frac{3}{4}$ of the deals – the number has decreased by 7% compared to 2018 study.

In majority of cases, the limitation period of warranties was between 12-24 months.

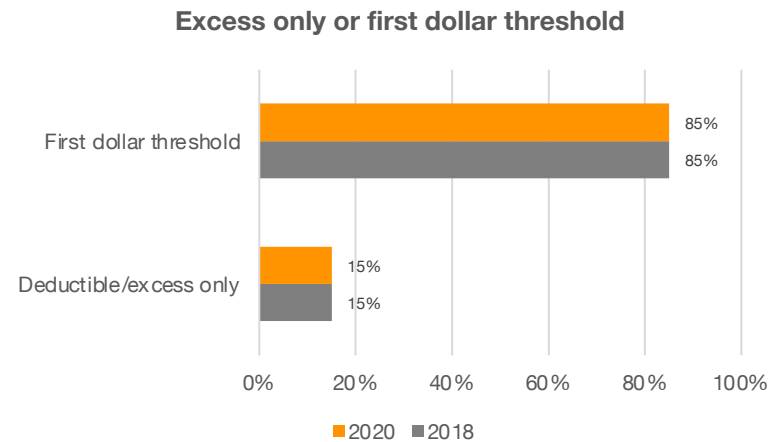
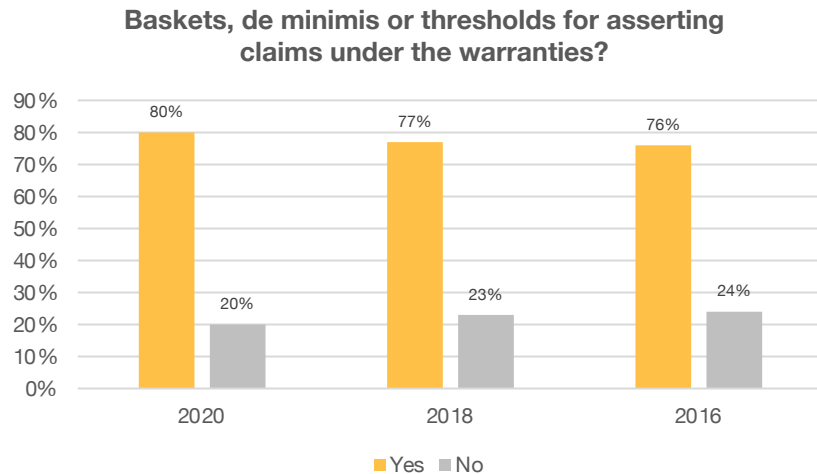
Survival of Warranties Carve-Outs



The use of carve-outs continues to be popular, but their usage has steadily been decreasing since 2016.

Tax and title warranties remain the most common carve-outs.

Baskets and Thresholds

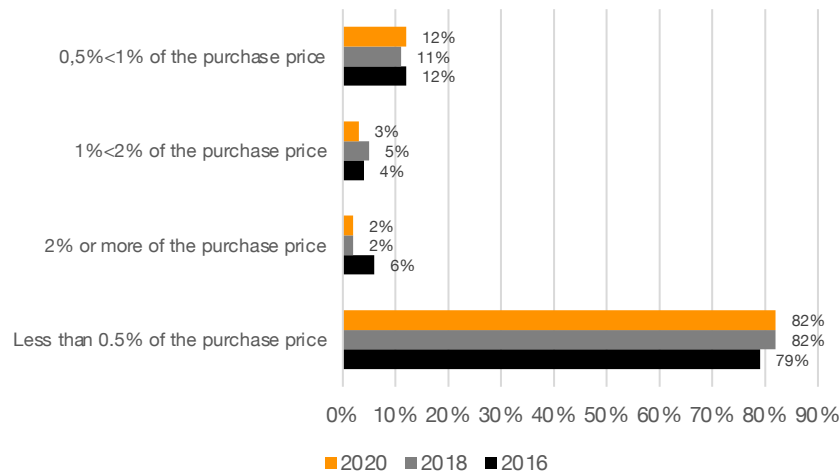


The use of baskets/thresholds continues to be a common practice.

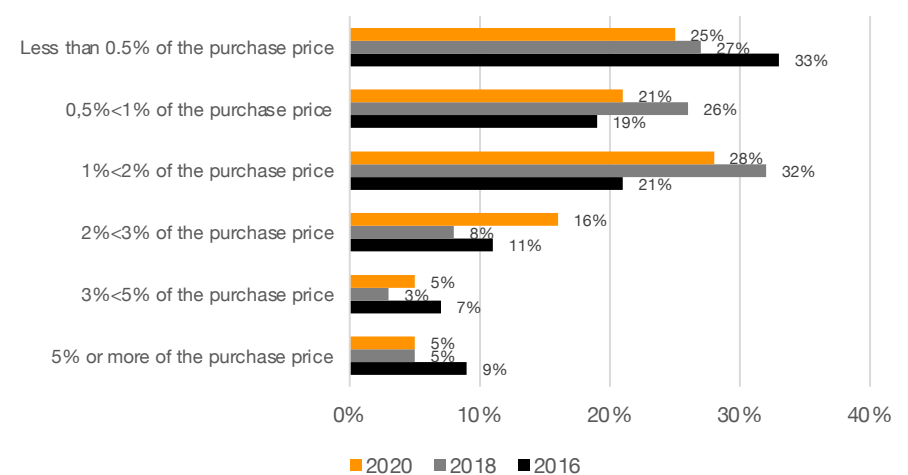
Typically, baskets/thresholds in the Baltics are *first dollar* (not deductible), as has been the case in all previous studies.

Thresholds for claims and baskets

Amount of threshold per claim



Amount of basket/threshold for the aggregate of all claims

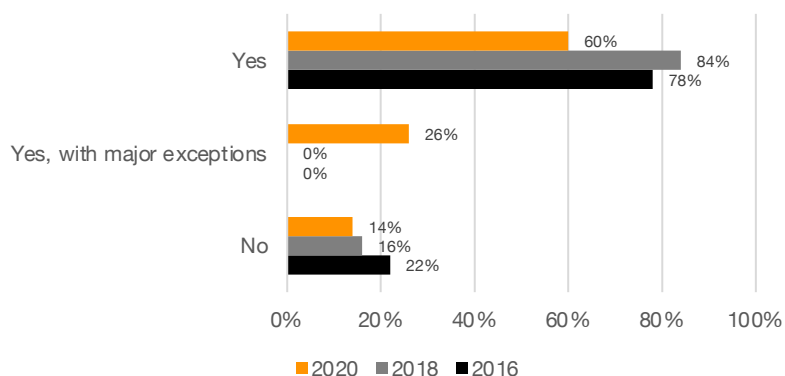


The typical *de minimis* claim threshold continues to be less than 0.5% of the purchase price.

The aggregate claim basket threshold has risen compared to previous studies, whereas the most widely used basket threshold is still 1-2% of the purchase price.

Overall Cap on Liability

Is the Seller's liability for breach of warranties limited to a maximum total amount?

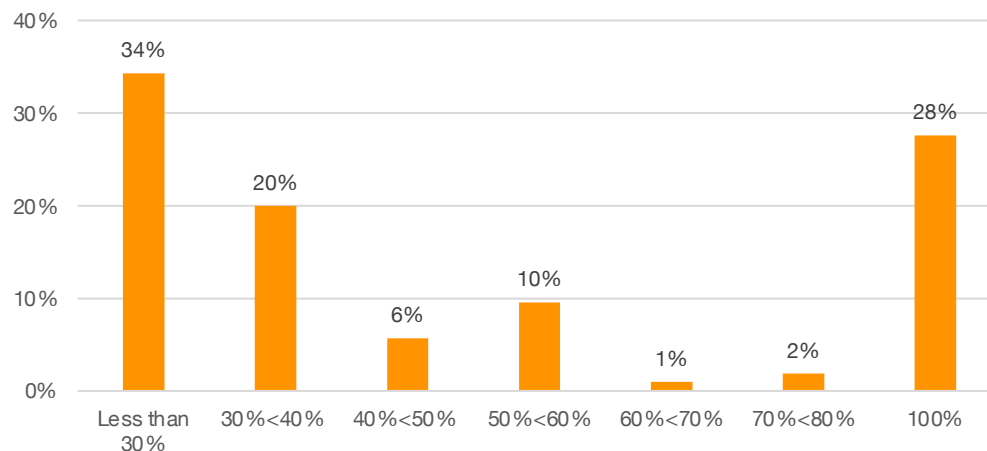


In 2020, we introduced the option "yes, with major exceptions" in addition to the previously introduced options "yes" and "no".

Consequently, the liability is not limited as regards to fundamental warranties or intentional breaches.

Nevertheless, the proportion of transactions with an overall cap on the Seller's liability continues to increase.

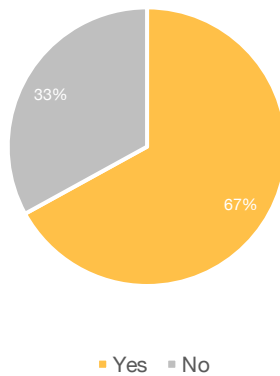
Liability cap as percentage of the purchase price



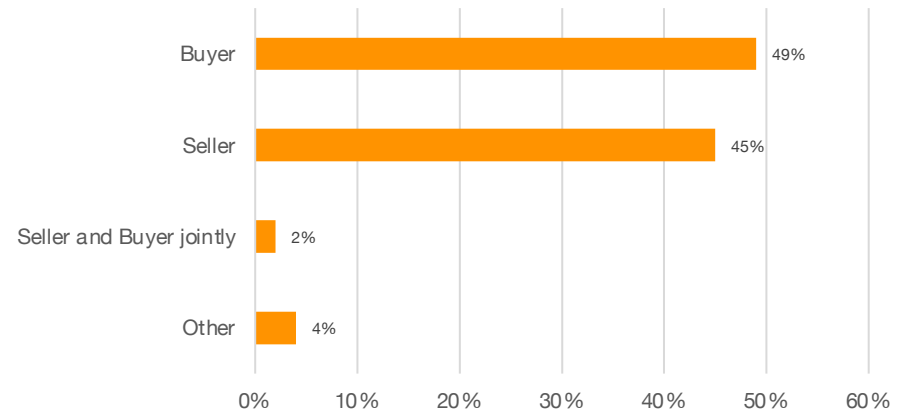
Due to a change in the scales in 2020 the data cannot be compared to the previous studies. Nevertheless, caps set below 30% and at 100% of the purchase price remain most common.

Third Party Claims

Does the agreement set out Third Party Claims regulation?



If yes, who is controlling the dispute?



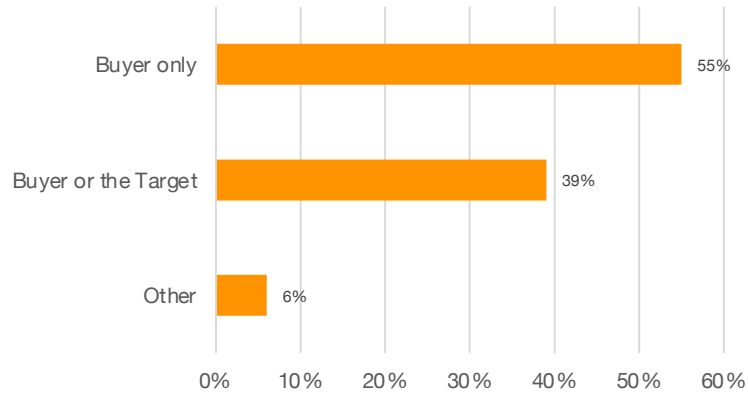
We introduced new topic to this year's study – Third Party Claims.

In two thirds of cases, the agreement provided regulation on Third Party Claims.

Control over dispute management was divided almost equally between Buyer and Seller.

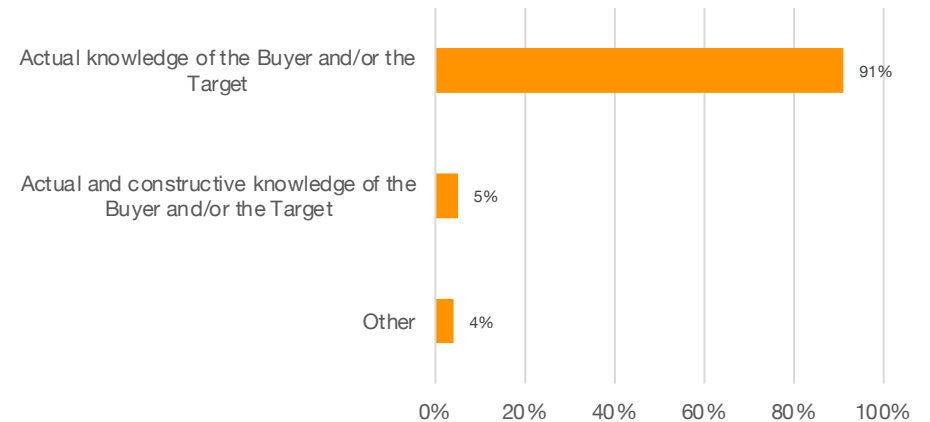
Third Party Claims

Notifying the Seller is linked to the knowledge of...



In majority of cases, notifying the Seller about Third Party Claim is linked to the knowledge of the Buyer.

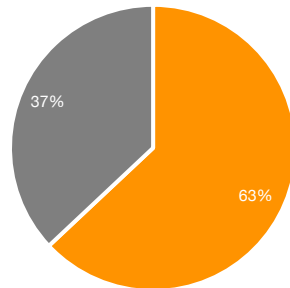
Knowledge standard of notifying the Seller



Actual knowledge of the Buyer and/or the Target is by far the most common knowledge standard of notifying the Seller.

Third Party Claims

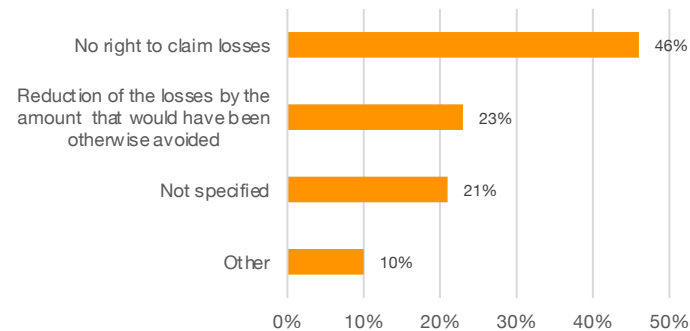
Notifying the Seller is linked to which circumstances?



- Third Party Claim
- Third Party Claim or circumstances which are likely to give rise to a third party claim

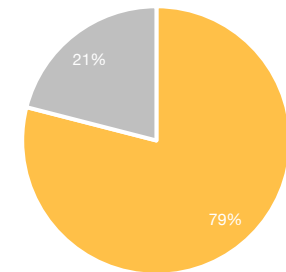
In general, the Seller must be notified when a Third Party Claim has been submitted.

Breach of the Third Party Claim regulation leads to



In almost half of the cases, breach of the Third Party Claim led to no right to claim losses.

Regulation applies irrespective whether it is detrimental to the business of the Target?

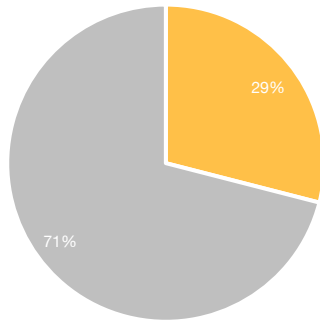


- Yes
- No

In vast majority of cases, the third party regulation applies irrespective whether it is detrimental to the business of the Target.

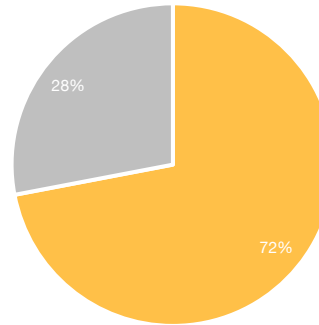
Liability and Indemnification

Does the agreement allow to recover loss of profit?



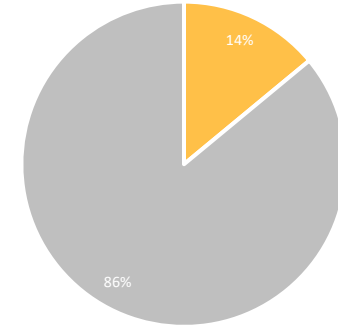
■ Yes ■ No

Does the loss of profit cover all breaches?



■ Yes ■ No

Does the agreement allow to calculate loss based on multiples?



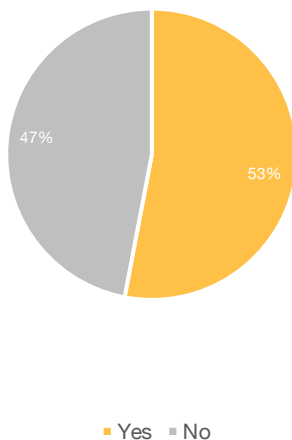
■ Yes ■ No

We introduced new questions to the study on loss of profit. In vast majority of cases, the agreement does not allow to recover loss of profit. However, if loss of profit can be claimed, it usually covers all breaches.

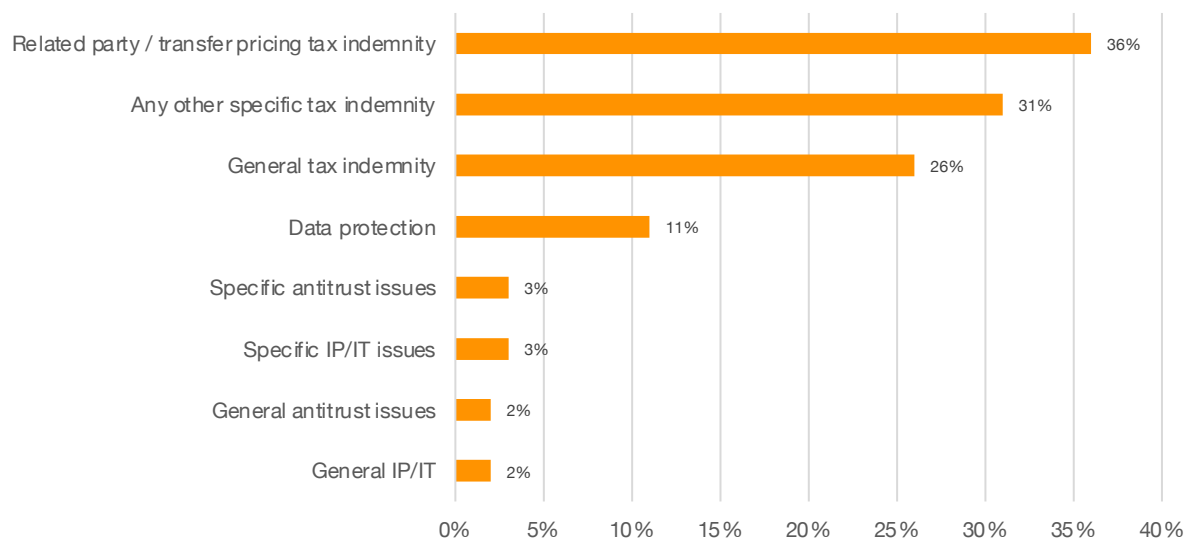
In general, calculating loss based on multiples is not allowed.

Specific Indemnities

Specific indemnities



Specific indemnities used

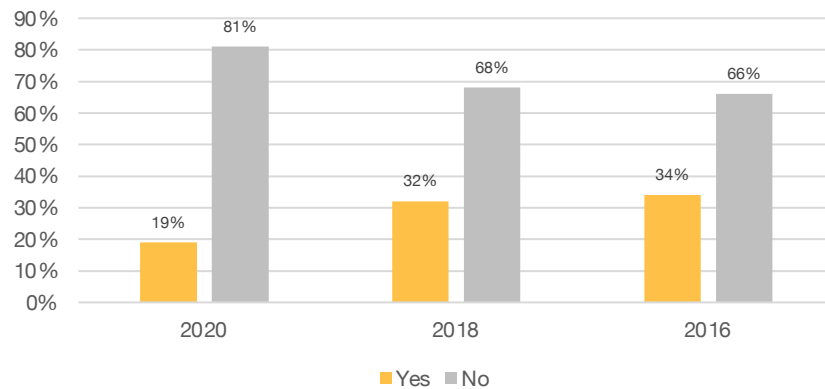


We introduced new topic to this year's study – Specific Indemnities.

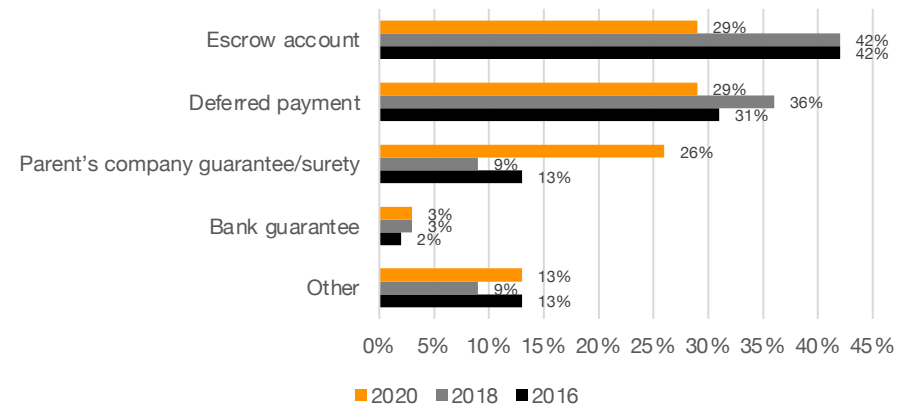
Approximately in half of the cases, the agreement provided for specific indemnities. Tax indemnity is by far the most commonly requested indemnity.

Security for Seller's Obligations

Existence of security for Seller's obligations



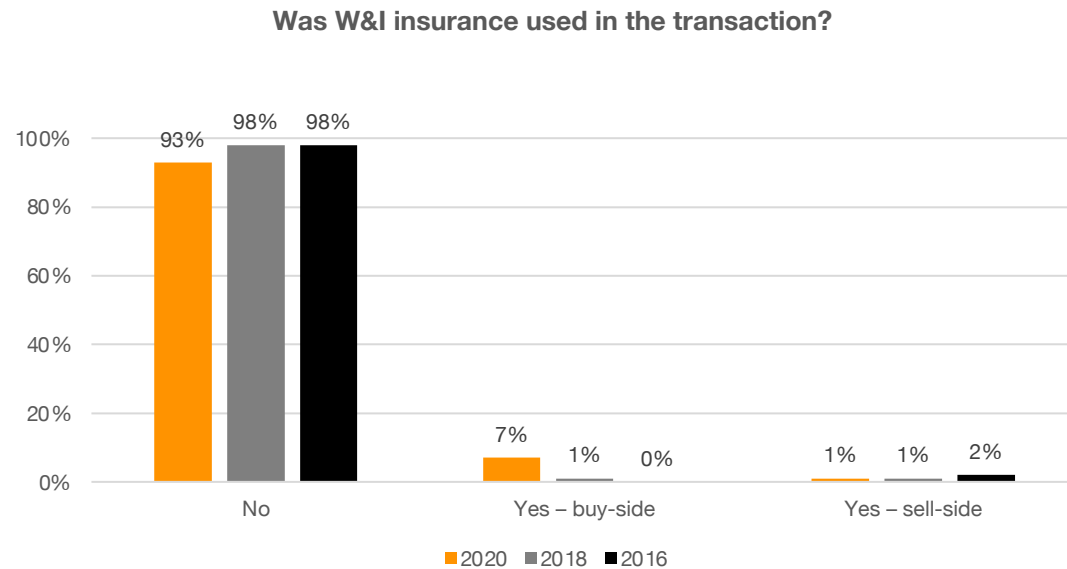
Form of security of Seller's obligations



Providing a security for seller's obligations has considerably decreased compared to the previous studies.

Usage of escrow account and deferred payment still remain as the most common forms of security. Meanwhile the usage of parent guarantee has increased significantly.

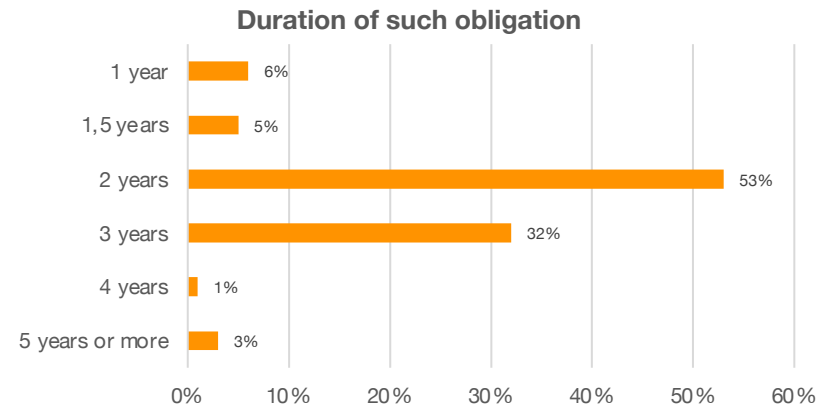
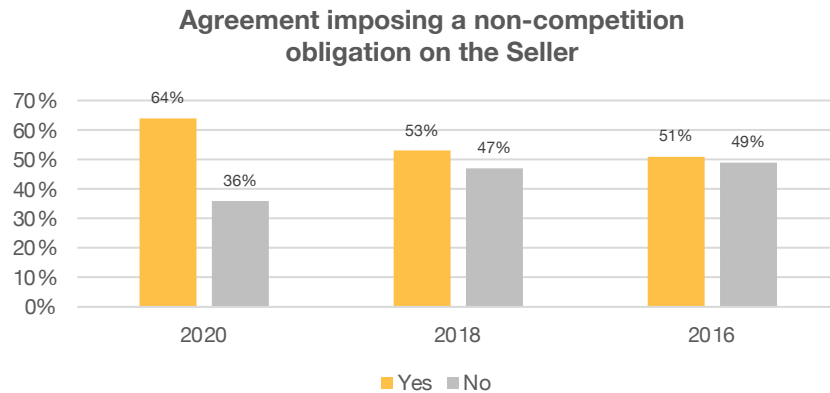
Warranty & Indemnity Insurance (“W&I Insurance”)



The usage of W&I insurance remains rather uncommon in Baltic countries, however, there was a 5% increase in this year's study.

Covenants

Seller's Non-Competition Obligation

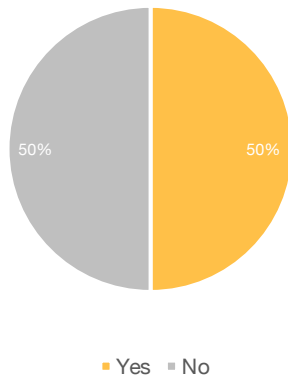


Inclusion of a non-competition obligation of the Seller in the agreement has considerably increased compared to the previous studies.

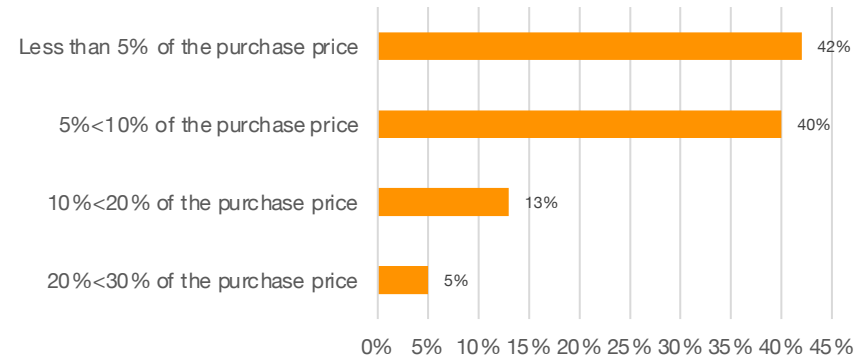
In more than half of the cases, the 2-year covenant is used, and in approximately 1/3 of cases, 3-year covenant is used.

Seller's Non-Competition Obligation

Penalty for non-competition breach



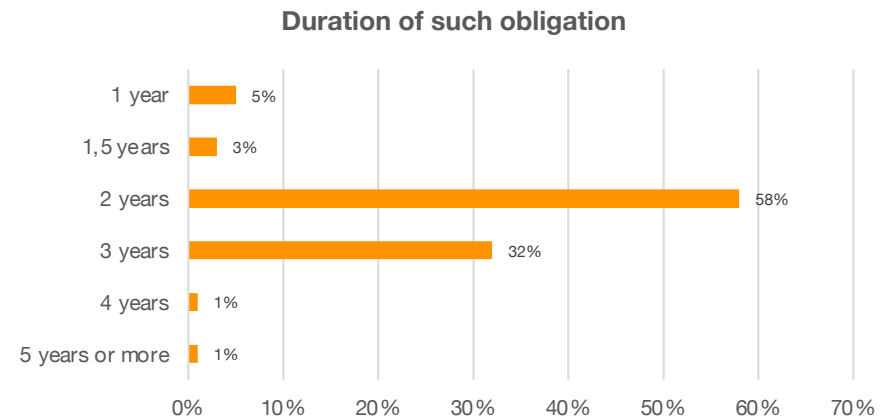
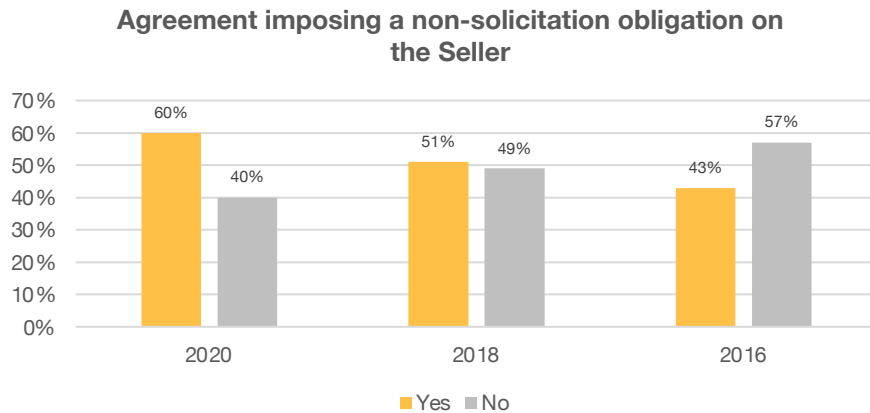
Amount of penalty for breach of non-competition obligation



We introduced new questions to this year's study and asked whether there was a penalty included for breach of obligation and, if yes, what was the amount of such penalty.

In half of the cases, penalty was included and if included, the amount of penalty was predominantly less than 10% of the purchase price.

Agreement imposing a non-solicitation obligation on the Seller

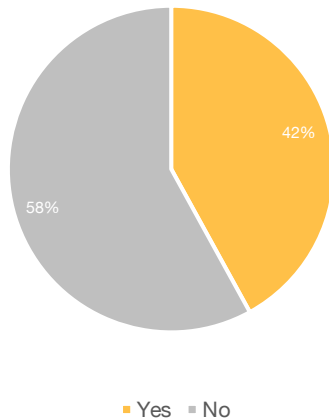


Similarly to the non-competition obligation, the usage of a non-solicitation covenant has steadily been increasing since 2016 study.

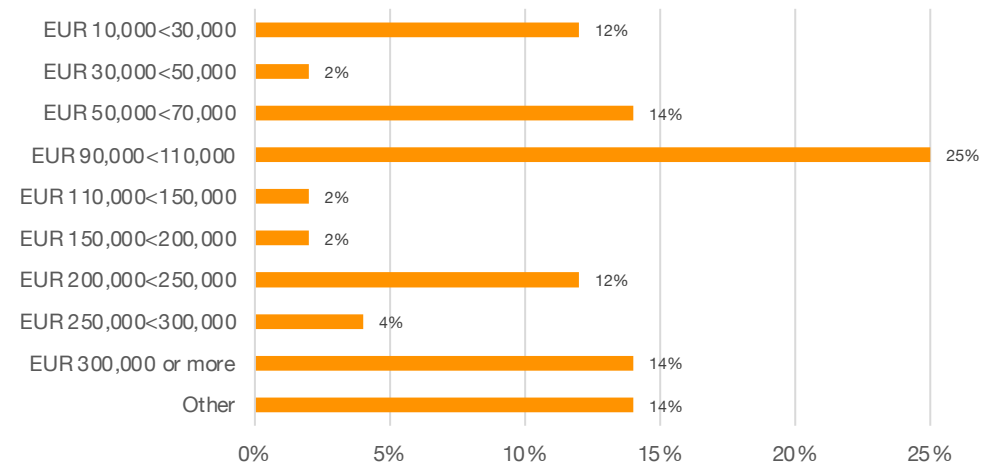
Likewise, in more than half of the cases, the 2-year covenant is used, and in approximately 1/3 of cases, 3-year covenant is used.

Seller's Non-Solicitation Obligation

Penalty for non-solicitation breach



Amount of penalty for breach of non-solicitation obligation

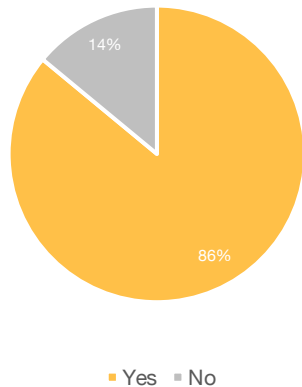


We introduced new questions to this year's study and asked whether there was a penalty included for breach of non-solicitation obligation and, if yes, what was the amount of such penalty.

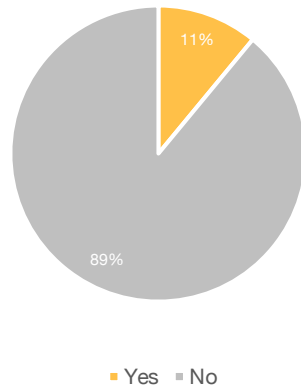
In almost half of the cases, a penalty was included.

Seller's Confidentiality Obligation

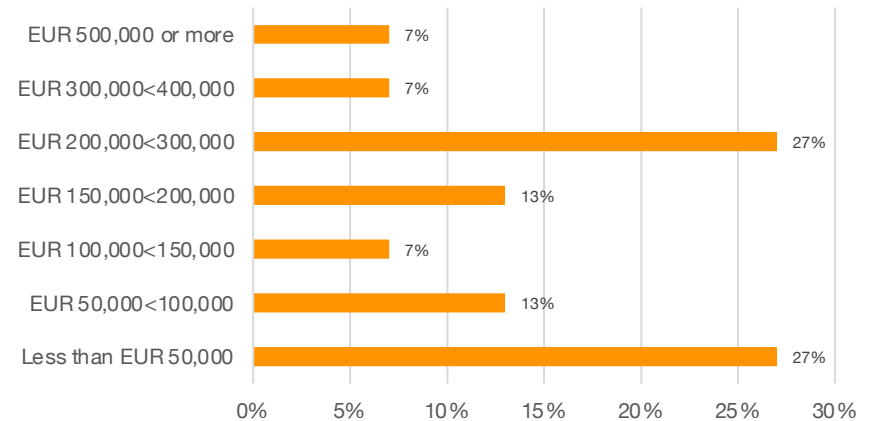
Agreement imposing a confidentiality obligation on the Seller to keep information regarding Target confidential after Closing



Penalty for breach of confidentiality



Amount of penalty for breach of confidentiality obligation (if included)



We introduced new questions regarding the confidentiality obligation of the Seller.

In vast majority of cases, the agreement imposed a confidentiality obligation on the Seller.

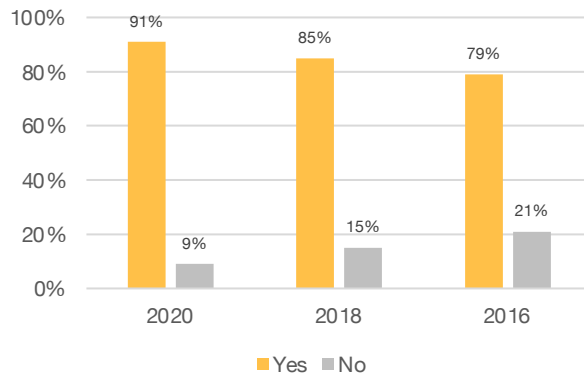
In only 11% of cases, a penalty was included for breach of the confidentiality obligation.

An abstract geometric pattern composed of numerous black and white lines that intersect to form a large, central diamond shape. The lines vary in thickness and orientation, creating a complex, woven texture. The pattern is set against a solid black background on the left and a white background on the right.

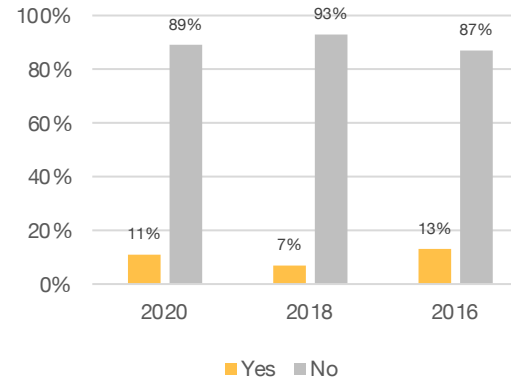
Due Diligence

Due diligence

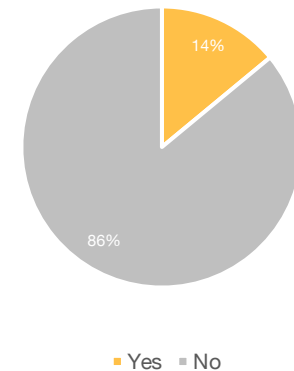
Was the due diligence conducted by the Buyer?



Was a vendor's due diligence conducted?



Usage of Clean Team arrangement



In line with previous studies, buyers conducted due diligence exercises in vast majority of the cases. The trend of conducting a buyer's due diligence has increased steadily over the studies.

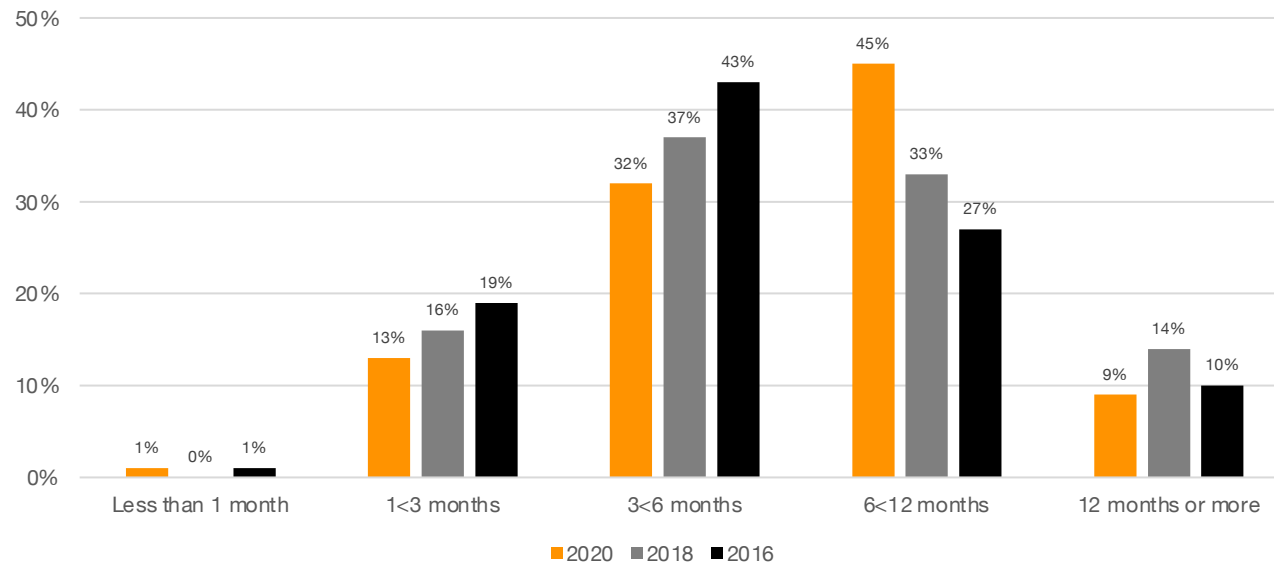
While buyers routinely carry out a target due diligence, vendor's due diligence is still quite rare in the Baltic countries.

Clean Team arrangement is still rarely used in the transactions.



Duration of Transaction Process and Letters of Intent

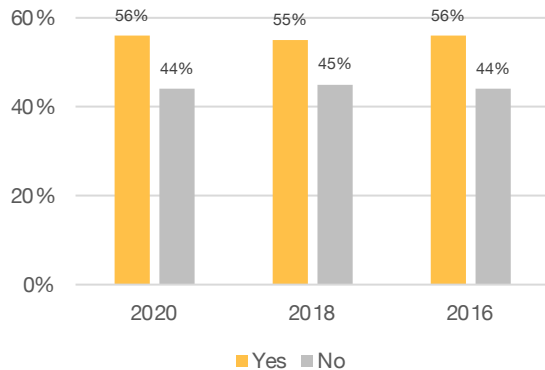
Duration of the Transaction Process



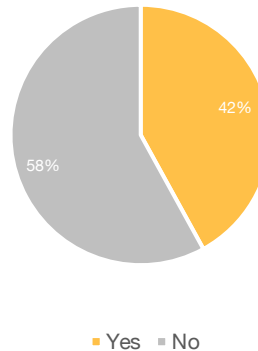
As in previous studies, the vast majority (77%) of transactions take between 3 and 12 months from letter of intent or start of due diligence to closing.

Use of Letters of Intent

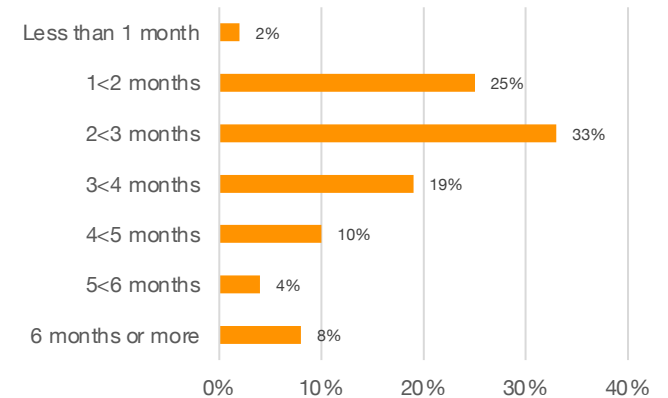
Were the initial negotiations formalised by signing a letter of intent, term sheet or similar?



Does the letter of intent provide for the exclusivity?



Period of exclusivity



Similar to previous studies, more than half of transactions in the Baltics were formalised in the negotiations stage by a letter of intent, term sheet or similar.

In nearly half of the cases (42%), exclusivity was provided.

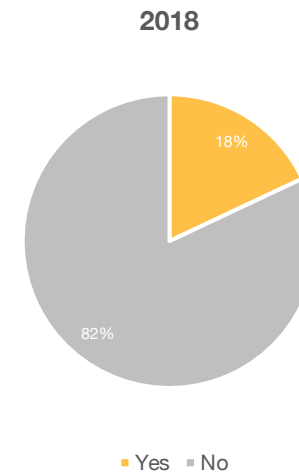
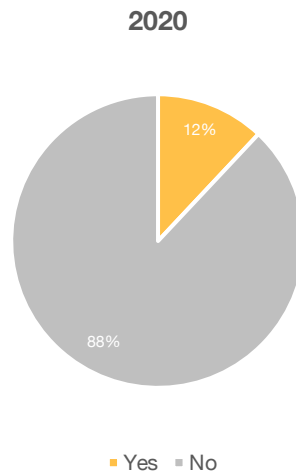
In 3/4 of the cases where exclusivity was provided, the period was between 1 and 4 months.



Financing

Financing

Was the transaction related to financing or refinancing of the business?



Compared to 2018, the % of transactions which are related to financing of the business has decreased by 6%.

Final Remarks

The survey analysed 122 private M&A transactions completed during the period January 2018 – March 2020. During the period, Baltic M&A market was very active and the survey period ends exactly at the first Covid-19 lockdown. It would be interesting to see in next surveys, whether the pandemic brought any material changes to the market practices.

In 2018-2020, the most active economic sectors in the Baltic M&A market were Services, Retail/Wholesale, Manufacturing and Construction & Real Estate. The share of M&A transactions in Technology sector dropped significantly.

Compared to previous periods, there are no major changes as to whether foreign or local shareholders are selling businesses in the Baltics. However, the share of pan-Baltic targets has decreased.

Although transaction values vary greatly, the value of most typical Baltic M&A transaction remains in the EUR 1-10 million bracket.

In this 2020 study, we introduced a number of new questions in order to expand the interesting data. It can be generalised that Baltic M&A counterparties are becoming more sophisticated in the use of internationally acknowledged transaction tools, such as price adjustments, MAC clauses, liability limitations (warranty limitation periods, overall caps, claim baskets and thresholds). However, R&W insurance is still very seldom used in Baltic M&A transactions.



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