

A photograph showing several business professionals in light-colored suits. One person is holding a black folder, another is holding a white document, and they appear to be in a meeting or discussion. The background is slightly blurred, focusing on the hands and documents.

# Identifying Trends in B2B Services M&A

## A Study of the Principal Deal Points in the Lower and Middle Market

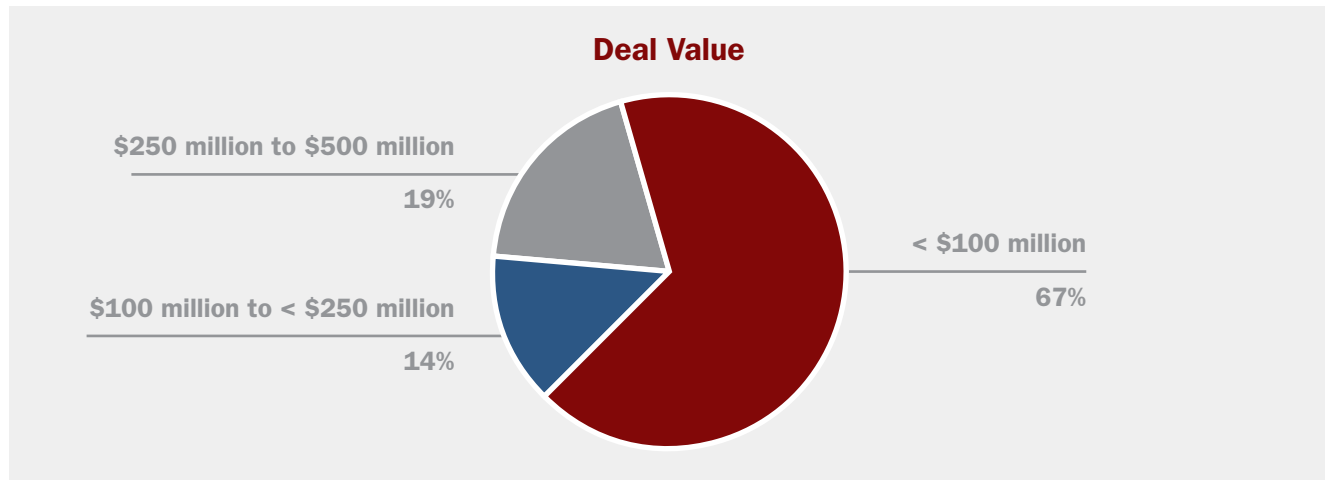
M&A activity in the wide-reaching business-to-business (B2B) services sector (including information, marketing, training and advisory services) has been consistently strong for almost a decade, particularly deals targeting private companies in the lower and middle market, with Seward & Kissel taking an active role in many of these transactions on behalf of its clients.

Despite the high volume of deals in this sector, there has been little in the way of published information relating to key business terms. As such, Seward & Kissel recently undertook a comprehensive study of relevant publicly available or otherwise accessible acquisition agreements involving lower and middle market transactions (i.e., with a purchase price below \$500 million) in the B2B space from 2016 to 2019, including transactions that Seward & Kissel worked on. Our process involved identifying all small and mid-cap public companies traded on Nasdaq, NYSE or LSE that are in the B2B sector and reviewing all applicable acquisition agreements during the relevant period that are available on Edgar, Lexis Securities Mosaic or through other similar sources. Based on this information, we believe that the data we compiled is large enough to extract a representative sample of important data points relevant to lower and middle market B2B services M&A.

The results of our study reveal that acquisition agreements in the B2B services sector continue to reflect seller-friendly terms driven by a combination of market dynamics and the growing use of representations and warranties (R&W) insurance, but there appear to be exceptions depending on the size and structure of the transaction. Our key findings include the following:

## Deal Size

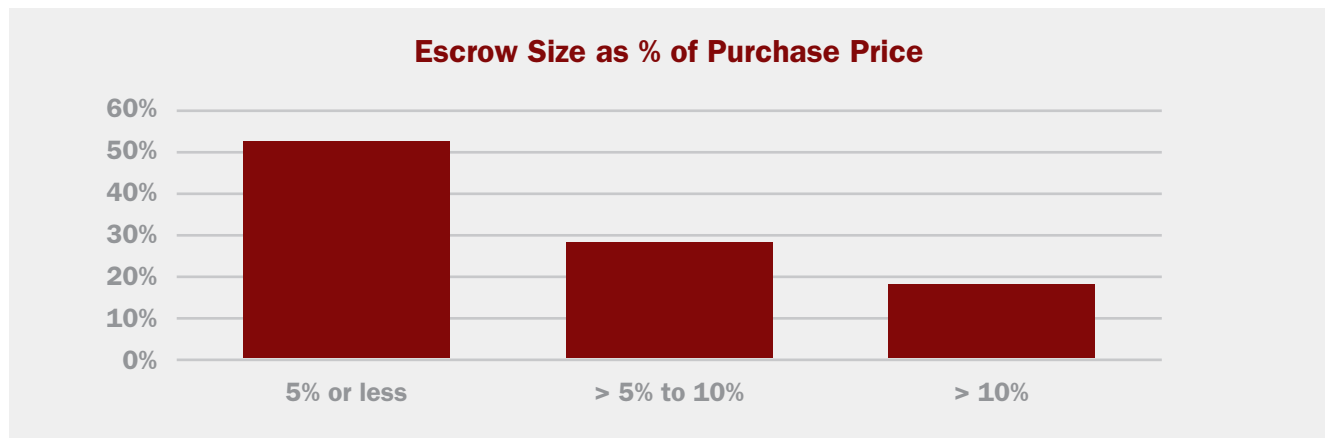
Average deal size was approximately \$115 million, with purchase prices ranging from \$16 million to \$470 million. Sub-\$100 million deals made up a comfortable majority of these transactions, indicating lower and middle market M&A activity in this sector is being fueled by “smaller” deals.



## Escrows and Holdbacks

Approximately 52% of all deals included an escrow or holdback, where a portion of the purchase price is placed in a third-party escrow account or simply retained by the buyer to serve as security in the event of an indemnification claim against the sellers. However, this percentage rose to approximately 71% for all deals below \$100 million, perhaps reflecting not as much risk tolerance on the part of buyers or less creditworthiness of sellers in lower middle market deals.

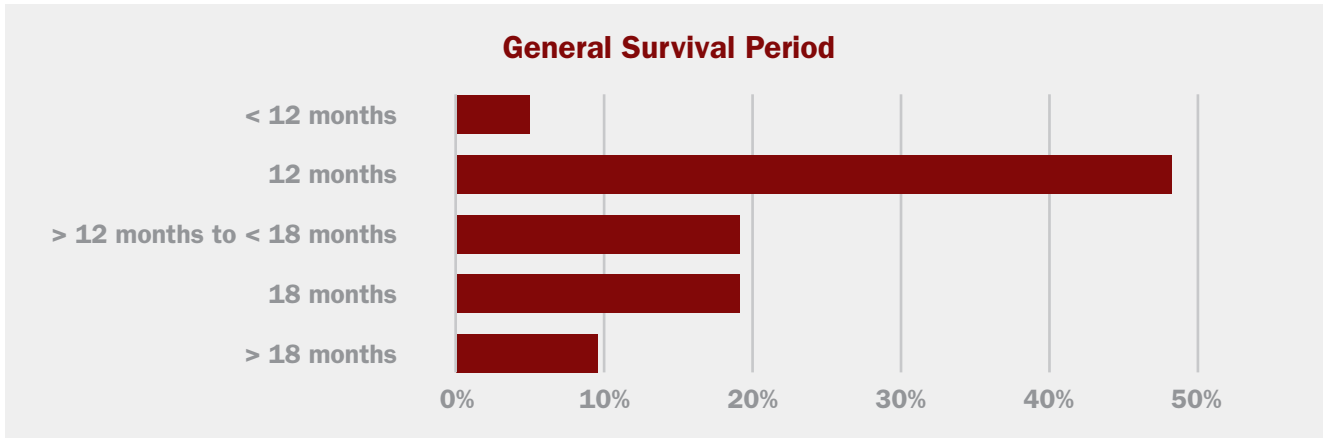
The average escrow or holdback as a percentage of purchase price was approximately 5.0%, with most escrows and holdbacks falling below that percentage, reflecting a continued downward trend.



Interestingly, approximately 21% of sub-\$100 million deals also contained an escrow or holdback to secure post-closing working capital adjustment payments that may come due from sellers.

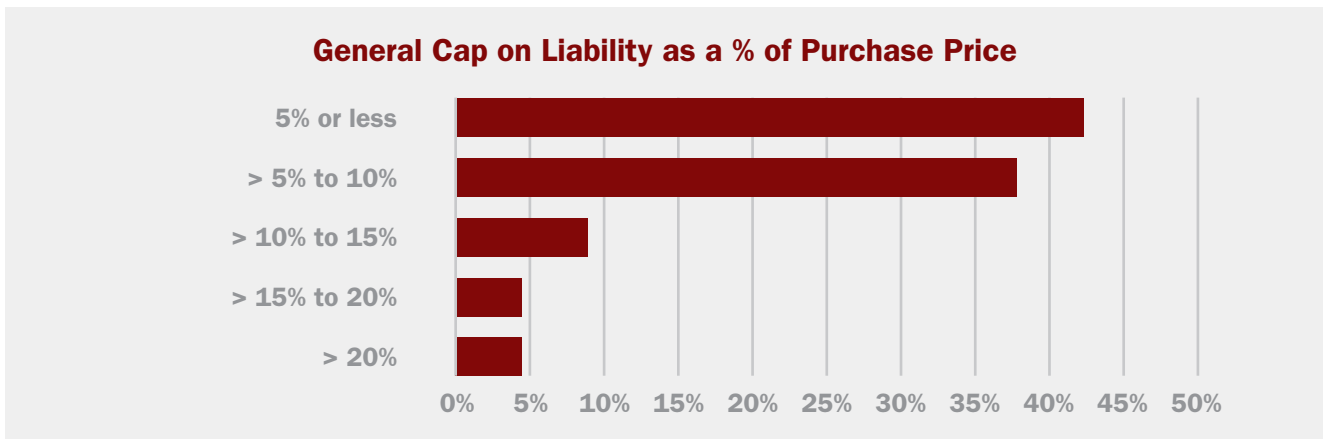
**Survival of Representations and Warranties**

The average time period after closing during which a buyer may make an indemnification claim against a seller for a breach of its non-fundamental representations and warranties was approximately 15 months across all deals, with most such survival periods being exactly 12 months in duration.



**Cap on Seller Liability**

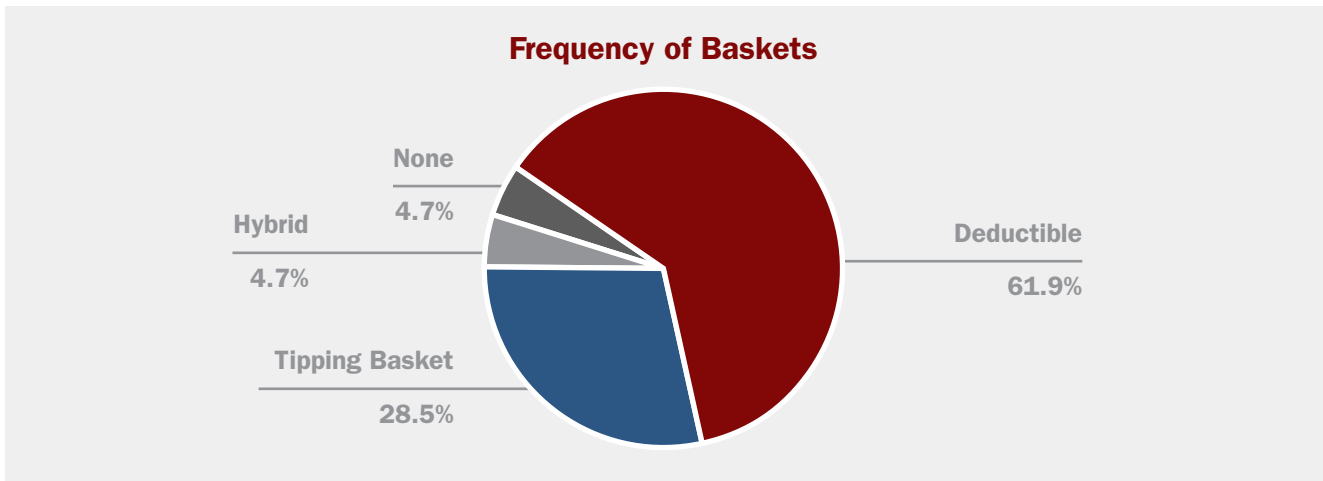
The average cap on a seller’s liability for breaches of its non-fundamental representations and warranties was approximately 6.5% of the purchase price, increasing slightly to approximately 7.0% for sub-\$100 million transactions (again reflecting slightly less risk tolerance or perhaps greater bargaining power on the part of buyers in lower middle market deals, but still seller-friendly nonetheless). In many instances, the escrow or holdback equaled the amount of this cap.



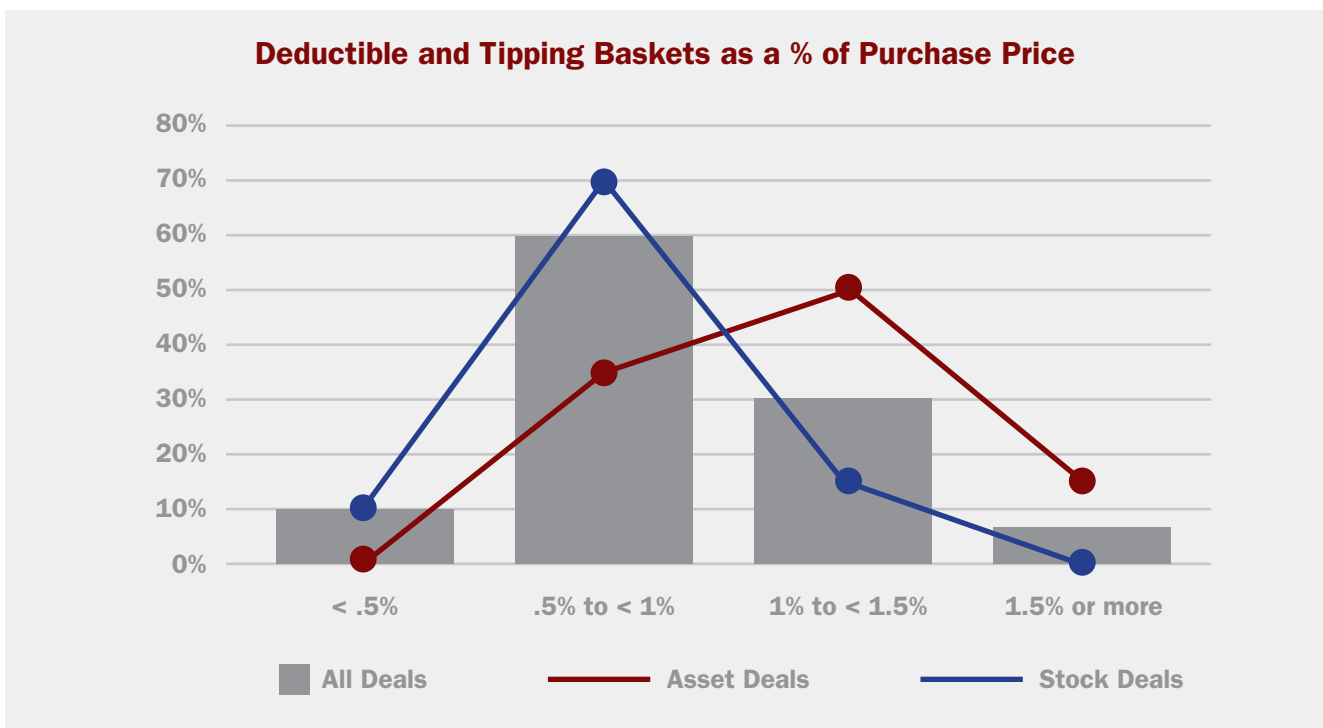
Notably, over 80% of deals also included some form of overall cap on a seller’s liability arising from the transaction equal to the purchase price.

**Indemnification Baskets**

Over 95% of deals included an indemnification basket, which is a threshold amount of losses that a buyer must incur before it is entitled to any indemnification from the seller. Of those, approximately 30% were “tipping” baskets (meaning if losses exceeded the basket amount, the buyer would be entitled to indemnity for all losses from the first dollar) and approximately 65% operated as a true deductible (meaning the buyer would be entitled to indemnity only with respect to losses exceeding the basket amount), continuing a seller-friendly trend that has been spurred in part by the increased use of R&W insurance. These percentages were generally consistent across deal sizes. A small percentage of baskets were hybrid in nature (i.e., a combination of a deductible and tipping basket).



As a percentage of purchase price, the average deductible basket was approximately 0.75%, while the average tipping basket was approximately 0.88%. However, there was a notable difference between asset and stock acquisitions. In asset acquisitions, the average deductible basket and tipping basket as a percentage of purchase price rose to approximately 0.93% and 0.98%, respectively. Conversely, in stock acquisitions the average deductible basket and tipping basket fell to approximately 0.57% and 0.78%, respectively.



Furthermore, in sub-\$100 million deals, we generally observed a drop in average basket size of approximately 0.09%.

The foregoing may reflect that buyers ascribe more risk to stock deals (since buyers generally cannot exclude pre-closing liabilities as they would in an asset deal) and have less risk tolerance (or perhaps greater bargaining power) in lower middle market deals.

### Other notable findings include:

#### De Minimis Claims

A little over 50% of deals included a de minimis threshold, an amount of losses per claim below which any claims up to that amount are completely disregarded and do not count towards the indemnification basket. De minimis thresholds are widely used in the UK and Europe, but historically have not been as prevalent in US M&A deals. Their seemingly increased use in B2B services deals may be a function of a larger number of UK and European-based participants in this sector, or simply another reflection of an increasingly seller-friendly M&A environment.

#### Break-Up Fees

Over 20% of deals contained some form of break-up fee payable by the buyer or seller upon termination, although such provisions were more prevalent in deals above \$100 million.

#### Earnouts

Only a little over 14% of deals contained some form of earnout payment (i.e., consideration contingent on the target business achieving certain milestones), which is not surprising in a seller-friendly market.

#### R&W Insurance

Over 40% of deals utilized R&W insurance. While the use of R&W insurance by private equity buyers has become quite commonplace, the same cannot be said for strategic buyers, which may be one reason why this percentage is not higher.

It is clear that M&A deal terms in the B2B services sector, much like in other industries, have been trending in a pro-seller manner. However, depending on the risk profile of the transaction, there appear to be circumstances where buyers have been able to negotiate terms that are more buyer-friendly.

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For more information about this study, or B2B services transactions generally, please contact your relationship attorney at Seward & Kissel or Nick Katsanos at [katsanos@sewkis.com](mailto:katsanos@sewkis.com).

## SEWARD & KISSEL LLP

New York  
One Battery Park Plaza  
New York, NY 10004  
+1-212-574-1200

Washington, D.C.  
901 K Street, NW  
Washington, D.C. 20001  
+1-202-737-8833

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