



September 2020

2020 Buy-Side Representations and Warranties Insurance (RWI) Deal Terms Update

An analysis of deal terms in private-target M&A transactions
that closed between January 1, 2018–June 30, 2020

Please direct inquiries to: insurance@srsacquiom.com

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Table of Contents

| | |
|---|-----------|
| About this Update and the Data | 4 |
| About Buyer Power Ratio | 6 |
| Market Insights Key and Findings | 7 |
| Deal Characteristics | 11 |
| Buyer Power Ratio | 12 |
| Transaction Size | 13 |
| Prevalence of Buy-Side RWI Across Industries | 14 |
| Financial Terms & Provisions | 15 |
| RWI Effects: Escrow Size | 16 |
| Purchase Price Adjustment ("PPA") | 17 |
| Reps & Warranties and Qualifiers | 18 |
| "10b-5" and "Full Disclosure" Representations | 19 |
| "Non-Reliance" and "No Other Representations" | 20 |
| Sandbagging | 21 |
| Materiality Scrape | 22 |
| Sellers Duty to Notify Buyer of Pre-Closing Breaches of Reps and Warranties | 23 |
| Loss Mitigation and Setoffs | 24 |
| Buyer Obligation to Mitigate Losses | 25 |
| Baskets | 26 |
| More About SRS Acquiom | 28 |
| Contact Information | 32 |

Our role at SRS Acquiom as a transactional insurance broker and a provider of escrow, paying agent and shareholder representation services gives us a unique view of the M&A market.

The 2020 Buy-Side Representations and Warranties Insurance (RWI) Deal Terms

Update is powered by SRS Acquiom MarketStandard®, a proprietary database of more than 2,500 private-target M&A deals. This update analyzes 681 private-target acquisitions (\$132.6 billion) that closed from January 1, 2018, through June 30, 2020, in which SRS Acquiom provided professional and financial services.

The majority of these deals are not required to be publicly reported. Medians are presented in addition to averages to counterbalance the effect of outliers.

About This Study and the Data

A Note on Sample Considerations

Buy-Side RWI coverage first appeared in the U.S. more than 20 years ago, becoming increasingly popular in recent years as more buyers, sellers and M&A advisors became aware of and familiar with it. The 2020 SRS Acquiom Representations and Warranties Insurance Deal Terms Update shows how the presence of a Buy-Side RWI policy relates to key deal terms, aggregated across many deals and discusses how purchase agreements for deals that use Buy-Side RWI differ from purchase agreements for deals that don't use the coverage.

We continue to believe the effects noted in this study are generally underreported, since buyers are not obligated to report to SRS Acquiom that they have purchased RWI coverage, nor do purchase agreements necessarily mention the use of Buy-Side RWI, although it is common for them to do so since the coverage often supplements a sell-side indemnification escrow or sits above an RWI retention escrow. Therefore, the two groups compared are "RWI Identified," where it is definitively known that the buyer has purchased RWI coverage, and "No RWI Identified," where either it is definitively known the buyer has not purchased RWI coverage (rare), or it is unknown as to whether the buyer has purchased RWI coverage (most common).

COVID-19 Impact

We also recognize that M&A deal terms, including indemnification provisions, have been and may continue to be impacted by the COVID-19 global pandemic. This update is a snapshot of deal terms for transactions that closed during the period starting January 1, 2018, and ending June 30, 2020. We continue to collect deal-data and market information regarding M&A and the use of RWI to be able to analyze it and spot trends that may be emerging as the situation unfolds. A topic we're paying attention to is whether Buy-Side RWI becomes less common or is used differently in a shifting or disrupted M&A market.

Understanding Buyer Power Ratio

One of the filters in SRS Acquiom MarketStandard is the **Buyer Power Ratio**. This metric was developed in conjunction with the American Bar Association Mergers & Acquisitions Committee. Buyer Power Ratio has two components:

1. The **market capitalization** (market cap) of the buyer; and
2. The **purchase price** paid by the buyer in the acquisition (including escrowed amounts, but not including potential earnouts).

The Buyer Power Ratio for a particular acquisition is determined by dividing the buyer's market cap by the applicable purchase price.

$$\text{Buyer Power Ratio} = \frac{\text{Buyer Market Cap}}{\text{Purchase Price}}$$

Buyer Power Ratio generally correlates with the merger parties' relative negotiating strengths and their ability to obtain favorable deal terms.

Of course, Buyer Power Ratio is not the only factor that can affect a party's negotiating leverage. Among the other factors that may come into play: the price the buyer is willing and able to pay, the relative importance of the transaction to the buyer and the seller, and the presence of competing bidders for the target company.

Buyer Power Ratio is only calculated for transactions in which the buyer was publicly traded on a U.S. Stock Exchange on the date of the signing of the acquisition agreement.

Market Insights and Key Findings

Market Insights and Key Findings (1 of 3)

Impacts of COVID-19

The shifting economic landscape and related challenges experienced by companies during 2020 led to increased discussion of using Buy-Side RWI for deals in which the sellers are unwilling or unable to agree to post-closing indemnification obligations. Examples include distressed sales, since all or most of the deal proceeds may be earmarked for third parties or otherwise unavailable for post-closing obligations, and public companies that are selling a division or subsidiary and do not want post-closing obligations.

Across all of these contexts, what tends to hold steady when Buy-Side RWI is in play is that certain deal terms in the purchase agreement tend to be more buyer-favorable or more seller-favorable compared to uninsured deals, with the direction correlating to whether the underlying risk regarding such provision is retained by the sellers or transferred to the insurer. Deal terms that transfer risk to the insurer tend to lean more buyer-favorable. Conversely, using Buy-Side RWI generally leads to a more seller-favorable formulation with respect to deal terms that result in sellers retaining risks.

Effect on Deal Characteristics

Buyer Power Ratio is highly correlated with the decision to use Buy-Side RWI in acquisitions involving publicly traded, strategic buyers (see slides 6 and 12 for definitions). The closer buyer's market cap is to the transaction value, the higher the probability that Buy-Side RWI will be used (slide 13).

Prevalence of RWI has increased across numerous industries, with more deals using RWI where the buyer is in the financial, industrial or information technology space. The life sciences industry continues to see very limited use of RWI.

Market Insights and Key Findings (2 of 3)

Effect on Financial Terms

While having a **separate escrow** for the purchase price adjustment is a key feature of most deals with Buy-Side RWI (78%), over one-third (34%) of deals in the “No RWI Identified” category also used a separate escrow for the adjustment (slide 17).

Effect on Reps and Warranties and Qualifiers

With respect to purchase agreement provisions that RWI insurers often follow, agreement wording tends to be more buyer-favorable in deals with Buy-Side RWI than in deals without Buy-Side RWI. For example, a “double” materiality scrape (i.e., applicable to the determination of both breaches and the damages calculation) is present in 82% of deals with Buy-Side RWI but only 41% of deals without Buy-Side RWI (slide 22). Notably, we have seen a trend in some of these provisions such that non-RWI deal terms have shifted in the direction of those from RWI deals.

Sellers continue to use purchase agreement wording to try to minimize the risks not covered by Buy-Side RWI. For example, deals that use Buy-Side RWI are significantly more likely than other deals to be seller-favorable in these respects:

- 92% of deals with Buy-Side RWI contain neither a **10b-5** nor **full disclosure** representation and warranty, compared with 67% of other deals (slide 19)—having neither of these provisions protects sellers from claims that Buy-Side RWI typically doesn’t cover.
- The combination of “**non-reliance**” and “**no other representations**” wording is more likely to be present for insured deals (78%) than uninsured deals (51%)—these provisions help reduce the chance that a buyer will be able to successfully pursue the sellers for risks not covered by the RWI (slide 20).

Market Insights and Key Findings (3 of 3)

Effect on Baskets and Thresholds

When Buy-Side RWI is present, sellers' indemnification obligations are overwhelmingly likely to be structured as (non-tipping) deductibles instead of first-dollar (tipping) baskets (slide 26). A non-tipping deductible purchase agreement provision mirrors the "split" insurance retention often contemplated by Buy-Side RWI, with the parties sharing the burden of the RWI retention.

Insured deals were less likely to contain eligible claims thresholds (23%) compared to uninsured deals (29%) (slide 27). This differs from what we noted in last year's 2019 Buy-Side RWI Deal Terms Study, when thresholds were more common for insured deals compared to uninsured deals. We considered last year's results somewhat surprising since we viewed thresholds as less relevant for deals where most risk was shifted to an insurer above an aggregate RWI retention. We proposed that it may have demonstrated another example of sellers trying to limit their liability for uninsured risks, i.e., the risk of multiple small-dollar claims that could impact the sellers' portion of the RWI retention without reaching the insured layer—which may be why we still see threshold provisions in almost one-fourth of insured deals.

Deal Characteristics

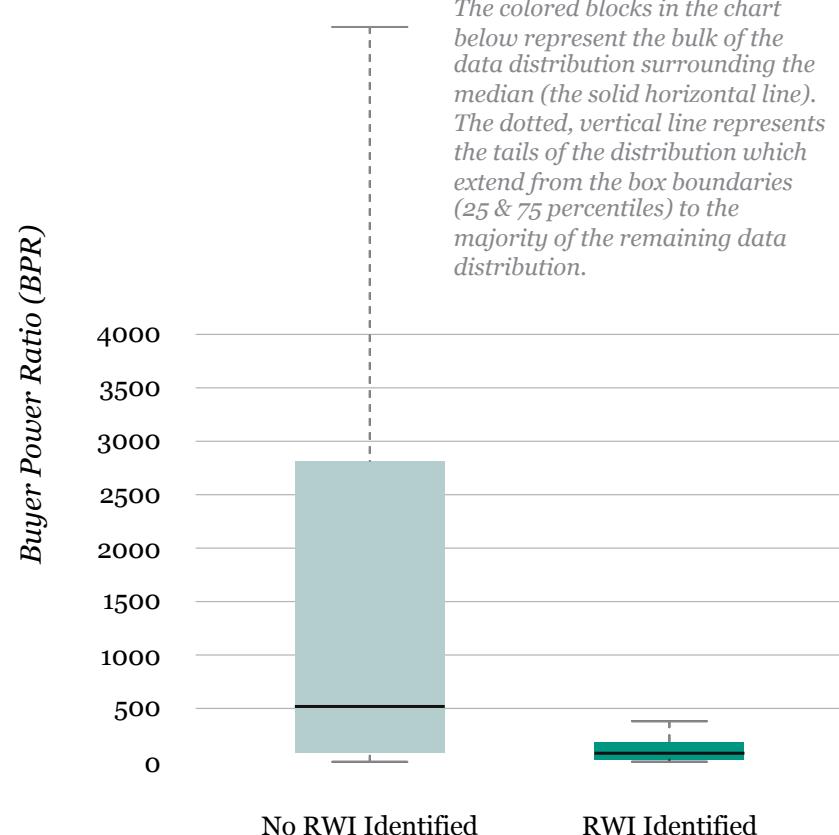
Buyer Power Ratio*

Correlation to Buy-Side RWI

In deals where the buyer is a publicly traded company, Buyer Power Ratio ("BPR") continues to be the greatest indicator of whether Buy-Side RWI will be purchased on a particular deal.

Transactions with public-company buyers without RWI show a wide range of BPR values, while transactions with public-company buyers that use Buy-Side RWI have low BPR values, which typically correlate with less divergent relative negotiating strengths between the buyer and sellers.

Buyer Power Ratio, deals 01/2018–06/2020



* For more information on Buyer Power Ratio and its effect on deal terms, download our 2017 study, *Impact of Buyer Power Ratio on M&A Deal Terms* (<https://www.srsacquiom.com/resources/impact-of-buyer-power/>)

► Target industry, transaction value, Buyer Power Ratio, and other factors may affect this deal point. Explore MarketStandard at [srsacquiom.com/marketstandard/](https://www.srsacquiom.com/marketstandard/)

Transaction Size*

Correlation to Buy-Side RWI

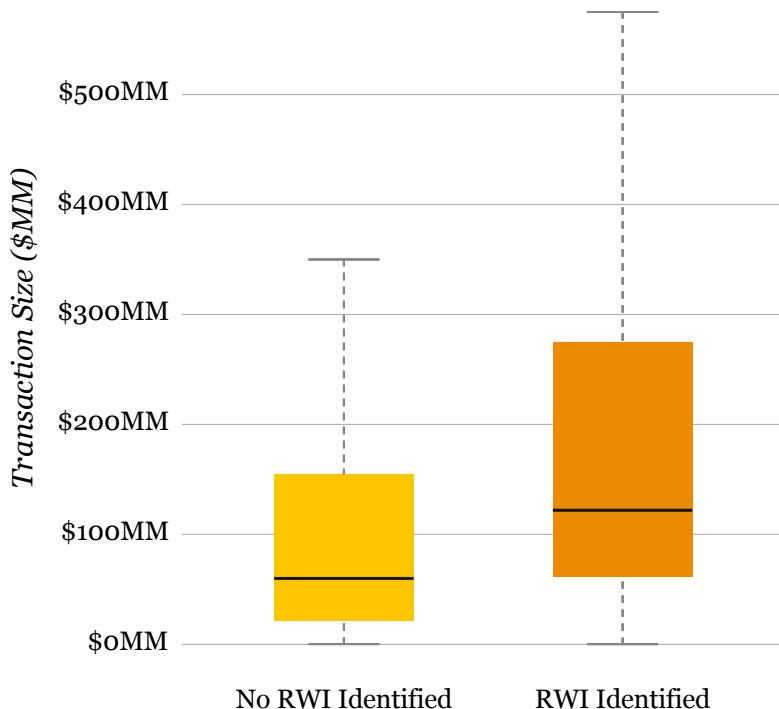
For transactions in the “No RWI Identified” category, median transaction size was \$60MM, while for transactions in the “RWI Identified” category, median transaction size was \$122MM.

Historically, most insurers were not keen on offering RWI coverage for deals with transaction values below approximately \$50MM or above several hundred million, but that has changed over the years as insurers have shown a willingness to consider smaller and larger deals.

Some insurers are willing to quote Buy-Side RWI for deals with transaction values as low as \$10MM - \$20MM or as high as \$1billion+. "Insurance towers" (similar to lending syndicates) can provide large coverage amounts.

Transaction size, deals 01/2018–06/2020

The colored blocks in the chart below represent the bulk of the data distribution surrounding the median (the solid horizontal line). The dotted, vertical line represents the tails of the distribution which extend from the box boundaries (25 & 75 percentiles) to the majority of the remaining data distribution.



* Transaction values include escrowed amounts but do not include potential earnout consideration.

► Target industry, transaction value, Buyer Power Ratio, and other factors may affect this deal point.
Explore MarketStandard at srsacquiom.com/marketstandard/

Prevalence of Buy-Side RWI Across Industries

Buyers in the financial sector continue to embrace insurance at a much higher rate than buyers in other sectors. The 2020 update shows 38% of buyers from the industrials space using Buy-Side RWI compared to 19% in last year's study.

Buyer industry, use of Buy-Side RWI



Financial Terms and Provisions

RWI Effects: Escrow Size

Correlation to Buy-Side RWI

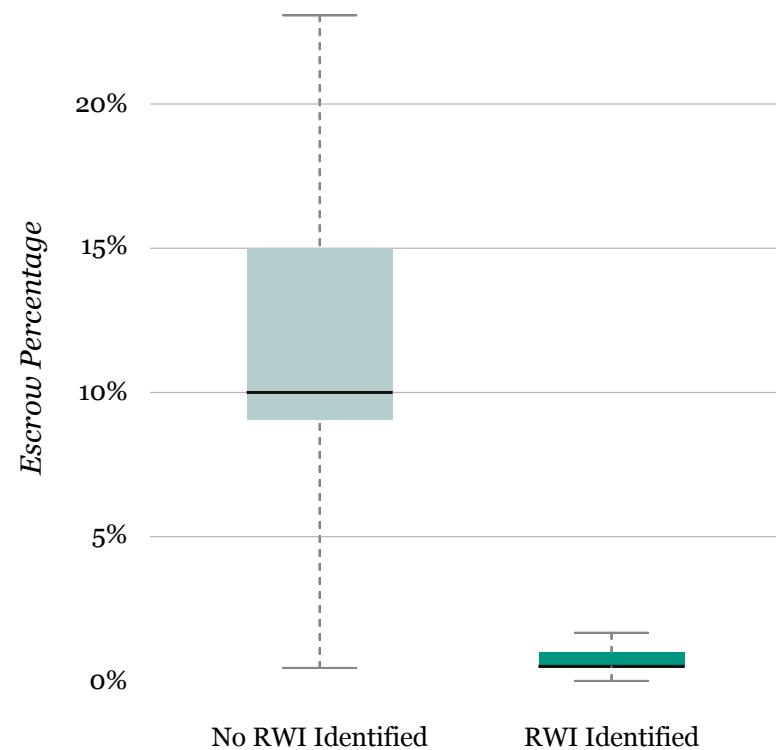
Use of Buy-Side RWI continues to correlate strongly with a material reduction in the size of the indemnification escrow, or with elimination of the indemnification escrow entirely.

Summary statistics

| RWI Identified: | No | Yes |
|---------------------|--------|-------|
| Average Escrow Size | 12.3% | 2.3% |
| Median Escrow Size | 10.0 % | 0.5 % |

Escrow size (% of purchase price), deals 01/2018–06/2020

The colored blocks in the chart below represent the bulk of the data distribution surrounding the median (the solid horizontal line). The dotted, vertical line represents the tails of the distribution which extend from the box boundaries (25 & 75 percentiles) to the majority of the remaining data distribution.



Purchase Price Adjustment: Separate Escrows

Overview

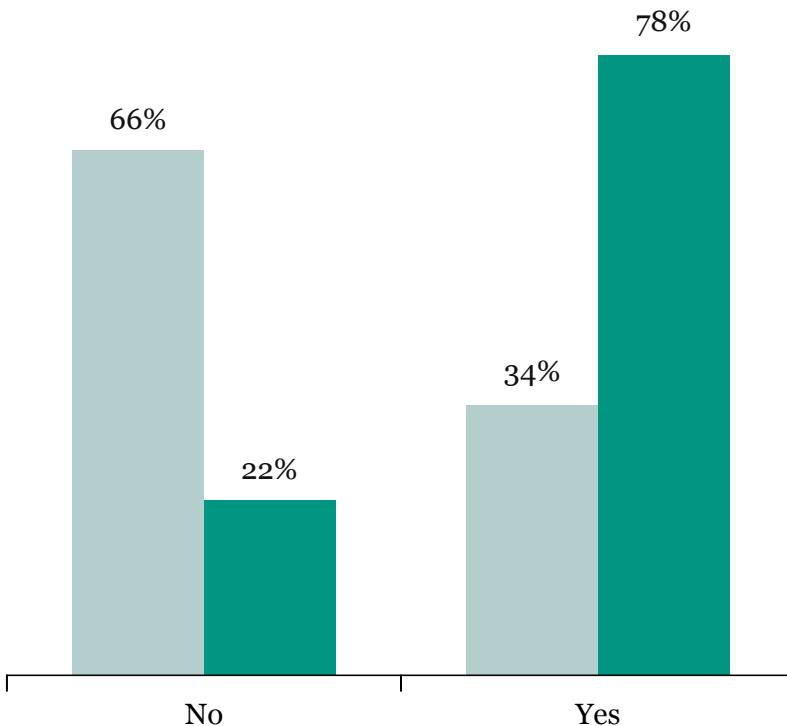
Separate PPA escrows, deals 01/2018–06/2020

Continuing another trend from last year's study, for deals that use Buy-Side RWI and incorporate a PPA, the vast majority incorporate a separate PPA escrow to secure that obligation.

A separate PPA escrow is a leading categorical attribute associated with Buy-Side RWI.

Even when Buy-Side RWI is not used, approximately one-third of deals still incorporate a separate PPA escrow.

■ No RWI Identified ■ RWI Identified



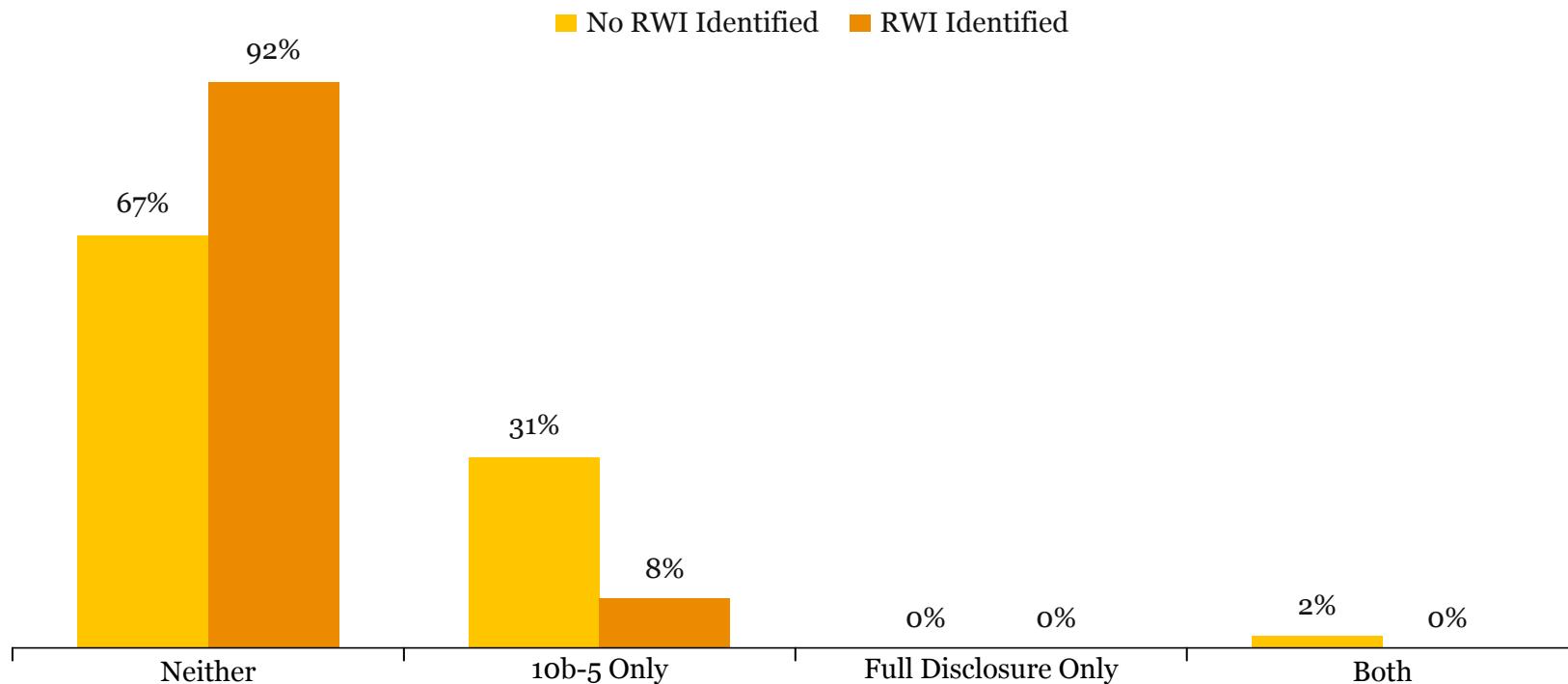
► **Target industry, transaction value, Buyer Power Ratio, and other factors may affect this deal point. Explore MarketStandard at srsacquiom.com/marketstandard/**

Reps and Warranties and Qualifiers

“10b-5” and “Full Disclosure” Representations

Purchase agreements contain 10b-5 and Full Disclosure representations significantly less often when there is a Buy-Side RWI policy.

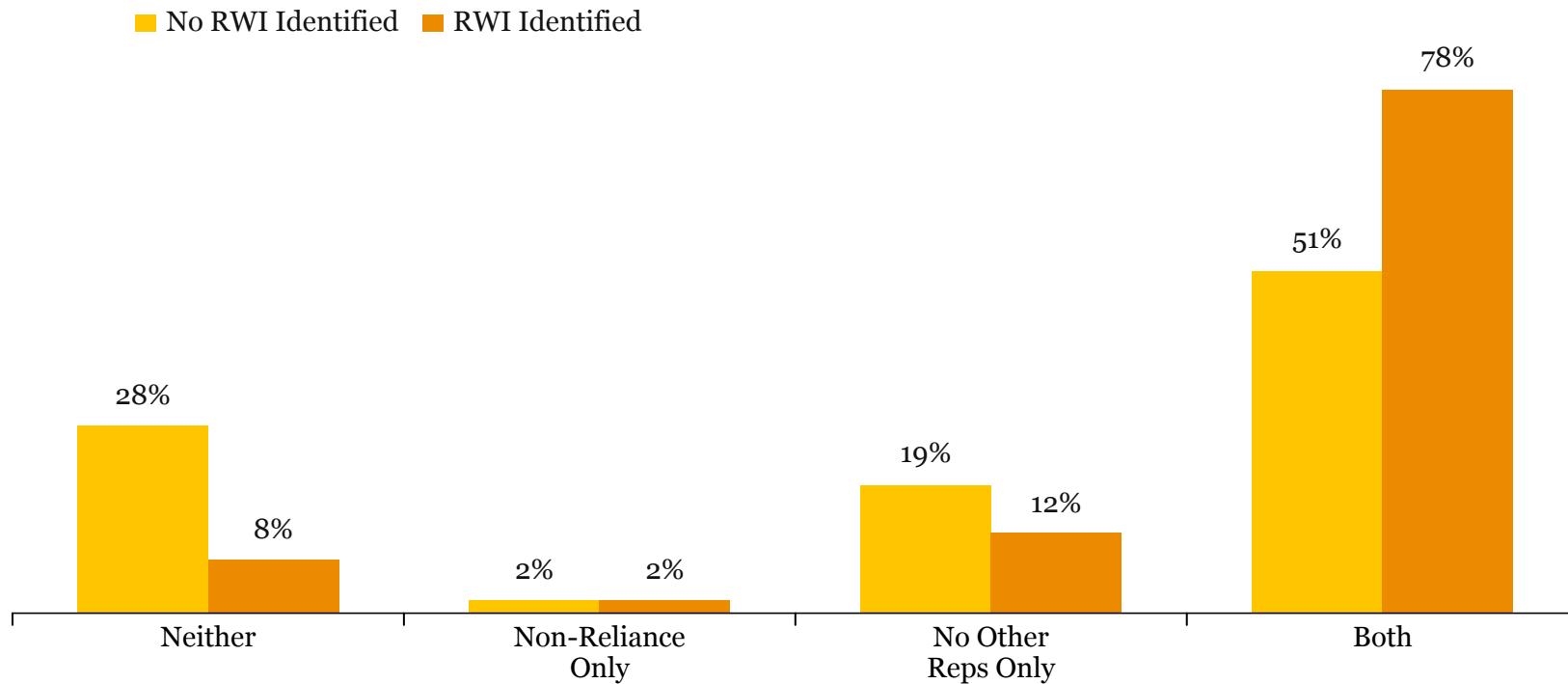
10b-5 / Full Disclosure Representations (01/2018–06/2020)



“Non-Reliance” and “No Other Representations”

In transactions that utilize Buy-Side RWI, sellers are more likely to insist on statements regarding Non-Reliance and No Other Representations.

Non-Reliance / No Other Reps (01/2018–06/2020)

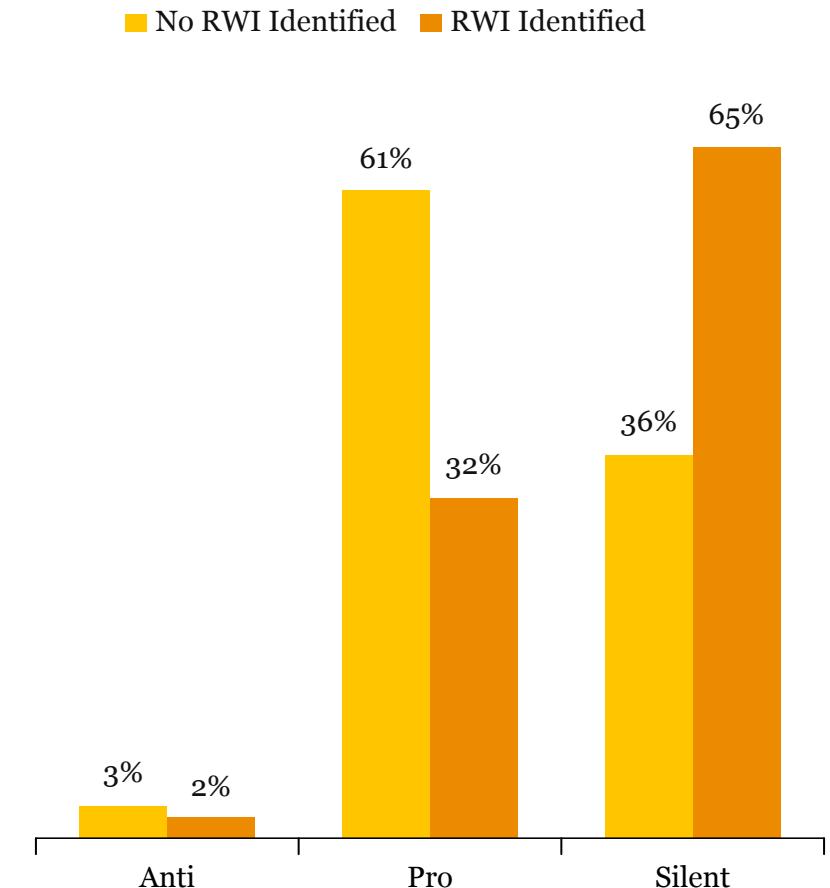


Sandbagging

Correlation to Buy-Side RWI

Sandbagging provision, deal years 01/2018–06/2020

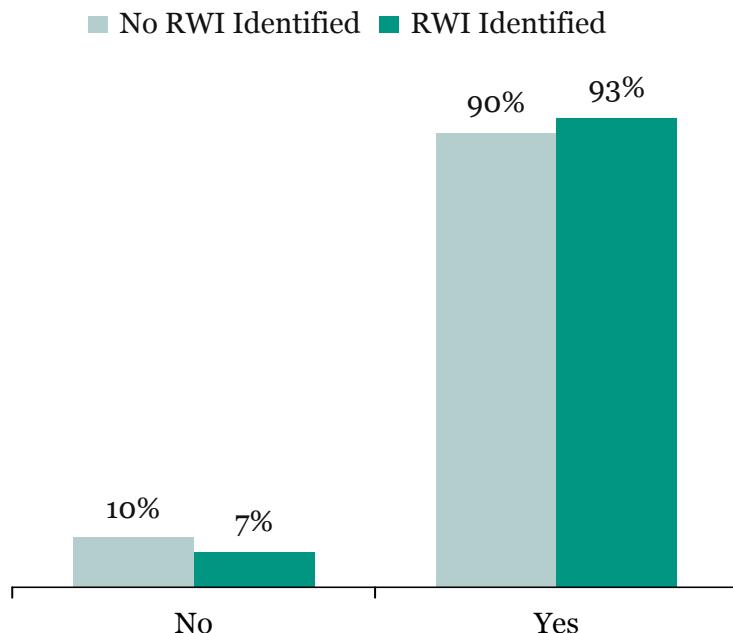
Buy-Side RWI policies typically contain a knowledge exclusion, rendering pro-sandbagging provisions of little use to buyers with respect to indemnification matters covered by the Buy-Side RWI policy. This term appears to parallel the insurance coverage—when Buy-Side RWI is present, less than one-third of agreements include a pro-sandbagging provision.



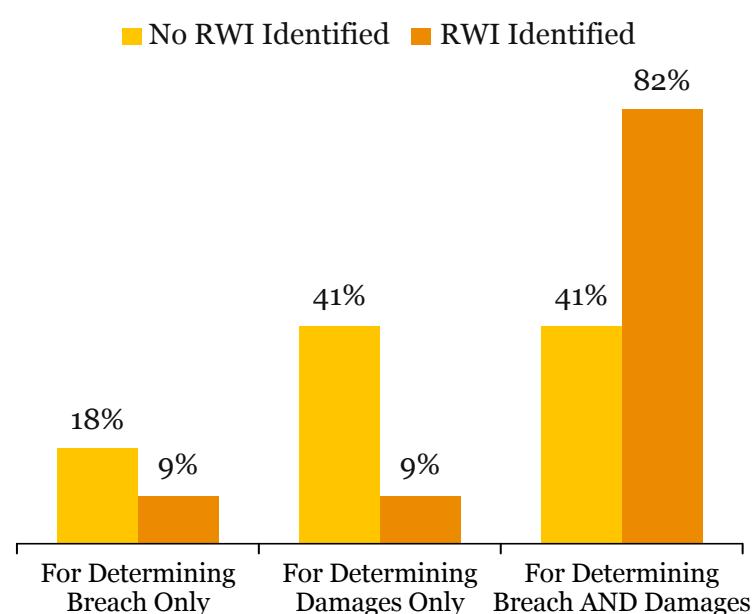
Materiality Scrape

Buy-Side RWI does not significantly affect the frequency of a materiality scrape. Most deals include a scrape regardless of whether or not Buy-Side RWI is used. The use of Buy-Side RWI does affect the details of language, with a preference to disregard materiality qualifiers both for determining whether or not breach exists and for determining damage amounts.

Materiality scrape included (01/2018–06/2020)



Materiality scrape details (01/2018–06/2020)

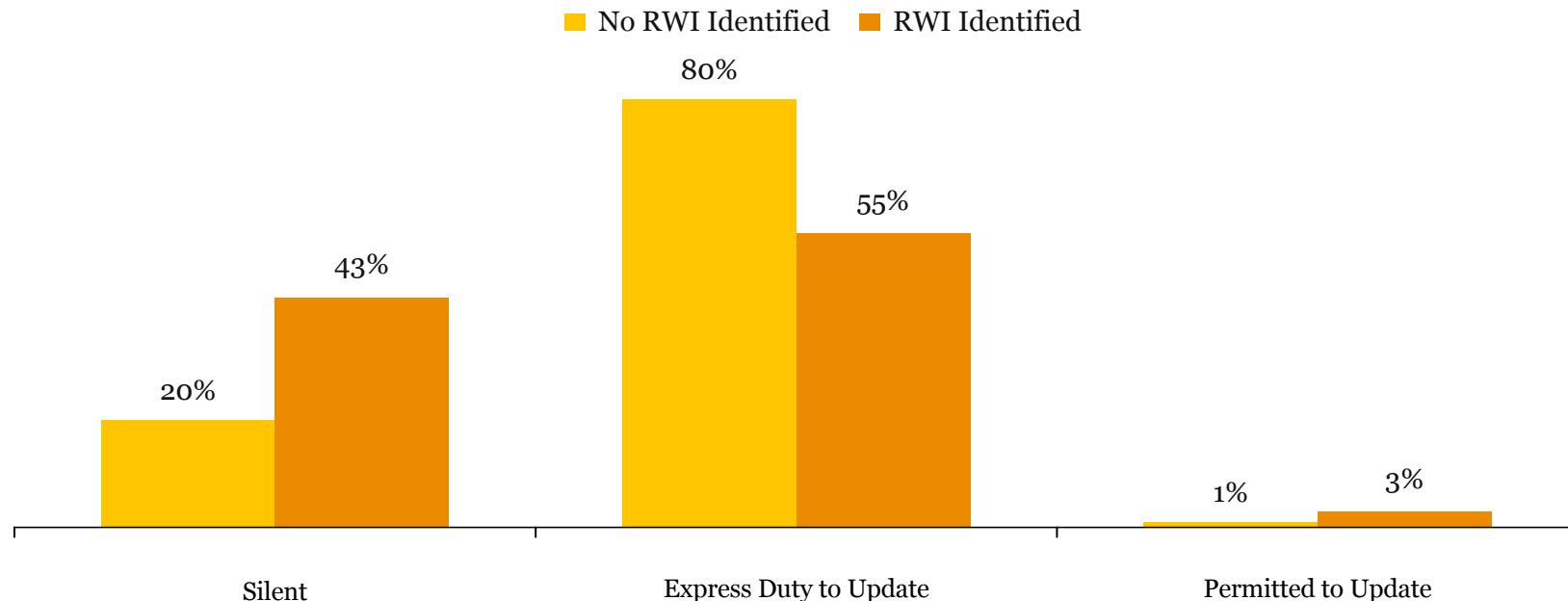


► Target industry, transaction value, Buyer Power Ratio, and other factors may affect this deal point.
Explore MarketStandard at srsacquiom.com/marketstandard/

Seller's Duty to Notify Buyer of Pre-Closing Breaches of Reps and Warranties*

For deals with Buy-Side RWI, the seller is less likely to be required to notify the buyer of breaches of representations and warranties discovered between signing and closing. This may be because known breaches, including those discovered between signing and closing for deals that involve a separate sign and close, are typically not covered by Buy-Side RWI.

Covenant to notify of breaches of representations and warranties, deal years 01/2018–06/2020



* Sample excludes simultaneous sign and close deals.

► Target industry, transaction value, Buyer Power Ratio, and other factors may affect this deal point.
Explore MarketStandard at srsacquiom.com/marketstandard/

Loss Mitigation and Setoffs

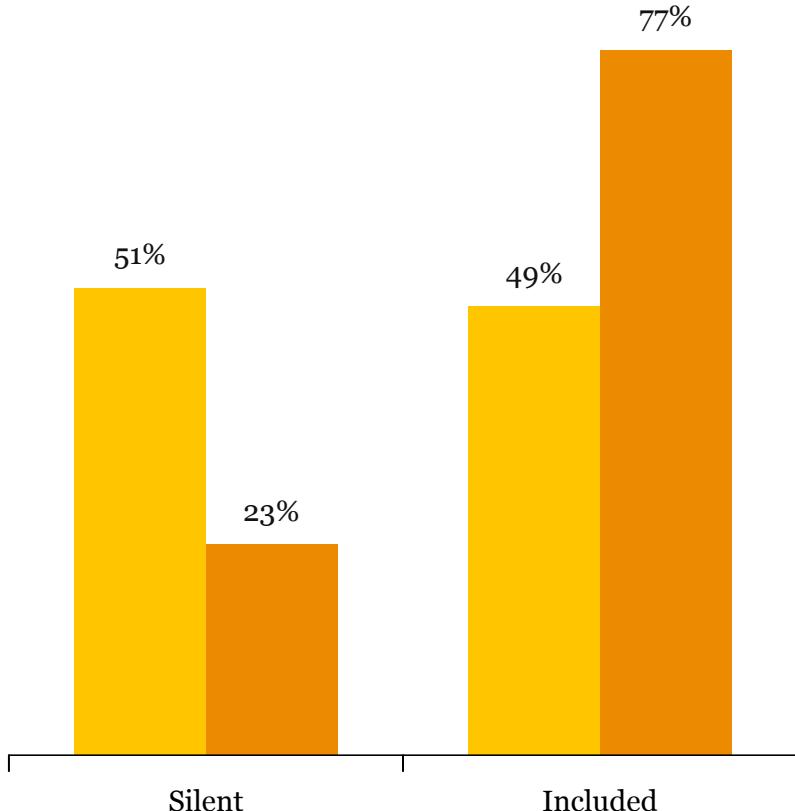
Buyer Obligation to Mitigate Losses

Correlation to Buy-Side RWI

Purchase agreements in transactions that use Buy-Side RWI continue to be much more likely to include a loss mitigation provision relative to transactions that don't use the coverage. Buyers and sellers may be drafting this part of the purchase agreement in a manner that follows the mitigation concept that is typically included in Buy-Side RWI policies, and this may also be a function of insured deals being more likely to involve parties with relatively similar bargaining strength or highly sought after target companies—both of which embolden sellers to insist on this seller-friendly provision.

Buyer obligation to mitigate losses (01/2018–06/2020)

■ No RWI Identified ■ RWI Identified



Baskets

In insured deals, sellers' indemnification obligations are much more likely to be structured as deductible (non-tipping) baskets than as first-dollar (tipping) baskets, while uninsured deals trend the opposite. Multifaceted "combination" baskets continue to be very rare, appearing in only 1%–2% of purchase agreements whether or not insurance is used.

Sample provisions

Deductible:

"Securityholders shall not be required to indemnify Buyer for Losses until the aggregate amount of all such Losses exceeds \$300,000 (the 'Deductible') in which event Securityholders shall be responsible only for Losses exceeding the Deductible."

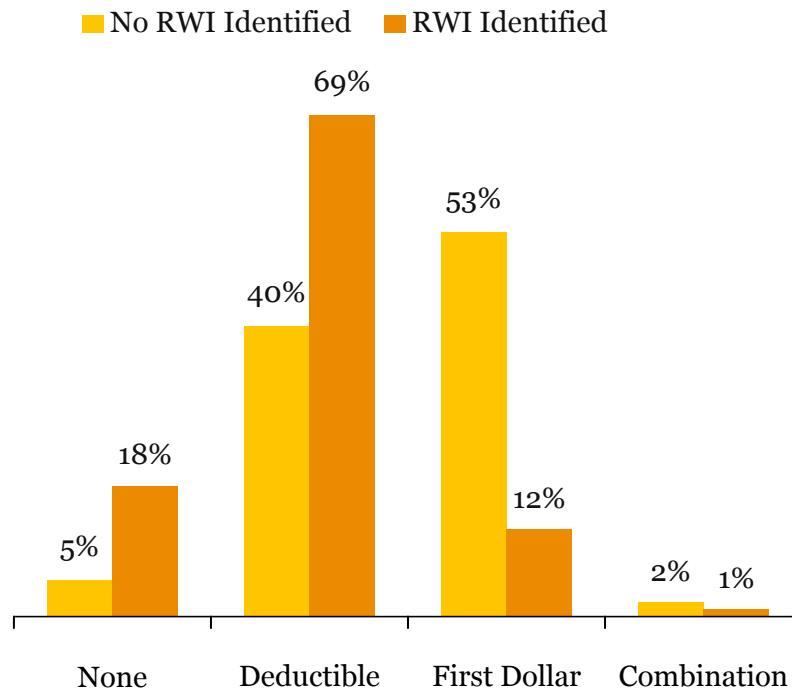
First Dollar:

"Securityholders shall not be required to indemnify Buyer for Losses until the aggregate amount of all such Losses exceeds \$500,000 (the 'Threshold') in which event the Securityholders shall be responsible for the amount of all Losses, regardless of the Threshold."

Combination:

"Securityholders shall not be required to indemnify Buyer for Losses until the aggregate amount of all such Losses exceeds \$500,000 (the 'Threshold') in which event the Securityholders shall be responsible only for Losses in excess of \$300,000 (the 'Deductible')."

Basket type distribution, deals 01/2018–06/2020



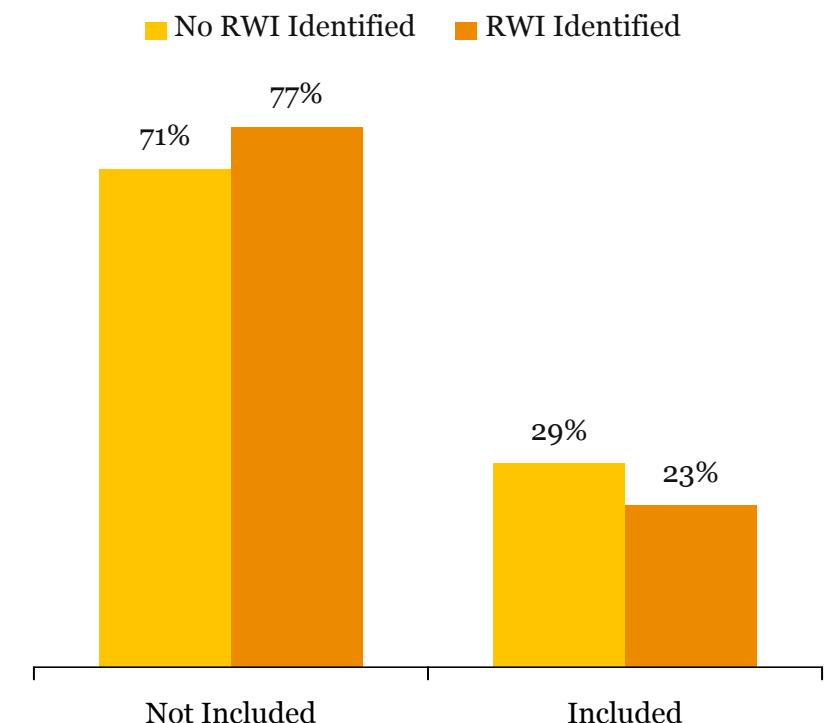
Baskets: Eligible Claim Threshold

Counter to the results of the 2019 study, Eligible Claim Thresholds are less common in insured deals than uninsured deals. Regardless of whether or not Buy-Side RWI is used, this type of provision appears in less than 30% of deals.

Eligible claim threshold formulation

Eligible claim threshold included

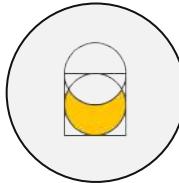
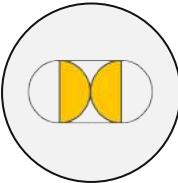
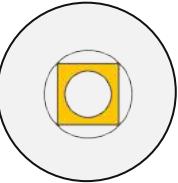
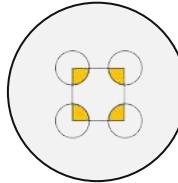
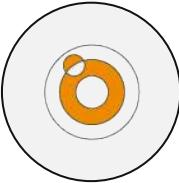
“Securityholders shall not be required to indemnify Buyer for any individual item where the Loss relating to such claim (or series of claims arising from the same or substantially similar facts or circumstances) is less than \$25,000.”



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- ✓ You determine what is relevant to your deal to negotiate with real-time knowledge

Utilize Buyer Power Ratio

- ✓ An interactive filter developed by SRS Acquiom and the American Bar Association's M&A Committee
- ✓ This filter may be the most accurate predictor of expected results for a particular transaction

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Additional Resources

- **2020 SRS Acquiom M&A Deal Terms Study:** <https://info.srsacquiom.com/2020-Deal-Terms-Study>
- **2019 SRS Acquiom Life Sciences M&A Study:** <https://info.srsacquiom.com/2019-Life-Sciences-Study>
- **Impact of “Buyer Power Ratio” on M&A Deal Terms:** <https://info.srsacquiom.com/buyer-power-ratio>
- **Impact of “Buyer Power Ratio” Appendices:** <https://info.srsacquiom.com/buyer-power-ratio-appendices>
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