THE INTERNATIONAL COMPARATIVE LEGAL GUIDE TO: PRIVATE EQUITY 2019

5TH EDITION

Dechert

LLP

global legal group

Contributing Editors
Christopher Field & Dr. Markus P. Bolsinger, Dechert LLP

Publisher
Rory Smith

Sales Director
Florjan Osmani

Account Director
Oliver Smith

Senior Editors
Caroline Collingwood
Rachel Williams

Sub Editor
Jenna Feasey

Group Consulting Editor
Alan Falach

Published by
Global Legal Group Ltd.
59 Tanner Street
London SE1 3PL, UK
Tel: +44 20 7367 0720
Fax: +44 20 7407 5255
Email: info@glgroup.co.uk
URL: www.glgroup.co.uk

GLG Cover Design
F&F Studio Design

GLG Cover Image Source
iStockphoto

Printed by
Ashford Colour Press Ltd
July 2019

ISBN 978-1-912509-82-9
ISSN 2058-1823

Strategic Partners

General Chapters:

Country Question and Answer Chapters:

Continued Overleaf →

global legal group

Country Question and Answer Chapters:

PREFACE

We are privileged to have been invited to preface the 2019 edition of *The International Comparative Legal Guide to: Private Equity*, one of the most comprehensive comparative guides to the practice of private equity available today. The Guide is in its fifth edition, which is itself a testament to its value to practitioners and clients alike. Dechert LLP is delighted to serve as the Guide's Editor.

With developments in private equity law, it is critical to maintain an accurate and up-to-date guide regarding relevant practices and legislation in a variety of jurisdictions. The 2019 edition of this Guide accomplishes that objective by providing global businesses leaders, in-house counsel, and international legal practitioners with ready access to important information regarding the legislative frameworks for private equity in 31 different jurisdictions. This edition also includes five general chapters, which discuss pertinent issues affecting private equity transactions and legislation.

The fifth edition of the Guide serves as a valuable, authoritative source of reference material for lawyers in industry and private practice seeking information regarding the procedural laws and practice of private equity, provided by experienced practitioners from around the world.

Christopher Field & Dr. Markus P. Bolsinger

Dechert LLP

2019 and Beyond: Private Equity Outlook for 2020

Ross Allardice

Dr. Markus P. Bolsinger

Dechert LLP

I. Introduction

In 2018, the global private equity (PE) industry continued to make deals, pursue exits and raise capital. Limited partners remain committed to investment in funds and portfolio companies alike and continue to provide fresh capital as part of new fundraisings.

Heavy competition across all asset classes has seen seller valuation expectations pushing deal multiples to historic highs. For general partners, putting record amounts of capital to work has led to exploration of non-traditional asset classes and a requirement to be creative across capital structures whilst identifying targets and planning for the worst against the backdrop of Brexit and the tariff wars between the US and China.

Funds are therefore continuing to further diversify into credit, real estate, infrastructure and growth investments. Larger funds are creating more strategic funds with lower return expectations and longer hold periods, as well as smaller funds addressing smaller cap transactions. PE dry powder has been on the rise since 2012 and hit a record high of $2 trillion at year end 2018.

More liquidity in the market coupled with a limited number of attractive assets means competition for those assets is fierce. This impacts the acquisition process on any auction or bilateral deal. In order to successfully acquire attractive assets, PE buyers must transact within a tight timeframe and on seller-friendly terms (with limited seller recourse and more aggressive pricing structures).

Consequently, PE funds have to be creative to ensure capital is deployed timely and effectively.

II. Trends in the PE Market

Buy and Build Strategy

Larger funds are beating strategic buyers at their own game by executing large-scale strategic mergers that create value out of synergies and combined operational strength and by implementing more ambitious buy-and-build strategies. Such structures allow general partners to justify the initial acquisition of a relatively expensive platform which can then act as a foundation for further strategic add-on acquisitions that can be acquired for lower multiples as part of a longer-term focused strategy. Further strategic acquisitions have the effect of reducing the overall acquisition cost of such platforms. However, optimising the implementation of a buy-and-build strategy requires GPs to adapt and diversify traditional investment approaches, as well as familiarising investors with longer-term hold strategies.

Portfolio equity minority stakes

Consistent with the need for PE sponsors to seek alternative opportunities for capital deployment and value, there has been a significant increase in the volume of minority investments and partnership structures by PE sponsors over the course of 2018 and this is expected to continue. Throughout this period, we have continued to see the invocation of alternative capital structures (from pure common equity investments with certain control/veto rights as well as preferred equity or debt-like structures with limited governance rights but with the ability to participate in equity returns (i.e. through warrants)).

A seller in a minority deal may be looking for more than a financial return and may be more interested in investment by firms that also have a deep knowledge and network to expand its business internationally and be willing to cede certain control and veto rights in order to obtain the investment (particularly, where there is the opportunity to potentially obtain step-up economic and control rights over a longer-term horizon).

In addition, the hunt for valuable assets has led to a renewed interest in founder-led and family businesses which often lend themselves to partnership capital structures. This trend has been particularly visible in central and eastern Europe and the Middle East where we have continued to see a growth in transactions of this type. The desire of founders to retain an ongoing interest in trophy assets over the long-term has also complemented the growth of funds focused on long-term holds and the continued increase in activity of historically passive investors, including pension funds and family offices.

The growth of strategic partnership investments is another example of PE using the capital structure and opportunities to take advantage of trophy assets and set themselves apart through expertise rather than just buying power.

GP equity minority stakes and LP transfers

We have seen in the past few years, general partners and limited partners taking direct minority stakes in portfolio companies with increased frequency. In addition, traditional PE firms like Bridgepoint are selling minority stakes in themselves. Firms like Dyal Capital and Blackstone are raising billions of capital for "fund

of firms" vehicles dedicated to buying portfolios of GP minority stakes. This market for GP minority stakes is a natural extension of a mature PE market. Selling GP stakes this way means firms can deploy further capital to fund growth initiatives. For the investor, striking a close relationship with a GP can result in better terms for the firm's primary fund as well as direct co-investment opportunities.

In addition to the growth in transfers of GP stakes, we have witnessed an increased frequency of transfers of LP interests by PE sponsors. These transaction structures are being used creatively in order to allow sponsors to retain trophy and high-growth assets (avoiding potential negative investor sentiment regarding so-called "pass the parcel" transactions) and to hold portfolio assets for longer periods and in order to ensure strategic alignment between sponsors and investors.

Co-investment Opportunities

In recent years, PE funds have had to change tack in order to meet the demands of investors and give themselves a competitive edge. In the industry's early years, it used to be that funds could rely on financial engineering to achieve returns. One of the most striking developments in recent times has been the collaboration of sponsors with strategic investors. This has come in two forms:

- giving LPs direct access to deals as co-investors thereby increasing a PE fund's firepower and ability to complete larger deals; and
- bringing in corporate co-investors on buyouts, again increasing financial firepower and bringing valuable industry knowledge to the portfolio company and a potential suitor to exit to in the future.

In addition, LPs have come to seek greater levels of co-investment as a means to improve investment performance by reducing management fees.

Direct lending and alternative capital growth

2018 has been notable for the continued growth of transactions funded through leverage provided by debt-funds rather than from traditional sources of loan finance. The ability of debt funds to offer more creative structures and leverage multiples in excess of those provided by banks, coupled with the increasing amounts of investor capital being deployed within debt funds means that this trend is expected to continue. Given potential economic headwinds, the rise of the direct lenders is expected to enhance momentum in deal flow even if traditional financing sources become unavailable, or where the leverage available from such sources decreases.

However, the ability to obtain enhanced leverage, along with the ability of sponsors to cherry-pick advantageous debt terms in a competitive market could, in the context of significant economic upheaval, feasibly lead to an increase in defaults and associated work-out scenarios, particularly as regards assets which have significant exposure to macro-economic trends.

Take private transactions

In the last two years there has been a considerable increase in interest in take-private transactions across Europe. We expect this to continue. More than half of the successful take-private transactions in the UK in the past two years have been sold to PE sponsors.

In the first quarter of 2019, key stock indices lost gains made throughout 2018 which will provide PE funds with an opportunity and focus on certain undervalued assets (especially publicly listed companies experiencing stock price decline).

Whilst the requirement for the ability to control their investments will continue to represent a roadblock for traditional PE sponsors, the amount of capital available for deployment, together with the rise of non-traditional equity investors, provide positive indications of the potential for the return of strategic minority investments into public companies (so-called "PIPE" investments).

Subscription lines

Whilst subscription lines offer general partners the opportunity to act quickly in an auction (by avoiding the need to wait for investor commitments through a capital call process before a transaction can be completed), the use of subscription lines (and the increase of the use of subscription lines for longer-term bridge financing purposes) continues to be a contentious issue from an investor perspective. This is where loans to general partners are secured against investor commitments and have the potential of improving returns through financial engineering rather than the quality of investments by the general partner. The internal rate of return on which PE fund managers are commonly judged is sensitive to when PE investors' cash is put to work. Subscription lines allow fund managers to draw down from their investors at a later date improving the fund's IRR in the process. Accordingly, it is expected that investor pressure for more rigorous control on the use of subscription lines in fund documents will increase and, with funds focused on long-term holding periods, for the use of multiple-of-money investor return metrics (alongside or *in lieu* of IRR metrics) to continue to grow.

Growth Equity

The rise of growth equity in the past five years is striking. Since 2014, some $367 billion has been raised globally for growth equity and for many larger PE funds this pool of capital offers a way to focus on fast growing companies and achieve a return without the need for high leverage multiples. Growth equity occupies the space between buyout which focuses on companies with years of proven cash flow and profitability and venture capital which invests in start-ups that are generally yet to generate EBITDA and are still in development mode. Growth equity is closer to traditional leveraged buyout funds and this is why we are starting to see larger established funds set aside pools of capital for growth equity deals.

III. Outlook

While fundraising trended down in 2018 in line with a weaker exit market and lower distributions to investors, the amount of dry powder available is at a historic high and must be put to work. As a consequence, this dynamic means that deal-making activity is likely to remain robust and competitive through to the end of 2019 and into 2020, as managers continue to try and navigate a highly competitive and well capitalised PE market by using some of the methods outlined above.

We should therefore expect the trend of increased asset prices and seller-friendly terms to continue along with further diversification by general partners looking for new avenues (in line with the themes above) in which to make returns from their increasing amounts of committed capital, even in the face of economic headwinds. That said, global events may also provide significant opportunities for investors to acquire distressed assets at advantageous valuations as well as rewarding those sponsors who are implementing creative and innovative investment strategies.

Acknowledgment

Mark Evans, a corporate and securities associate at Dechert LLP, also contributed to this chapter.

Ross Allardice

Dechert LLP
160 Queen Victoria St
London
EC4V 4QQ

Tel: +44 20 7184 7362
Email: ross.allardice@dechert.com
URL: www.dechert.com

Ross Allardice's focus solely on financial sponsor matters means he sees a large number of transactions across the European private equity, portfolio and restructuring space. He is heavily involved with every phase of a transaction and has an excellent understanding of current market terms in the financial sponsor market. He represents parties across multiple industry sectors.

Dr. Markus P. Bolsinger

Dechert LLP
Three Bryant Park
1095 Avenue of the Americas, New York
NY 10036-6797, USA /Skygarden, Erika-Mann-Straße 5,Munich 80636, Germany

Tel: +1 212 698 3628 / +49 89 2121 6309
Email: markus.bolsinger@dechert.com
URL: www.dechert.com

Dr. Markus P. Bolsinger, co-head of Dechert's PE practice, structures and negotiates complex transactions – domestic and transatlantic M&A, leveraged buyouts, recapitalisations and going-private transactions – and advises on general corporate and corporate governance matters. Dr. Bolsinger's experience extends across industries, including healthcare, industrial, packaging, agribusiness, consumer, food and beverage, and restaurant sectors. His clients have included leading PE firms, such as First Atlantic Capital, ICV Partners, J.H. Whitney & Co., Morgan Stanley Capital Partners and New Mountain Capital. In addition to his core M&A and PE experience, Dr. Bolsinger has extensive expertise in transactional risk insurance, and frequently speaks and writes on the topic in major media outlets.

He has been listed as a recommended lawyer by the U.S., EMEA and Germany editions of *The Legal 500*, a legal directory based on the opinions of clients and peers. Recognised for M&A and PE buyouts in 2018, Dr. Bolsinger has been cited as "a trusted adviser" who "takes the time to understand a client's business and motivations before undertaking any way". Since 2010, every year Dr. Bolsinger has been recognised and received a *pro bono* service award.

Dechert LLP

Dechert is a global law firm focused on sectors with the greatest complexities and highest regulatory demands. We deliver practical commercial insight and judgment to our clients' most important matters. Nothing stands in the way of giving clients the best of the firm's entrepreneurial energy and seamless collaboration in a way that is distinctively Dechert.

Dechert has been an active advisor to the private equity industry for more than 30 years – long before it was called "private equity". As a result of our longstanding roots and diverse client base, we have a deep understanding of the latest market terms and trends and provide creative solutions to the most complex issues in evaluating, structuring and negotiating PE transactions. Ranked among the top law firms for PE by prominent league tables and legal directories, Dechert's global team has been recognised for its commercial judgment and client focus.

Almaty ▪ Austin ▪ Beijing ▪ Boston ▪ Brussels ▪ Charlotte ▪ Chicago ▪ Dubai ▪ Dublin ▪ Frankfurt ▪ Hartford ▪ Hong Kong
Jeddah* ▪ London ▪ Los Angeles ▪ Luxembourg ▪ Moscow ▪ Munich ▪ New York ▪ Orange County ▪ Paris ▪ Philadelphia ▪ Princeton
Riyadh* ▪ San Francisco ▪ Silicon Valley ▪ Singapore ▪ Washington, D.C.

* Dechert has in Jeddah and Riyadh an association with the Law Firm of Hassan Mahassni.

Dechert
LLP

PRIVATE EQUITY
INVESTED IN YOUR SUCCESS SINCE 198 4

dechert.com