market intelligence

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Private equity

Bill Curbow leads the global panel • Interviews in 19 key jurisdictions
Cross border transactions • Inside track • Trends for 2014

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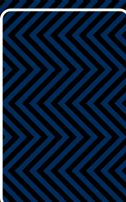

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GETTING THE DEAL THROUGH

market intelligence

Welcome to *GTDT: Market Intelligence*.

This first issue focuses on the global private equity markets.

Getting the Deal Though invites leading practitioners to reflect on evolving legal and regulatory landscapes. Through engaging and analytical interviews, featuring a uniform set of questions to aid in jurisdictional comparison, *Market Intelligence* offers an opportunity for readers to gain closer insight into key markets and legal jurisdictions.

Market Intelligence is available in print and online at www.gettingthedealthrough.com.

Getting the Deal Through
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Arne Grimme

Ton Schutte

PRIVATE EQUITY IN THE NETHERLANDS

Arne Grimme, Ton Schutte, Paul Cronheim and Klaas de Vries are partners in De Brauw's private equity group, advising private equity investors, ranging from niche funds to major European global venture capitalists, management, and senior debt and mezzanine providers. The practice advises on venture capital investments, complex leveraged buyouts, public-to-private transactions and large multi-jurisdictional transactions.

Arne Grimme advised UNIT4 on reaching an agreement with Advent International on a recommended full public offer (€1.2 billion).

Ton Schutte has handled various matters for private equity clients such as One Equity Partners, American Capital, Sun Capital Partners, Providence, CVC Capital Partners, Lindsay Goldberg, Silver Lake and Riverstone LLC. He advised Lindsay Goldberg on reaching a final agreement with Odfjell for the expansion of their terminals joint venture.

Among other high-profile deals, Paul Cronheim advised Omnicom on its proposed US$35 billion merger of equals with Publicis last year.

Klaas de Vries has handled various matters for private equity clients such as Waterland Private Equity Investments, HAL Investments, Egeria and One Equity Partners.

GTDT: What trends are you seeing in overall activity levels for private equity firm buyouts and investments in your country during the last year or so?

Arne Grimme, Ton Schutte, Paul Cronheim, Klaas de Vries: The conditions for private equity investment in the Netherlands continued to improve throughout 2013 and into 2014. This improving environment is expected to remain and generate relatively high deal activity over the next year or so. Dutch funds alone are estimated to hold approximately €10 billion of dry powder and, like foreign funds, are under pressure to put capital to work.

Many funds are still holding a substantial number of investments that are expected to be exited before long. The economic climate and, in particular, consumer confidence, is continuing to improve. Portfolio company defaults on existing loans are becoming rarer. The debt markets, including the markets for collateralised debt, have been open for quite some time, especially for high-quality assets. Interest rates are expected to remain low for some time to come. Relative optimism prevails.

At the same time stock market valuations are high and many listed business are holding considerable amounts of cash. They are buyers not sellers. Only high-quality assets are therefore brought to market and are usually immediately in demand by many private equity investors; many sale processes become highly competitive auctions. Private equity firms are struggling to find real bargains.

GTDT: Looking at types of investments and transactions, are private equity firms continuing to pursue straight buyouts or are other opportunities, such as minority-stake investments, partnerships or joint ventures, also being considered?

AG, TC, PC, KdV: Most private equity deals are straight buyouts. Many larger businesses are cash-rich and have decent access to bank financing on competitive terms. They do not need private equity to invest and grow specific parts of their business or to execute an M&A strategy.

This may perhaps be a little different in the mid-market segment in which bank financing can be harder to arrange for higher-risk businesses. Still, minority investments or other atypical private equity investment structures are rare in the current market.

GTDT: What were the recent keynote deals? And what made them stand out?

AG, TC, PC, KdV: Advent's recent €1.2 billion public-to-private acquisition of Unit4 stands out for various reasons. First, public-to-private deals have been relatively scarce in recent years as record highs in stock markets have pushed up prices for public assets. Public-to-private transactions are more common for undervalued smaller businesses that are suffering from illiquidity or have other reasons to seek private investment. Second, this was an auction in a public market setting. Especially following a leak announcement, the deal generated interest from a considerable number of international private equity firms.

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Paul Cronheim

Another public-to-private transaction of D.E Master Blenders 1753 by Joh. A. Benckiser in 2013 also stands out for its size (approximately €7 billion) and timing (only one year after the business was spun off by Sara Lee on the Dutch stock market).

GTDT: Does private equity M&A tend to be cross-border? Tell us about some of the typical challenges legal advisers in your jurisdiction face in a multi-jurisdictional deal.

AG, TC, PC, KdV: The larger private equity transactions tends to be cross-border. Due to the size of the Dutch consumer market, many of the larger businesses need to operate internationally. For many centuries Dutch entrepreneurs have not felt particularly constrained by the country's borders!

Advisers in the Netherlands are well prepared for this. Many international advisory firms have offices in the Netherlands. Independent Dutch firms have very strong alliances with similar firms in other countries and are used to providing a similarly seamless service. Dutch professionals speak their languages and are used to dealing with overseas clients in all time zones.

A challenge for any legal adviser is to remain cost-efficient. An area in which this is particularly relevant is legal due diligence. While still thorough, legal due diligence is increasingly focused on risk areas affecting the target business in question, rather than covering a full scope. Due diligence reporting is similarly focused ('by-exception'), reporting only on material issues that have been identified. Because many current deal are prepared for auction, often vendor due diligence reports are available to ease the process. It is key for bidders to pick and choose and top up on due diligence only in key areas.

Negotiation of warranty and indemnity in sale documentation can be arduous. Buyers need comfort on the target assets while private equity sellers need to limit possible residual liability following exit. For as long as interest rates remain low, the warranty and indemnity insurance market provides an opportunity for private equity sellers to limit their exposure to residual liability in certain exits. This may ease the negotiation process and limit execution costs.

GTDT: What are the current themes and practices in financing for transactions? Have there been any notable developments in the availability of debt financing or the terms of financing for buyers over the past year or so?

AG, TC, PC, KdV: Especially in medium-sized and large financings, traditional acquisition financing from bank lenders is not always available or only as bridge facility. Strong corporate borrowers may continue to draw on existing lines, but as leverage ratios in many sectors are still up, the search for alternative financing continues. Layered structures of loans and (high-yield) bond issues are quite common, as are short-term commitments with larger refinancings shortly thereafter.

As an alternative to stand-alone acquisition financing, buyers may look more towards their existing lending syndicate, adding acquisition lines and alternative (layered) structures including trade financing to their existing package rather than obtaining stand-alone acquisition financing.

We have also seen an increasing usage of vendor loan notes, also in larger transactions, although the identity and financial capabilities of the (often strategic) seller will determine whether that is an option or not.

GTDT: How has the legal and policy landscape changed during the last few years in your country?

AG, TC, PC, KdV: Dutch corporate law has undergone significant changes over the past two years which are likely to affect private equity investors and the way in which they structure transactions.

In particular, the rules applicable to Dutch private limited liability companies (BVs) have become considerably more flexible. For example, the stringent restrictions regarding 'financial assistance' have been lifted. It may also be worth noting that companies can now adopt a one-tier structure, with

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executive and non-executive members on the same board. In particular, Anglo-Saxon private equity firms, which were less familiar with the role of the supervisory board in a two-tier structure, may welcome this change. It is also now possible to issue special shares that entitle the holder to give specific instructions to the management board on matters as may be agreed, or even non-voting shares. Corporate governance in Dutch holding companies can now be tailored to suit specific situations.

GTDT: What are the attitudes to private equity among policymakers and the public? Has there been any noteworthy resistance to private equity buyouts by target boards or shareholders? Does shareholder activism play a significant role in your country?

AG, TC, PC, KdV: Policymakers and the public have no particular concern with private equity investors in general. Sometimes, the press and public sentiment tend to focus on private equity portfolio companies that are well-known or that are considered to have a particular public angle, and are financially suffering, such as child care (Catalpa), media (NRC) or companies such as HEMA. At the same time, however, this increased interest is usually short term.

GTDT: What levels of exit activity have you been seeing? Which exit route is the most common? Which exits have caught your eye recently, and why?

AG, TC, PC, KdV: Exit activity has been increasing. A number of private equity firms are making preparations for IPOs while the equity market remains favourable. Bain Capital's IPO of IMCD on Euronext Amsterdam took place in June 2014 and we expect that others will follow.

Secondary buyouts are also common. The assets that come to market are high quality and suitable for private equity investment with a proven business model and predicable cash flow. Other private equity firms need to put capital to work and, while the debt market remains favourable, they are often able to put in competitive bids. Other than for assets for which there is an obvious strategic buyer with lots of synergies, many exits will turn out to be secondary buyouts in current markets.

Waterland's exit from Intertrust was a success story. Waterland Private Equity Investments jumped on the opportunity to acquire the business from Fortis in 2009. It streamlined the business operations and executed a successful add-on acquisition of ATC, another trust service provider, in 2013. Shortly afterwards Waterland exited the investment in an auction with interest from a number of international private equity firms with Blackstone ultimately buying the business.

Klaas de Vries

"Buyers need comfort on the target assets while private equity sellers need to limit possible residual liability following exit."

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THE INSIDE TRACK

What factors make private equity practice in your jurisdiction unique?

The Netherlands has a very open market. So if you look at private equity investments you will see, for example, that we have the same amount of investment as Spain and Italy combined. And there is a reason for that: our open business climate. This lends itself well for Anglo-Saxon investors, for expanding to a global industry, and for internationally focused management. That's what makes private equity interesting to the Netherlands.

What three things should a client consider when choosing counsel for a complex transaction in your jurisdiction?

You need counsel experienced with complex deals so that you can get to the heart of the matter immediately. This way you can pass over all standard stuff. There is no need to reinvent the wheel. Counsel should get 90 to 95 per cent of the deal done efficiently and quickly; once that is done, all you have to do is concentrate on the remaining 5 per cent where the difference is made and which is critical to clients in making a success of their acquisition or divestment. For all of this, counsel must have market experience. Moreover, if the target business is complex, you must choose a firm that can deliver all the relevant expertise. For example, if you do a deal in a regulated industry, you will need regulatory specialists to complement the deal team.

What is the most interesting or unusual matter you have recently worked on, and why?

There is no particular deal in the last 20 years that we would single out. It is perhaps interesting to mention a recent one. We have just finalised the sale of Nedschroef to a Chinese party, in which we were counsel for Gilde Buy Out Partners. It was special; we also represented Nedschroef in 2007, when it was still a listed company. We took care of the public-to-private, with Gilde on the other side of the table. We now represent Gilde on the subsequent exit. We enjoyed watching Nedschroef go through these phases in seven years, from public to Dutch private equity to Chinese ownership.

Arne Grimme, Ton Schutte,
Paul Cronheim & Klaas de Vries
Debrauw
Amsterdam
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GTDT: Looking at funds and fundraising, does the market currently favour investors or sponsors? What are fundraising levels like now relative to the last few years?

AG, TC, PC, KdV: The market in general tends to favour investors although the gap between funds with a success full track record and those lacking such a track record seems to widen with the latter finding it increasingly difficult to attract investors. In 2013 private equity funds and venture capital funds raised €693 million of new funds; this is a significant decline of 39 per cent relative to 2012. Before 2013, Dutch private equity funds raised €1.1 billion in 2012, €2.1 billion in 2011 and €1.1 billion in 2010. Pension funds in particular withdrew over the last three years: in 2011 they invested €456 million in investment funds, while in 2013 they invested a mere €49 million. Family offices and private individuals stayed in the market and gained market size from 20 per cent in 2011 to 41 per cent in 2013. Captive PE firms used by banks, insurers and other large institutions grew proportionally to individual PE firms from roughly 10 per cent in 2011 to 30 per cent in 2012 and have remained stable since. In 2013, Dutch private equity funds held €29.8 billion of assets under management in 2013.

GTDT: Talk us through a typical fundraising. What are the timelines, structures, and the key contractual points? What are the most significant legal issues specific to your country?

AG, TC, PC, KdV: The timeline to come to a first closing often depends on the sponsor's track record and currently ranges from six months to two years. Structures commonly used in the Netherlands are either tax transparent or opaque. Tax transparent funds are structured as limited partnerships (CVs) or funds for joint account (FGRs). Opaque funds often are structured as private companies with limited liability (BVs) or cooperative associations (Coops). Key contractual points include incentives for first closing investors, management commitment, management fee and no fault divorce. When structuring the fund as a CV, one of the legal issues that comes up relates to the limited liability of the limited partners. If the name of a limited partner is referred to in the name of the CV or if the limited partner is involved in the day-to-day management or has an dominating influence on the general partner, it becomes liable for all liabilities of the CV.

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GTDT: How closely are private equity sponsors supervised in your country? Does this supervision impact the day-to-day business?

AG, TC, PC, KdV: Managers used to be unregulated in the Netherlands if they marketed to fewer than 150 non-professional investors or if the amount paid up by each investor for that investor's interest in the fund was more than €100,000. As of 22 July 2014 managers of private equity funds must have applied for an AIFM licence. Apart from supervision by the Dutch regulator (AFM) and reporting requirements, the introduction of a depositary impacts the managers most. Sub-threshold managers (AUM below €100 million, if leveraged or AUM below €500 million, if unleveraged) typically will not opt for a licence unless they are forced to do so by their investors or in order to be able to market in Europe.

GTDT: What effects has the AIFMD had on fundraising in your jurisdiction?

AG, TC, PC, KdV: Until 22 July 2014 a grandfathering regime applied in the Netherlands allowing marketing to continue under the old regulatory regime if the manager had been active in the Netherlands prior to 22 July 2013. Many managers have relied on exemptions that were available under the old regime. Therefore the AIFMD will have an impact on fundraising in the Netherlands after 22 July 2014.

GTDT: What are the major tax issues that private equity faces in your jurisdiction? How is carried interest taxed? Do you see the current treatment changing?

AG, TC, PC, KdV: Private equity typically faces tax challenges in relation to interest deductibility, taxation of carried interest and management incentives and withholding taxes.

Until 2012, the Netherlands had a number of anti-base erosion rules aimed only against related-party debt. Recently, these anti-base erosion rules have been supplemented, and partially replaced, with new interest restrictions limiting the deductibility of 'excessive' interest on both related-party and external debt. With careful planning private equity can still achieve substantial interest deductions on shareholder loans and bank debt, but the era of near unlimited tax base erosion is certainly over.

Historically, carried interest and management incentives could often be structured to be taxed at a very low rate (1.2 per cent tax annually of the value, no tax on actual gains). Since the introduction of so-called 'lucrative interest' rules in 2009, this has changed. Generally, carried interest and management incentives are now taxed at progressive rates of up to 52 per cent, although in many cases they can be structured through an intermediate holding company to be taxed at a flat rate of 25 per cent.

International private equity investors also need to consider the mechanics of extracting profits from the Netherlands without dividend withholding tax. Typical ways to avoid dividend withholding tax include the use of a Dutch cooperative association or EU-resident entity as a holding company for the portfolio company but in recent years both Dutch and foreign tax authorities have become increasingly sensitive to the use of such entities.

We do not expect any major changes to the existing Dutch tax system in the near future, but the international debate about base erosion and profit shifting is certainly going to change the international and Dutch tax landscapes in the years ahead.

GTDT: Looking ahead, what can we expect? What will be the main themes over the coming year?

AG, TC, PC, KdV: We expect the trends from 2013 and 2014 to continue. There is plenty of dry powder to last a while and interest rates are expected to remain low. We expect much of the M&A in the foreseeable future to be exit-driven.

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