market intelligence

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Private equity

Global interview panel covering key economies led by Bill Curbow

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GETTING THE DEAL THROUGH

market intelligence

Welcome to *GTDT: Market Intelligence*.

This is the second annual issue focusing on global private equity markets.

Getting the Deal Through 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 readers a highly accessible take on the crucial issues of the day and an opportunity to discover more about the people behind the most interesting cases and deals.

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Christoph Neeracher

PRIVATE EQUITY IN SWITZERLAND

Christoph Neeracher specialises in international and domestic M&A transactions (focusing on private M&A and private equity transactions, including secondary buyouts, public-to-private transactions and distressed equity), transaction finance, corporate restructurings, relocations, corporate law, general contract matters (eg, joint ventures, partnerships and shareholders' agreements) and all directly related areas.

He is experienced in a broad range of national and international transactions, both sell and buy side (including corporate auction processes), and in assisting clients in their ongoing corporate and commercial activities. Additionally, he represents clients in litigation proceedings relating to his specialisation.

Philippe Seiler has a broad experience in M&A transactions in various industries (inter alia, manufacturing and engineering, IT, real estate and logistics, as well as pharmaceuticals and biotechnology). As well as covering large-scale transactions and takeovers, he focuses on small and midsize M&A transactions, private equity transactions, management buyouts and outsourcing projects.

In addition, Philippe Seiler focuses on reorganisations and restructurings, general contract and commercial law and real estate transactions, along with data protection and unfair competition.

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

Christoph Neeracher & Philippe Seiler: The private equity market is still going strong. However, the euphoria of last year has subsided. From the strong showing in the previous year, Swiss M&A activity has been characterised by a declining number of transactions and a lower transaction volume in the first half-year. According to a market survey by Ernst & Young, a total of 137 transactions were recorded in the first quarter of 2015 (13 per cent less than in the fourth quarter of 2014). The decrease of the transaction volume may indicate an end of the mega-deals. In the first half-year, six transaction were valued over 1 billion Swiss francs and only one mega-deal over 5 billion Swiss francs – the merger between Holcim and Lafarge, which totalled at 6.8 billion Swiss francs. Overall, the first two quarters of 2015 resulted in 264 deals and a total deal volume of 25.7 billion Swiss francs. The number of transactions hence fell by 6 per cent against the previous year.

Broadly speaking, the Swiss private equity market faced – in line with the European market – a cool-down in 2015. The main reasons are the worsening geopolitical development, the ongoing monetary instability in the eurozone and – in Switzerland – the strong Swiss franc, which puts pressure on the Swiss export industry and makes potential targets more expensive for foreign investors. However, several industries, in particular pharma and healthcare, as well as IT, are expected to remain attractive sectors for private equity transactions.

GTDT: Looking at types of investment and transaction, 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?

CN & PS: Private equity firms active in Switzerland follow a wide range of strategies, including control and non-control deals, club deals and joint ventures with corporates. Private equity firms acquiring a business line of a company within the context of a corporate divestiture of non-core assets are frequently seen in Switzerland. Also, private equity firms recently conducted several add-on investments. Finally, succession planning in many Swiss companies creates a wide range of investment opportunities.

Swiss law does not prevent or restrict the participation of two or more private equity firms in a club or group deal. In the recent past, several private equity investments were syndicated. Typically, private equity players taking non-control positions seek protection via shareholders' agreements, which usually not only restrict the transferability of the shares, but also include board appointment rights as well as provisions regarding voting undertakings for certain or even all board or shareholders' resolutions. In this respect, Swiss law provides ample flexibility and

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Swiss market practice has in recent years reached a high level of sophistication. As Switzerland's economy is well diversified, private equity firms traditionally are active in a wide array of industries. Recent 'hotspots' include pharma, healthcare, IT, communications and the traditional industries sector.

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

CN & PS: In the first quarter of 2015, French NJJ Capital, Xavier Niel's private holding company, agreed to buy Orange Switzerland from Apax Partners in a deal worth €2.3 billion. With this transaction, one of France's best-known entrepreneurs in the communication sector continues to expand his telecoms assets across Europe. Apax, one of the world's leading private equity firms, held Orange Switzerland for roughly two years.

Another recent deal worth mentioning is the intended sale of Swissport by the European private equity firm PAI Partners to the owner of Hainan Airlines of China for 2.7 billion Swiss francs. Closing is expected by the end of this year. Swissport International, based in Zurich, provides cargo and ground services at airports in 48 countries and employs about 60,000 people. PAI Partners agreed in 2010 to acquire Swissport International from Ferrovial of Spain for €654 million, or about $722 million.

GTDT: Does private equity M&A tend to be cross-border? What are some of the typical challenges legal advisers in your jurisdiction face in a multi-jurisdictional deal. Are those challenges evolving?

CN & PS: Cross-border private equity M&A deals have always been a major pillar in an overall busy M&A market in Switzerland. However, inbound activity has somewhat slowed down with certain sectors of the European economy still in crisis and especially because of the discontinuation of the minimum Swiss franc–euro exchange rate by the Swiss National Bank at the beginning of 2015. The discontinuation of the minimum Swiss franc–euro exchange rate, which made the Swiss franc more expensive compared with the euro, had two negative effects on Swiss inbound M&A transactions: first, Swiss targets tend to be more expensive for foreign investors; second, potential Swiss targets that sell to the eurozone (of which there are a fair number) suffer from lower margins. Many investors want to see how these companies are handling the 'Swiss-franc shock' before investing.

While cross-border activity between Switzerland and Europe has cooled, deals with the United States have increased. As the US economy has picked up pace in recent years, Swiss bidders have shifted their focus to the United States, while US investors have also increasingly targeted Swiss companies.

Cross-border transactions with Swiss involvement create challenges for the legal advisers involved, as coordination and communication become the key success factors. Thus, getting all legal advisers on the same page, by assigning clear responsibilities and committing to strict deadlines from kick-off to closing, is critical, in particular where coordination has to take place between different law firms that are dispersed over different time zones. Although such transactions are not always without frictions, the major Swiss corporate law firms are well experienced in handling multi-jurisdictional M&A transactions and dealing with fast-paced private equity dealmaking.

> "Cross-border private equity M&A deals have always been a major pillar in an overall busy M&A market in Switzerland."

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?

CN & PS: After already record low interest rates and an expansionary monetary policy, the Swiss National Bank has introduced negative interest rates, which may be unique. Therefore, banks are more inclined towards financing transactions and as they continue to be flexible, financing conditions remain favourable for funding investments in Swiss companies. While not yet at pre-crisis level, debt-to-EBITDA levels have been steadily increasing.

Bidders looking to invest are very flexible with regard to transaction financing. This is due to the fact that Swiss corporate law only stipulates limited restrictions on a company's debt-to-equity ratio (however, from a Swiss tax-law perspective, de facto limitations exist). Securing bank financing can be challenging, as banks are still cautious and require specific guarantees when lending funds to

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borrowers. However, with the current (negative) interest rates, banks have indeed become more inclined to provide financing. It is standard market practice that pledges are taken by the financing institutions to protect their rights. It is not unusual that both the shares in the portfolio company and the shares in any of its material subsidiaries are pledged. Additionally, financing banks secure the financing by requiring that existing debt is refinanced and that existing securities will be released and used as collateral. Various restrictions apply to up- and cross-stream guarantees, as well as to other security interests granted by the target to the parent or an affiliate (other than a subsidiary). Swiss corporate law requires shareholders' approval from both companies, and approval from the board of directors. Financial planning is a mandatory responsibility of the board that cannot be delegated, therefore the board must assess whether incurring such new debt would put the company at risk. Should the company go bankrupt because of excessive debt incurred, personal liability of the board members is possible. Further, the articles of association of the company may have to be changed before it is able to grant security interests, as the company's purpose according to its articles of association must provide the basis for the granting of security interests.

When structuring such financing, tax law should always be taken into account, as it stipulates certain requirements and limitations.

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

CN & PS: Publicly listed companies on a Swiss stock exchange are subject to a new law approved by the Swiss voters in 2013, which is intended to limit fat-cat salaries. The law, which also includes criminal charges if violated, sets forth a range of mandatory rules on transparency and compensation that have increased administrative costs for companies. The law prohibits, inter alia, severance payments, advance payments and similar extraordinary payments to directors or senior managers, and requires the articles of association to include rules on additional remuneration for the board and senior management. Furthermore, as of the annual general meeting 2015, shareholders must approve the aggregate compensation of the board of directors and the senior management. Additionally, the voting rules at the shareholders' meeting have been overhauled, which strengthens the role of the independent proxy advisers.

In view of the increased costs in connection with these new regulations, some smaller listed companies have already delisted and further companies may consider doing so. Accordingly, private equity players may step in to enable a 'taking private' of listed companies. Last year saw a public Swiss company in the pharma sector (Acino Holding) taken private by two private equity firms (Avista Capital Partners and Nordic Capital). It now remains to be seen whether these two private equity players will be regarded as having set the trend for taking smaller Swiss companies private. In any case, their transaction showed that delisting can be a real option in Switzerland as well.

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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, and if so, how has it impacted private equity M&A?

CN & PS: The political system in Switzerland is organised as a direct democracy, which means that the Swiss voters are ultimately the policymakers. Therefore, public opinion is often in the forefront of new regulations and laws. Public opinion in

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Switzerland with respect to big companies – in particular in the finance sector – has been fairly negative recently. The new law against fat-cat salaries is an example for this. However, it seems that public opinion is again shifting back to a more pro-business approach. Although transactions involving public companies often come under scrutiny by the media and the public – as currently seen in the contemplated transaction between the majority shareholder of Sika and Saint-Gobain – fortunately public opinion in Switzerland is generally not negative towards the sale of Swiss companies to (foreign) private equity firms. As a consequence, there is no regulatory framework specifically targeted at such transactions.

In recent years, shareholder activism has risen significantly. As this is a phenomenon that primarily affects listed companies, there is no direct connection between shareholder activism and private equity transactions.

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?

CN & PS: A private equity firm's ability to exit its investment very much depends on the terms of the investment documents and especially the shareholders' agreement. Contractual arrangements regarding transfer restrictions and exit rights are particularly decisive. While the right to coerce the other shareholders to a sale (drag-along) or to unilaterally request an IPO can facilitate the exit of the private equity investor, the minimum rights of the common shareholders (for example, minimum valuation thresholds) may have a limiting effect. Ultimately, the terms agreed upon are a direct reflection of the parties negotiation leverage, and primarily hinge on the size of the investment and the relative attractiveness of the target.

According to the European Private Equity and Venture Capital Association (EVCA), the number of exits in Switzerland is almost at the level reached in the past year. The most prominent exit routes by amount have been trade sales and sales to another private equity firm. Exits through an IPO on the SIX Swiss Exchange are still less common. One reason for this low exit activity lies in the fact that the SIX Swiss Exchange's listing rules set the bar for an IPO quite high. According to those rules, there must be a free float of at least 25 per cent following the listing, which means that at least 25 per cent of all of the issuer's outstanding shares have to be in public ownership. Furthermore, the capitalisation of those shares in public ownership has to amount to at least 25 million Swiss francs.

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However, despite these regulatory hurdles, in February 2015 Sunrise Communications AG, Switzerland's second-largest wireless carrier, raised 2 billion Swiss francs ($2.2 billion) in the biggest initial public offering on the country's stock exchange in eight years. The shares closed at 76 francs on their first day of trading in Zurich, almost 12 per cent higher than the IPO price of €68. CVC Capital Partners, which paid 3.3 billion francs for Sunrise in 2010, no longer controls the company.

GTDT: Looking at funds and fundraising, does the market currently favour investors or sponsors? What are fundraising levels like now relative to the past few years?

CN & PS: The trend for portfolio rebalancing by shifting into the less crowded but rising private equity markets by liquidating stock market gains has continued. This positive investor sentiment has led to numerous successful fundraisings by a number of Switzerland's leading private equity players this year. These included Partners Group's announcement of raising a total of $1.35 billion in 2015. Investment funds are a pool of capital and have no operative activities. Since the overhaul of the Swiss collective investment schemes legislation in 2013, private equity funds may now qualify as collective investment schemes under Swiss law (the Collective Investment Schemes Act (CISA)). Under the revised CISA, there is no distinction between public distribution and private placement. As a result, only the concept of 'distribution' is relevant to determine the admissibility of offering interests in private equity funds in or from Switzerland. Following the CISA revision, fundraising has become more complex in the past few years. In particular, special attention has to be paid to what kind of investors can be approached for fundraising. In short, interests in private equity funds may still be freely offered to regulated financial intermediaries such as banks, securities dealers, fund management companies and insurance companies in Switzerland (the 'super-qualified investors'). Fundraising from these super-qualified investors does not qualify as 'distribution' and is therefore not subject to the distribution rules of the CISA. The offering of interests in private equity funds to qualified investors is different, as this may be subject to legal and regulatory requirements. Under the revised CISA, private equity funds or the general partner (who acts for the private equity fund), respectively, must appoint a Swiss representative and a paying agent in Switzerland. Furthermore, the sponsors or other entities offering interests in a private equity fund to qualified investors must either obtain a distributor licence from the Swiss regulator, FINMA or, in the case of foreign sponsors acting on a cross-border basis, be licensed to distribute fund interests in their respective home countries. Furthermore, it must be noted that the definition of 'qualified investors' has significantly changed under the revised CISA. Whereas pension funds are generally deemed to be qualified investors, foundations, family offices and high-net-worth individuals are usually deemed to be non-qualified investors and are treated as qualified investors only if specific requirements are fulfilled. Therefore, before any fundraising may take place in Switzerland, sponsors and private equity funds should seek legal advice from securities lawyers.

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?

CN & PS: In Switzerland, private equity funds typically seek to raise capital in 'private placements' of interests in accordance with exemptions from the CISA approval requirement with regard to the fund. Approval by FINMA is required for the distribution of fund interests to non-qualified investors, whereas no such requirement exists for the fundraising with qualified investors. Generally speaking, private equity fundraising is effected by one-on-one presentations by general partners (GPs) to investors (LPs), often set up by specialised placement agents. These presentations typically involve the distribution of a private placement memorandum or other marketing documents. Although it is not a requirement under Swiss law, it is advisable to include specific Swiss disclaimer language in all offering or marketing material, and legal advice should be sought from securities lawyers before any investor is contacted. Furthermore, as already mentioned, fundraising must take place in accordance with all the applicable legal and regulatory requirements.

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

CN & PS: As noted, fundraising in Switzerland is nearly always made as a 'private placement' of interests in the private equity fund. If sponsors seek to raise funds from professional investors other than super-qualified investors, (ie, regulated financial intermediaries, in particular qualified investors), they must be supervised in Switzerland (only Swiss-domiciled sponsors) or be subject to equivalent supervision in their respective home countries. Entities distributing interests in private equity funds on the basis of a FINMA distributor licence are not subject to prudential supervision once granted a licence.

However, they must at all times comply with licence requirements and current regulatory or self-regulatory requirements. A sponsor that manages private equity fund assets is subject to regulatory supervision if such assets exceed a certain amount.

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THE INSIDE TRACK

What factors make mergers and acquisitions practice in your jurisdiction unique?

Switzerland's stable political system, liberal economy, highly educated workforce, stable banking system, sophisticated and efficient legal environment and traditionally mild tax regime all contribute to an excellent environment not only for private equity, but also as a business environment in general.

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

The most important thing is without a doubt deal experience, followed by industry knowledge and availability.

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

Every deal raises interesting and unique questions. One of the most interesting and challenging deals we worked on in the past few months was the acquisition of BASF's textile chemicals business by Archroma, a portfolio company of SK Capital Partners. The deal raised questions in every field of law and in various jurisdictions.

Christoph Neeracher & Philippe Seiler
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GTDT: What effects has the AIFMD had on fundraising in your jurisdiction?

CN & PS: As a non-EU jurisdiction, Switzerland is under no obligation to implement the AIFMD.

However, the recent legislative developments in the field of Swiss securities law have their source in international legislative developments, in particular the EU. To allow FINMA to license Swiss AIFMs and to ensure that such AIFMs are fully compliant with the AIFM Directive, the Swiss federal parliament approved a partial revision of the collective investment schemes legislation (CISA). In line with the AIFMD, the revised CISA newly regulates any manager of Swiss and foreign funds. Furthermore, the CISA introduced a new regime governing the distribution of funds in Switzerland. The Swiss legislature is currently working on new legislation for financial services and products offered to investors in Switzerland, the Federal Financial Services Act (FFSA). It is expected that the FFSA will also have an impact on fundraising in Switzerland. The earliest possible date for the FFSA to enter into effect is 1 January 2017.

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?

CN & PS: Major tax issues include limitations on the acceptance of debt push-downs, rules regarding indirect partial liquidation, rules in relation to employee participation and a stricter treatment of non-compete undertakings.

Generally, mergers in Switzerland may be conducted in a tax-neutral way if tax liability remains in Switzerland and the taxable assets are continued. However, based on the so-called tax-avoidance doctrine, Swiss tax authorities often deny tax-effective deduction of interest upon a merger of the acquisition vehicle with the target, which results in a debt push-down. As a consequence of this practice, alternative debt push-down strategies, such as cascade purchases and equity or debt swaps, have been developed to eschew the tax-avoidance doctrine while securing (at least partially) tax-effective deduction of interest.

Philippe Seiler

As a Swiss particularity, the issue of the 'indirect partial liquidation' applies in the event of a qualifying disposal of shares held by a private person as private assets to an investor holding the shares as business assets. Such a disposal of shares of at least 20 per cent formerly held by individual Swiss tax-resident investors holding the shares as part of their private assets may qualify as indirect partial liquidation (deemed partial liquidation) if certain conditions are met. If an indirect partial liquidation event is triggered, part of the sale proceeds is reclassified as taxable investment income in the hands of the individual shareholder. In principle, any distribution out of existing and distributable reserves (ordinary or construed dividends, including merger proceeds) caused by the buyer during the first five years after the disposal is considered harmful if and to the extent the target had non-operating assets at the time of disposal. Although such taxes arise with the sellers, the sellers will ask for an indemnity in the SPA in case the purchaser triggers such an indirect partial liquidation event post-closing.

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The Swiss tax law on employee participations together with the corresponding circular letter provides a legal basis for the taxation of financial benefits derived from employee participations. It regulates, inter alia, the taxation value of employee shares, the taxation point of employee stock options and the treatment of artificial employee participations, which do not provide for an allocation of ownership rights. Lastly, there is no special taxation rate applicable to carried interest in Switzerland. Depending on the structure and the domicile, taxation of between 8 and 20 per cent of the carried interest is possible.

Finally, Swiss tax authorities have recently been stricter with non-compete undertakings of private sellers in connection with a share sale. Basically, in Switzerland, when a person sells his or her shares in a company, he or she can realise a tax-free capital gain on the sales proceeds. If, however, in connection with such a sale the person undertakes not to compete (which is often required for a private equity buyer), the tax authorities requalify the sales proceeds as income, which is subject to income tax.

GTDT: Looking ahead, what can we expect? What will be the main themes in the next 12 months for both private equity M&A and for fundraising?

CN & PS: We are fairly optimistic looking ahead. The economies in the United States and many parts of Europe, including Switzerland, are still going strong and leveraged financing is assured. In addition, many industries in Switzerland, remain very attractive for PE transactions. On the other hand, the factors that impeded further growth in inbound M&A activities (a strong Swiss franc, uncertainties regarding the competitiveness of Swiss companies due to higher production costs, as well as uncertainties in connection with certain pieces of legislation in Switzerland) will most likely be reduced in the second half of 2015 and the beginning of 2016.

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