PRIVATE EQUITY

Recent developments in German private equity transactions

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While the overall market for private equity investments is presently still far behind market highs of 2005-2007, there are a couple of indications of a moderate recovery of private equity investments in Germany.

PIPE transactions of private equity investors as well as family-owned businesses have caused some attraction, some more than maybe seen in rather volatile stock markets. An investment agreement between the investor and the publicly listed company is the most relevant legal document. It addresses issues related to a tender offer, including the support of the managing board and the supervisory board, to the degree legally permissible. Furthermore, it contains provisions regarding the future corporate governance, in particular board representation of the investor. Additional typical provisions are lock-up as well as stand-still obligations of the investor to the benefit of the company. A more modern feature is the addition of a so-called guarantor as party to such investment agreement. This guarantor, who may be a highly regarded person of the political or business world, shall safeguard the interests of other groups who have relationships with the company but are not a party to the investment agreement, for example, employees, other shareholders and customers.

An increase of minority participations of private equity investors in privately held companies is foreseeable. This is to some degree a deviation from the classic buy-out pattern with the standard majority participation of the private equity investor. On the other hand, it is not really new, since minority participations are usual in venture capital financings.

An equity stake seems to have become a more attractive alternative compared to other forms of financing in the present market environment. Since debt financing in general is still subject to various constrains and hybrid financing may presently be considered to be rather expensive, straight forward equity financing may be the choice. From the perspective of the private equity fund, such private equity financing may presently be structured as an all equity financing. However, these transactions are typically structured in such a manner, that a future partial debt refinancing by way of a recap is feasible.

From a corporate governance perspective, a shareholder or investment agreement addresses issues like, among other things, board representation and supervisory board consents to extraordinary business transactions for the benefit of the private equity investor. The protection of exit opportunities of the private equity investors has paramount importance. The parties may agree on call and put options under which the majority owner may acquire the equity stake of the private equity investor. Alternatives may be an IPO or a trade sale including secondary transactions. The IPO clearly has the advantage that each partner can pursue its own exit strategy after the company has been listed. However, with a few exceptions, the IPO markets have not recovered yet. In order to effectuate a trade sale, the minority private equity investor may seek to have a drag-along right against the majority shareholder in order to secure exit opportunities if a sale to such majority shareholder should not be possible.

PIPE TRANSACTIONS OF PRIVATE EQUITY INVESTORS AS WELL AS FAMILY-OWNED BUSINESSES HAVE CAUSED SOME ATTRACTION, SOME MORE THAN MAYBE SEEN IN RATHER VOLATILE STOCK MARKETS

As regards classic buy-outs, share purchase agreements contain a reasonable level of representations, warranties and indemnifications, including an adequate recourse in case of breaches. Closing accounts with cash/debt adjustments and working capital adjustments are becoming more usual again. On the other hand, the so-called locked box principle appears to lose relevance.

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Debt financing is still much more challenging compared to the boom years. Consequently, the equity requirements are increased up to all equity transactions (see above). Therefore, also vendor financing is becoming increasingly relevant in the overall financing package. Another device becoming more important to overcome deviating valuations or financing gaps is the earn-out. However, an earn-out may typically bear significant risks from the vendor's perspective and can therefore only be used in a limited number of transaction scenarios.

AS REGARDS CLASSIC BUY-OUTS, SHARE PURCHASE AGREEMENTS CONTAIN A REASONABLE LEVEL OF REPRESENTATIONS, WARRANTIES AND INDEMNIFICATIONS, INCLUDING AN ADEQUATE RECOURSE IN CASE OF BREACHES

In general, a further increase of private equity investments can be expected, notwithstanding that overall transaction volumes as generated in the boom years 2005-2007 can hardly be expected to return in the near future.