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# Private Equity 2022

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## Switzerland: Trends & Developments

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# Trends and Developments

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## Market Activity

Private equity in Switzerland had a standout year in 2021 with a higher number of deals recorded than in any previous year. No fewer than half of the ten largest Swiss M&A transactions in 2021 had private equity involvement (KPMG Clarity on Mergers & Acquisitions 2022), while at the same time small and mid-cap deal making also saw exceptional levels of activity. In line with this development there was an increased public spotlight on the private equity industry as a whole in Switzerland which was amplified by Partners Group being included in Switzerland's blue chip index SMI as from the end of 2020. All of this unfolded against the backdrop of a record-breaking year on a global scale both for M&A in general and private equity in particular according to market reports.

These events of course prompted a question: What next for private equity in Switzerland in 2022 and beyond? Macroeconomic factors such as rising interest rates and inflation pose serious challenges, as do global supply chain disruptions and the war in Ukraine. While both interest rates and inflation have not been increasing as much in Switzerland as elsewhere, private equity deal making in Switzerland is to a large extent a cross-border affair and is therefore of course impacted by international developments not only in this context. In particular, it has become more challenging for private equity sponsors to obtain debt financing in the international syndicated loan and high yield markets due to more cautious bank and investor sentiment.

As a result, the market currently faces a large amount of uncertainty. Overall deal making in Switzerland has slowed down in the first half of 2022 compared to 2021 but is still on a high level when measured against previous years. Private equity funds also still have plenty of dry powder to deploy and commentators often point out that private equity buyers have a higher tolerance for risk than many strategic buyers. In view of this, it is expected that the private equity market in Switzerland will continue to show high levels of activity and display its resilience in these uncertain times.

## Trends

Although overall deal making activity is down compared to 2021, the targets that are in the market are still highly sought after and so the prevalence of seller-friendly agreement terms as well as highly competitive auction processes persists. Swiss-style transaction agreements in this environment are characterised by locked-box purchase price concepts, minimal conditionality and limited recourse against sellers. "Buyside" warranty and indemnity (W&I) insurance policies are frequently required by sellers but still seem to be less widely used in Swiss transactions than elsewhere, in particular when it comes to small and mid-cap transactions with individual sellers. While classically structured auctions remain a popular way for sellers to exit, sellers have also been taking a more tailored approach recently. In such transactions, potential bidders are often hand-picked at the outset of the process which usually shortens periods to signing.

Spin-offs and carve-outs also continue to be a frequent theme as corporates refocus their strategies and brace for an economic downturn. This creates opportunities for private equity firms who are well equipped to navigate the complexities of such transactions and create value from them.

At the same time, some of last year's largest Swiss transactions with private equity involvement have been private equity exits to large corporates. Partners Group's and Canada Pension Plan Investment Board's sale of GlobalLogic to Hitachi is a notable example, so is KRR's and Carlyle's sale of The Bountiful Company to Nestlé. It will be interesting to observe whether this trend continues in 2022.

This year to date's weakness in equity capital markets has certainly made private equity exits by way of an IPO a less attractive route for many but it has also created opportunities for investors looking to take Swiss public companies private and the market is experiencing a much higher number of public to private situations at the moment

Looking ahead, as the economy slows down and funding from pandemic-related government stimuli dry up, it is also expected that private equity deal making in relation to distressed assets will increase.

### Regulatory Environment and Legal Developments

#### *Foreign direct investment control*

Switzerland still has very limited restrictions on investments by persons from abroad. It has not yet introduced a comprehensive foreign direct investment (FDI) control regime and existing restrictions are currently confined to specific sectors such as residential real estate, the financial sector and critical infrastructure. However, in line with recent developments internationally, efforts are now also underway in Switzerland to introduce a new law on FDI control. The Federal Council published a preliminary draft of the law in May 2022 after being tasked to do so by the Swiss Parliament. The respective consultation process is now ongoing and deliberations in the Swiss Parliament will follow thereafter. Interestingly, the Federal Council itself is opposed to the introduction of new FDI control regulations, a position which finds its reflection in the published draft. It will be interesting to follow further discussions on the topic as the legislative process advances in the coming months. For now, the regulatory FDI environment in Switzerland remains favourable for private equity investors.

#### *Company law reform*

A major reform of Swiss company law will enter into force in January 2023. The reform will address a wide array of topics and while many of these changes are not immediately relevant for M&A transactions, there are certain exceptions. Most notably, the delisting of companies will require shareholder approval going forward, with a qualified majority of two thirds of the voting rights and an absolute majority of the capital represented at the relevant general meeting of shareholders being applicable. It is expected that this may make it more challenging for private equity investors to take Swiss-listed companies private.

The new law will make it easier for boards of directors to issue shares by introducing the concept of a capital band. It will allow boards to increase or reduce capital within a range of between 50% and 150% of the issued share capital. The capital band is one of several ways the revised law aims to give companies more flexibility when it comes to share capital and dividends; another is the possibility of non-

Swiss franc denominated share capital. Further changes include a much-needed modernisation of the rules around shareholders' meetings and a stronger focus on companies' liquidity in the context of restructuring and financial distress.

### *ESG*

In January 2022, Switzerland saw the introduction of new ESG regulations on non-financial reporting obligations as well as due diligence requirements in connection with child labour and minerals and metals from conflict areas. Whereas the former are only mandatory for larger listed companies and prudentially supervised large financial institutions, the latter have a broader scope of application. In principle, the new due diligence requirements are applicable to all natural and legal persons as well as business partnerships whose registered office, central administration or principal place of business is/are in Switzerland, and which carry out a trade. The regulations do, however, provide for certain exemptions, in particular for SMEs. Companies that fall under the scope of these new regulations will need to comply with them for the first time in FY2023. However, a number of companies have been producing reports on non-financial matters on a voluntary basis already for several years now as this is perceived as good corporate governance and viewed favourably by many investors.

Additionally, gender quotas for boards of directors and executive management were introduced on a "comply-or-explain" basis in January 2021. They will apply to most listed companies but are subject to transition periods of five and ten years, respectively. Swiss law also recently saw the introduction of disclosure duties for Swiss companies in the natural resources industry, which will have to disclose certain payments to government entities starting from FY2022.

Of course, the breadth of topics that fall within the scope of ESG goes far beyond single legislative developments and ESG considerations are expected to be at the top of the private equity industry's agenda going forward for various reasons beside compliance with these regulations.

### *SPACs*

While the SPAC boom in other jurisdictions was in full swing in the first half of 2021, the Swiss Financial Market Supervisory Authority (FINMA) decided that the regulatory body of SIX Swiss Exchange had to first enact a formal framework before any SPAC could list on the SIX Swiss Exchange. FINMA's reasoning for this requirement was driven by concerns around investor protection. The pertinent Directive on the Listing of SPACs entered into force on 6 December 2021 by which time SPAC-related listing activities had already quieted down in many other jurisdictions. The passing of the directive was followed by the first Swiss SPAC listing shortly thereafter but, to date, no further SPAC listings have followed in Switzerland.

### *Phasing-in of licensing requirements for Swiss wealth managers*

Switzerland's new Federal Act on Financial Institutions (FinIA) entered into force in 2020, ending decades of industry self-regulation in the Swiss wealth management sector. Under the new FinIA rules, Swiss wealth managers need to apply for a licence from FINMA and they have until the end of 2022 to submit their licence application. These new requirements are expected to lead to a wave of consolidation in the sector, which in turn could be seen by private equity firms as an opportunity to build up their portfolios of wealth management businesses.

### Outlook

It is probable that private equity will strengthen its position as a driving force in the Swiss market in the near future. In the period of increased uncertainty that lies ahead, the creativity and flexibility that characterises the private equity sector should prove to be a key factor in successful deal making. This is particularly likely to be true for the P2P sector.

At the same time, Switzerland will remain an attractive market for private equity involvement given its favourable regulatory and legal framework for private equity investments as well as, relative to Switzerland's market size, a host of interesting targets.

**Advestra** is a corporate law firm comprising 22 professionals located in Zurich, Switzerland. The firm advises clients on a broad range of M&A transactions, such as acquisition and divestment transactions (including corporate auctions), public takeovers, mergers, demergers, joint ventures and financing rounds. It further advises on complex restructuring transactions and in situations of financial distress. Clients include private equity firms, public and private companies, sovereign wealth funds and other investors. The firm is also retained by entrepreneurs, growth companies and venture capitalists. Apart from corporate and M&A matters, Advestra advises clients on capital market transactions (both equity and debt), financing transactions, matters relating to financial services regulatory as well as tax. For practice areas not covered by Advestra, the firm relies on an extensive network of specialised firms.

## Authors

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