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Private Equity 2023

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Switzerland: Trends & Developments

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Trends and Developments

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Advestra is a corporate law firm 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 not covered by Advestra, the firm relies on an extensive network of specialised firms.

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Market Activity

After a record-breaking 2021, it may come as a surprise that overall deal volume in Switzerland again exceeded all previous levels in 2022, with private equity transactions accounting for about a third of all deals. However, deal value was down significantly compared to 2021, and of the top ten transactions with a Swiss dimension in 2022, only one had private equity participation (per KPMG's Clarity on M&A 2023).

These figures are a testament to the Swiss market's characteristically strong activity in the lower and middle markets, which is less dependent on raising financing in the international debt markets than large-cap transactions. In other words, they also reflect the challenges private equity investors have faced in securing debt financing for bigger tickets. In Switzerland, small and mid-cap transactions are often financed by Swiss banks, a source of financing that remained open throughout 2022. For larger transactions, private equity sponsors typically need to tap the international debt markets, which has proved to be challenging since the second quarter of 2022 and has led to private credit providers stepping in more frequently. The continuing rise of this asset class has been relevant for the private equity sector not only as a source of debt financing. It has also been a way for investment houses to expand the scope of their activities by growing their own private credit arms in parallel to their traditional buy-out funds.

Undoubtedly, it is not just the accessibility of financing that has been a major hurdle for the private equity sector recently, but more importantly, the cost of financing. Rate hikes by the Swiss National Bank have been more restrained than those of national banks in other jurisdictions and inflation in Switzerland has remained at a lower level than elsewhere. However, with many forecasts now expecting rates to remain at an elevated level for the foreseeable future, the purported "end of the era of cheap money" and what that means for the private equity sector is also on top of dealmakers' agendas here. Not least because private equity dealmaking in Switzerland is to a large extent a cross-border affair and therefore heavily impacted by international developments.

Interestingly, Deloitte's study on M&A activity of Swiss small and medium-sized enterprises (SME) in H1 2023 has shown that while overall deal volume and value are down compared to H1 2022, which was to be expected, inbound activity into Switzerland has been hit particularly hard. Swiss SMEs have traditionally been attractive targets for non-Swiss sponsors. Therefore, a lack of Swiss SME inbound M&A activity is also indicative of subdued private equity dealmaking in Switzerland in the past months. The good news is that Deloitte attributes this weakening of inbound dealmaking (and, conversely, a higher relative share of outbound dealmaking) primarily to a strong Swiss franc and the generally robust Swiss economy, so we do not expect the Swiss market to run out of interesting targets any time soon.

Looking ahead, while dry powder from previous fundraising efforts is still readily available to be deployed, the current fundraising environment is proving to be considerably more challenging for many GPs.

Trends

We are currently seeing fewer fully-fledged auctions in the Swiss market than in recent years, as potential sellers appear to be gauging the right time to bring their assets to market. For sought-after assets, however, auctions remain a popular exit strategy and bidders are still willing to offer seller-friendly terms in order to secure the deal. In line with a trend towards fewer auctions, we have seen a tendency towards more protracted transaction timelines. While structured processes generally tend to accelerate the time to signing, one-on-one negotiations are more prone to delays, in particular when parties take more of a “wait and see approach” as a way of dealing with the current uncertainties regarding the economic outlook.

In the same vein, a significant part of private equity deal activity in Switzerland recently has been focused on implementing buy-and-build strategies around existing platforms. These transactions frequently involve targets in the smaller-cap segment of the market that are in turn often sourced on the basis of proprietary intelligence. The healthcare, software and professional services sectors are all examples of industries that have seen plenty of add-on transactions lately.

Parallel to the decline in auctions, there has been a discernible shift towards the use of continuation funds and so-called GP-led secondaries in the Swiss market. As is not uncommon for trends and developments in the private equity sector, utilisation of these structures appears to have been less prevalent in Switzerland than elsewhere initially. However, the popularity of these structures has certainly grown in recent months.

In spite of the considerable interest that private equity houses have shown in taking Swiss-listed companies private both in 2022 and this year to date, only limited tangible deal activity has come from these efforts so far. One notable exception is Bain Capital’s offers for SoftwareOne which were, however, rejected by the latter’s board of directors.

Meanwhile, although IPOs may be on the table again as a potential exit route for certain assets, we have yet to see a Swiss listing of a private equity-backed asset this year.

Regulatory Environment and Legal Developments

UBS takeover of Credit Suisse

In March 2023, UBS and Credit Suisse signed a merger agreement following an intervention by the Swiss Federal Council, the Swiss National Bank and the Swiss Financial Market Supervisory Authority FINMA. In parallel, the Swiss Federal Council issued an emergency ordinance allowing for federal loss protection guarantees and liquidity assistance loans to be provided to UBS and Credit Suisse.

In the meantime, the merger has been consummated and the agreements regarding loss protection guarantees and liquidity assistance loans have been terminated by UBS, without taxpayer money having to be deployed. However, the merger of the country's two largest banks will of course remain a key focus of Switzerland's economy in many aspects. Notably from the private equity sector's perspective, it will be interesting to observe the merger's potential impact on the Swiss debt financing market and the Swiss M&A advisory markets.

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 and the financial sector. Specific additional licensing requirements also apply to foreign investors in such sectors as aviation, telecommunications, nuclear energy and radio/television. However, Switzerland, mirroring recent international developments, has been actively pursuing the introduction of new FDI control legislation for some time. 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 has so far been opposed to the introduction of new FDI control regulations, therefore the scope of application of the published draft is rather narrow compared to similar legislation in other jurisdictions. It will be interesting to follow further discussions on the topic as the legislative process advances in Switzerland against the backdrop of increasingly protectionist tendencies abroad. For now, the regulatory FDI environment in Switzerland certainly remains favourable for private equity investors.

Antitrust

In May 2023, the Federal Council published a revised draft for an amendment of the Swiss Cartel Act. It provides, inter alia, for a change in the substantive test applied by the Swiss Competition Commission (ComCo) in assessing whether to prohibit a transaction that is subject to merger control review. This means that the currently applicable CSDP (creation or strengthening of dominant position) test would be replaced by a SIEC (significant impediment of effective competition) test, which is in line with international practice. Importantly, however, the draft does not propose to lower the turnover thresholds that have to be met for a compulsory notification of a transaction to ComCo. These thresholds are rather high compared to international standards and therefore generally favourable from a dealmaking perspective.

Company law reform

A major reform of Swiss company law entered into force in January 2023. The reform addresses 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 now requires shareholder approval, 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. Given the typical acceptance thresholds in Swiss P2P transactions, we do not expect this to make it more challenging for private equity investors to take Swiss-listed companies private.

The new law makes it easier for boards of directors to issue shares by introducing the concept of a capital band. It allows 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 need to comply with them for the first time in the financial year 2023. However, a number of companies have already been producing reports on non-financial matters on a voluntary basis 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 now have to disclose certain payments to government entities since the financial year 2022.

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 continue to be at the top of the private equity industry's agenda going forward for various reasons besides compliance with these regulations.

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 existing managers had until the end of 2022 to submit their licence application. These new requirements have led to consolidation activities 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

The path ahead for private equity in Switzerland has certainly become more challenging in the course of the last year, as both financing issues and an uncertain economic outlook currently impact dealmaking. However, the Swiss economy continues to be in good shape and the regulatory environment in Switzerland remains investor-friendly. We therefore believe that private equity houses and their portfolio companies are well positioned to benefit from attractive investment opportunities as they continue to evolve and display the often-cited resilience that the private equity sector as a whole has become known for.

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