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Private Equity 2021

Switzerland: Trends & Developments

Alexander von Jeinsen and Beda Kaufmann
Advestra

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Trends and Developments

Contributed by:
Alexander von Jeinsen and Beda Kaufmann
Advestra see p.5

Market Activity

Switzerland's private equity market has seen a strong momentum in the first half of this year, thus continuing the upwards trend of the latter half of 2020. Deal-making had slowed down dramatically in an initial reaction to the COVID-19 pandemic, prompted not only by high levels of uncertainty but also by a need to focus on existing portfolio companies, as supply chains were disrupted and both financial and operational contingency planning was required. Overall, it seems that private equity-backed businesses were well equipped to deal with these challenges.

The market bounced back in the third and fourth quarters of last year and even concluded with a higher number of deals than in 2019, albeit with a lower aggregate deal value, according to KMPG's Clarity on M&A 2020. This is in line with Deloitte's study on small and mid-cap M&A which registered a record high number of private equity transactions in this space.

Expectations were and have remained high for 2021 as the economy recovered from the pandemic shock. Circumstances are favourable, with low interest rates, attractive financing conditions and plenty of dry powder. In addition, despite the rally towards the end of last year, there still seemed to be a backlog of transactions waiting to happen in 2021.

So far, it looks like 2021 will live up to these high expectations. As per KPMG's half-year report, no fewer than eight out of the ten largest transactions with Swiss involvement in the first half of 2021 involved a private equity buyer or seller.

Trends

The Swiss market remains a seller's market with fierce competition for attractive targets, as was the case in immediate pre-pandemic times. This not only shows in high valuations but also in seller-friendly agreement terms such as locked-box purchase-price mechanisms and stapled warranty and indemnity (W&I) insurance policies, with very limited residual liability of the seller. In such an environment, bidders frequently aim to get an edge in auction processes by submitting pre-emptive bids.

The pandemic caused various companies to revisit their strategies, which in turn is expected to result in divestments of non-core assets. High levels of private equity activity are therefore expected in connection with such corporate spin-offs. Recent examples of this are Lonza's sale of its Specialty Ingredients business to Cinven and Bain, which was announced in February 2021, as well as the acquisition of Clariant's Pigments Business by SK Capital and Heubach.

Sector-wise, unsurprisingly, a great deal of activity is being seen in the TMT industries (technology, media and telecommunications). This is expected to continue to be a strong theme in the near future, not least because this sector was among those well-placed to profit from some of the developments triggered, or at least accelerated, by the pandemic. Another sector with strong private equity involvement in Switzerland is the industrial market, in particular for small- and mid-cap transactions.

There is also a continuing trend in private equity firms partnering with other investors for acquisitions, whether with financial sponsors or strategic investors, one example being the SK Capital/Heubach deal previously mentioned. While on the one hand this allows for larger ticket deals, it also creates additional possibilities for investments on the other hand, especially when it comes to teaming up with industry players. In general, as private equity firms are constantly looking for additional ways to put their capital and skills to work, it is expected that new variations to the classic buy-out approach will continue to be seen, as well as other new strategies. Private equity investors have also been active in Swiss PIPE transactions (private investment in public entity) of late, with Ares' investment in Peach Property and Advent's stake in Dufry being notable examples.

Some outlooks for 2021 had highlighted the role that distressed transactions might play as another consequence coming out of the pandemic and the opportunities that may create for private equity investors. So far, this has not materialised, with the various economic stimulus measures adopted in Switzerland playing their part, as well as exceptional relief granted by the government from corporate law obligations to file for bankruptcy. The question will be whether this has merely postponed certain businesses' troubles and the wave of distressed situations is still to come.

Regulatory Environment and Legal Developments

Foreign investment control regime

Switzerland has, so far, refrained from introducing a comprehensive foreign investment control regime. However, in March 2020, the Swiss parliament instructed the Swiss Federal Council to create a legal basis for controlling foreign investments. Pursuant to the Swiss State Secretariat for Economic Affairs, the debate in parliament has shown that there is a desire for a targeted, effective and administratively lean investment-control scheme. The Swiss Government is currently in the process of implementing this mandate and in August 2021 published basic principles on what a new law could one day look like. For now, restrictions apply only to specific sectors such as residential real estate, aviation, banking and the financial sector more generally, postal services, telecommunications, energy and defence. Overall, Switzerland remains open for business for private equity investments. Nonetheless, as a majority of private equity transactions with Swiss involvement have a cross-border component, increased regulatory scrutiny in other jurisdictions also needs to be taken into consideration when it comes to deal-making in Switzerland.

SPACs and De-SPACs

For one of this year's hottest topics, special-purpose acquisition companies (SPACs), regulatory efforts are still underway in Switzerland. The Swiss Financial Market Supervisory Authority (FINMA) requested that the SIX Swiss Exchange implement respective provisions before allowing any SPAC to list. This has pushed back the listing of the first Swiss SPAC potentially to later this year or 2022. Consequently, Swiss SPACs are not yet available as a potential exit route for private equity portfolio firms. However, as US SPACs are expected increasingly to seek out targets in Europe, Swiss companies held by private equity firms may also take that route, but no Swiss "de-spac-ing" deal has been seen yet.

ESG

Environmental, social and governance (ESG) is becoming ever more prevalent in the private equity industry in Switzerland; not only in light of regulatory developments, but also because limited partners investing in private equity funds are tightening their internal requirements in this regard. In terms of regulation, Switzerland saw a rejection of the so-called Responsible Business Initiative by popular vote in November 2020, which aimed to introduce mandatory due diligence requirements and a liability regime for Swiss companies relating to human rights abuses and violations of environmental standards committed abroad, including by subsidiaries. As a result of the initiative's rejection, the Swiss government's counter-proposal will enter into force, which will provide for reporting requirements without any rules on liability. Additionally, gender quotas in boards of directors and executive management were introduced on a "comply-or-explain" basis in January 2021. They will apply to most listed companies; however, 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 the financial year 2022.

Company law reform

Looking ahead, a major company law reform is expected to enter into force in 2022 or 2023. This will certainly have an impact on Swiss M&A in general and thus also affect the private equity sector. Among other things, the new law will make it easier for boards of directors to issue shares by introducing the concept of a capital fluctuation band. This 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. The company law reform also makes the de-listing of companies an attribution of the general meeting of shareholders that requires a qualified majority of two thirds of the voting rights and an absolute majority of the capital represented at the meeting. It is expected that this may make it more difficult for private equity investors attempting to make Swiss-listed companies private. Further changes include the strengthening of minority shareholders' rights, 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.

Outlook

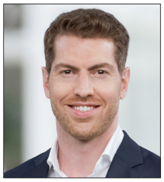
Private equity activity in Switzerland is expected to continue to accelerate in the near future. Beside increased involvement in large-cap transactions, private equity firms will likely also play a transformational role in small-cap and mid-cap segments. As private equity firms keep expanding their fields of activities, it is anticipated that their impact on the Swiss market to grow further. In the same vein, respondents to PwC's Private Equity Trend Report 2021 saw Switzerland in the top spot of the countries expected to become more attractive for private equity investments over the next five years.

Of course, uncertainties remain in connection with the COVID-19 pandemic and its aftereffects. However, Switzerland remains an attractive market with a 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|M&A, Advestra advises clients on capital-market transactions (both equity and debt), financing transactions, and 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.

AUTHORS

Alexander von Jeinsen is a founding partner of Advestra. Prior to that, he was a senior associate at one of the leading Swiss law firms. Alexander's broad practice covers M&A and financing transactions, capital market transactions as well as restructurings. Private equity investors, shareholders as well as public and private companies retain Alex for his advice on a wide range of M&A transactions, including acquisition and divestment transactions, public takeovers, mergers, demergers, joint ventures and financing rounds. Another focus of his work lies on both equity and debt capital market transactions, where he advises both issuers, shareholders and investment banks as well as other stakeholders.



Beda Kaufmann joined Advestra as a partner in July 2021. Prior to that, he was an associate at a leading Swiss law firm for six years, including a secondment to a magic circle firm in London, and an in-house legal counsel at a Swiss payment services provider. Private equity and venture capital firms as well as family offices and other investors retain Beda for his advice on international and domestic private M&A transactions, investments and joint ventures in various industries. Beda also frequently advises foreign and domestic private and public companies on acquisitions and disposals (including asset deals) and other M&A transactions.

Advestra

Uraniastrasse 9
8001 Zurich
Switzerland

Tel: +41 510 92 00
Email: info@advestra.ch
Web: www.advestra.ch

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