

COMMENT

Coming from America

Carl Bradshaw, Rajal Patel and Anne Stroude, members of the private equity group at international law firm Goodwin, discuss US-inbound investment activity in the face of foreign investment and public market reforms.

What role are US investors playing in the current deals market and what is driving this activity?

Amid the feverish pace of deal making over the last year, US sponsors have increased their investment activities in Europe by over \$80bn, involving 500 deals more than in the previous year.

A perception that the European market is less crowded by buyers and therefore less competitive, and importantly as a result of this, that valuations are at a discount relative to comparable companies in the US, might first prompt US investors to look ‘across the pond’ but that doesn’t necessarily play out on every deal and there are usually strategic drivers such as portfolio company synergies or overseas expansion of a successful investment model into a similar market that cause US investors to pursue European targets both as buyouts and bolt-ons.

US investors have been able to bring domain expertise in areas such as technology and healthcare, which has translated into expedited diligence timelines and a focus on high impact issues during negotiations that have helped them differentiate themselves in competitive processes. US investors have been particularly dominant in the growth equity space, an area we have been practicing in for over 30 years in the US and are now seeing momentum in Europe. US sponsors are taking advantage of this head start in getting to grips with the hybrid terms offered by growth companies.

What kind of education process is needed when you bring a US investor into Europe?

The old adage ‘buy in the US’, sell in Europe’ which purports to say buyers typically enjoy more favourable terms in the US, still has some truth today - notwithstanding the ultra-competitive state of the US market. US buyers are often not familiar with (or at least, not in favour of) the now almost-ubiquitous ‘locked-box’ mechanism which prices European deals off an historic balance sheet and the options for a buyer to walk away from a deal, for example, due to financing failure or because of a material adverse change in the target business are more prevalent in the US.

That said, to be forewarned is to be forearmed, and through early interventions we draw upon extensive insights from acting for US buyers to distill the risks and opportunities of European terms, helping them avoid the pitfalls that would otherwise render their bids uncompetitive.

Incentivising the management team is one particular area requiring US sponsors to recalibrate their expectations. European managers are accustomed to having their go-forward incentive terms negotiated in parallel to the deal, maximising their leverage during the all-important bidding stage.

What impact is the National Securities Act having on US-inbound investment?

Under the new regime that was enacted on 4 January 2022, and allows retroactive review of transactions that have completed after 12 November 2020, the UK government can screen investments in 17

sensitive industries (including data infrastructure, AI, computing hardware and quantum technologies) on the grounds of national security. US buyers now need to determine whether to make a mandatory or voluntary notification, and in the case of mandatory notifications, clearance will be required before a transaction can close.

This is a prime example of where US buyers need a coordinated, multi-jurisdictional approach to filings in the aftermath of Brexit, as the UK rules sit outside of the European framework. We are helping US buyers and their counterparts carry out pre-emptive assessments of potential implications on deal timelines, longstop dates and closing conditions to enable them to maximise the deliverability of their strategic vision. The UK Government estimates that there will be between 1,000 – 1,830 notifications under the new regime per year, approximately five times the number of filings screened by the equivalent US CFIUS regime.

How are UK capital markets evolving to hold onto rising companies that are increasingly choosing to exit via the US public markets?

The UK has introduced a number of Listing Rule changes aimed at creating greater flexibility for issuers and increasing investor confidence in the quality of listed companies. Dual class share structures had previously only been possible for less prestigious standard listings, and have now been introduced for premium listings, enabling a shareholder, such as a founder, to retain voting

control over the company following an IPO. Under the new rules, which came into force on 3 December 2021, the ‘free float’ requirement has been reduced from 25 per cent to 10 per cent, allowing companies to test the public markets with a smaller initial stake, and the minimum market capitalization requirement has been increased from £700,000 to £30m.

This trend of reform was also seen in the SPAC rules, when the UK removed the presumption of a share trading suspension after the announcement of a proposed acquisition and introduced a redemption option that allows shareholders who do not support the proposed acquisition to redeem their shares at a pre-agreed price. While the reforms have been rolled out in a year that has seen the highest number of IPOs in the UK since 2007, the IPO and SPAC regimes remain more stringent than some international equivalents.

Will the foreign investment restrictions and public market reforms serve to deter US investors?

The early signs are that Europe, and the UK in particular, are very much still considered by US investors as open for business and continue to be an attractive market for capital deployment. While we are staying alert to the most recent regulatory developments, the economic and strategic drivers of US-inbound investments remain robust and are giving sponsors the conviction to overcome the risks introduced into European buyout and growth opportunities. ●



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