GOODWIN

“Corporate Activity”
Panel, Brexit Workshop, University of Oxford

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IMPLICATIONS OF BREXIT FOR PRIVATE EQUITY AND PRIVATE EQUITY-BACKED FIRMS

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1. I am probably going to be the least interesting Panelist in any of this morning’s sessions because, in the longer term, it seems very unlikely that Brexit (or, for that matter, Nexit or Frexit or Quitaly) will have any significantly adverse impact on Private Equity. Plus ça change, frankly.

2. I am a Private Equity lawyer at Goodwin, one of the world’s leading Private Equity law firms. I’ve been doing Private Equity for 30 years (pretty much right from the start of it in the UK) and, in the context of this particular talk, there are three things I would note about the evolution of Private Equity during that time:-

    a. Point one: Private Equity folks are remarkably creative and inventive. They love a challenge: in fact, the best of them make the most money in those circumstances. They see Brexit as a money-making opportunity, just like the Black Monday Crash of 1987, the Dotcom Bubble Burst of 2000, the Global Financial Crisis of 2007-8, the election of Donald Trump etc., etc.

    b. Point two: Private Equity is a truly international business. Yes, there are some Private Equity investors who are very UK-centric and who focus on investing principally in UK businesses. But very few UK businesses, today, operate solely in the UK. Most are European, or even more International, in their reach. Take our client Bridgepoint – a leading mid-market European Private Equity house: they operate in over 80 different jurisdictions as a result of their investments. What’s happening as a result of Brexit in the UK, even in Europe, is only one (ever decreasing) aspect of their business.

    c. Point three: A number of Private Equity houses have diversified into alternative asset managers. Not only do they invest in Private Equity, they also invest in Real Estate, in Infrastructure, in Debt etc. Indeed, the fundamentals of what follows apply more widely than to just the Private Equity asset class. That softens the impact of Brexit.

3. In my talk, I will examine two aspects of Private Equity:-

    a. Private Equity fund-raising; and

   b. Private Equity investing.

4. Let me give you a few interesting and pertinent facts about the Private Equity industry in the UK and in the rest of Europe (rEU). These are statistics published by the UK's voice of Private Equity, the British Venture Capital Association (the BVCA):-

   a. Over the last 5 years, those Private Equity funds who are members of the BVCA have invested more than £27bn in around 4,000 UK-based businesses.

   b. Currently, UK-based Private Equity funds back some 3,000 businesses employing over 900,000 people (on a full-time basis) around the world, of which 40% are in the UK and 30% are in the rEU.

   c. Looking at the two distinct aspects of Private Equity, over the last 3 years:-

      i. With regard to fund-raising: 18% of funds raised by UK-based funds were from rEU countries; and

      ii. With regard to investing: 40% of UK-based fund investment activity was in companies based in the rEU.

5. By any measure:-

   a. Private Equity is important to the UK and to the rEU; and

   b. The rEU is important to UK-based Private Equity.

6. So, what are the implications of Brexit for Private Equity fund-raising? Most of the chatter in this area has been around:-

   a. Regulatory changes: effectively preventing UK-based funds from attracting investors from the rEU (the source of 18% of their funds over the last 3 years); and

   b. Tax changes: especially withholding tax preventing or restricting the up-streaming of dividends and interest within portfolio company groups. If investors suffer more (indirect) tax on these investments that will ultimately impact investor returns.

7. If regulatory or tax (or any other) changes make UK-based Private Equity significantly less attractive, guess what: those UK-based Private Equity funds will simply de-camp and move their operations elsewhere. Private Equity funds are not like big Investment Banks and Retail Banks. They employ relatively few back-office staff and their investment professionals are usually multi-cultural, multi-lingual people from far and wide who enjoy living in London. But it's our shops, our restaurants, our

culture and our schools that attract them to London, far more than the smooth and efficient workings of the current UK/rEU regulatory regime. If they have to, they will simply go and live in Geneva or Frankfurt or Dublin – indeed, many London-based Private Equity funds already have offices and established operations elsewhere in Europe. Our Private Equity fund clients are already contingency planning for this. They tell us that, based on the current Brexit timetable, they need to decide what to do in around six months' time so that, if necessary, they can transition away from the UK with minimal disruption to their businesses. If the post-Brexit landscape for Private Equity isn't clear by then, surely the business imperative will be to seek greater certainty by leaving the UK (and bickering politicians) behind.

8. And what are the implications of Brexit for Private Equity investing? In the longer-term, it looks as if Brexit will have very little effect (although, as we have already heard from other Panelists, businesses in certain geographies or sectors may become more or less attractive). Today, the uncertainties of Brexit are making it harder to do deals, and particularly to due diligence and to value potential investments. But a typical Private Equity fund is structured with a 10 year lifespan comprising an initial period of 5 years to invest the fund and then a subsequent 5 years to realise those investments. So, Private Equity funds cannot afford to sit on their hands for too long: they have to put their money to work. And today, with more "dry powder" (ie more money committed to Private Equity funds and waiting to be invested) across the globe than ever before, there is huge pressure to invest and Private Equity simply cannot ignore the UK or the rEU, despite Brexit uncertainty.

9. Which is why, even in the teeth of Brexit, we were still doing deals for our Private Equity clients. Very shortly after Brexit, for example:-

   a. We advised a Private Equity fund on its investment in an online food delivery company [Deliveroo]. This target is a very British business although it is growing very rapidly across Europe and more internationally. It was an unusual investment for our client (particularly because they were only taking a minority stake) and I was sure, immediately post Brexit, that they would call the whole thing off. But they didn't: they merely adjusted their pricing (by a very unscientific 3%) and closed the deal.

   b. We advised another Private Equity fund on the realization of its investment in a business manufacturing crisps [Tyrrells]. Another very British target business, although again one that is growing internationally. Again, I was sure that Brexit would immediately scotch the deal. But no: the business was sold, for a mouth-watering price, to a US strategic buyer who, because of Brexit, was able to get more bang for its buck and who, in any event, was more interested in leveraging the brand State-side than in Europe.

10. Private Equity, at least in the mid-market and upwards, needs "leverage" (i.e. money borrowed by the businesses that Private Equity funds buy) in order to enhance the returns on their investments. So, is Private Equity deal-doing likely to be adversely affected by the Brexit uncertainties surrounding the European banking industry which we heard about in our earlier Panel session? No, I don't think so.

Many of the European banks have still not fully recovered from the Global Financial Crisis of 2007-8. As a result, for quite some time now, Private Equity has looked elsewhere for its life-giving leverage: and abundant debt has been found in the US markets (what's known as the rise of Term Loan B), in the High Yield debt capital markets and from specialist Alternative Debt Providers.

11. One last thought. One of the things that distinguishes a Private Equity deal from a traditional M&A deal is that a Private Equity fund (in contrast to a Corporate buyer) will typically be looking to realise (Exit) its investment within 3-5 years. So, at the time when they make their Private Equity investment they're already looking ahead to what that target business might look like and where the markets might be around that time horizon. As they crystal ball gaze, we hear increasing concerns about another looming economic downturn which could hit in the next two years. Given the Brexit timings and uncertainties we've been hearing about this morning, it could be that a perfect storm is brewing.

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