2013 The Netherlands private equity and leveraged finance market— an outlook

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Introduction

In the course of writing the 2013, and second, edition of NautaDutilh's outlook on the private equity and leveraged finance market in the Netherlands, we spoke with a lot of people. We heard Dutch bankers explain how difficult it has become to finance leveraged buy-outs once debt levels exceed €150 - 200 million. We also heard a private equity manager describe how, operating out of London, he had not had any real difficulty in arranging competitive financing for a potential €2 billion-plus deal involving a Dutch target company. When you set out to investigate the trends and developments in the Dutch leveraged buy-out market, you quickly realize that this market is made up of many fundamentally different segments and that you therefore need to choose a particular focus. In this outlook, we focus mainly on the mid-market with deal sizes between around €50 million and €350 million.

Mid-market deals in the Netherlands are a predominantly Dutch affair, with only a limited number of private equity sponsors and leveraged finance bankers involved. In these deals, it is often the case that more than one bank is needed to provide acquisition financing, and this puts banks in a relatively favourable position. Whereas in smaller deals banks frequently go head-to-head (with the result that “pricing, fees, conditions, documentation,
everything goes down the drain, and banks sometimes suffer massive losses in these deals," as one banker admitted), in mid-market deals it is much more difficult to play banks off against each other on fees, pricing and/or conditions. In addition, banks are in a position to demand independent due diligence reports, more specialised legal advice and more extensive documentation. In this segment of the market, banks are therefore able not only to improve the economics of their loans, but also to further limit their risks. Hence, for reasons described more extensively in this outlook, the mid-market is a sweet spot for Dutch banks that provide leveraged financing.

The predominance of Dutch players in the mid-market also removes some of the sharp edges from the ways in which business is conducted. “In the Netherlands, private equity sponsors don’t need to negotiate towards maximum flexibility on loan covenants from banks. When problems arise, sponsors can usually count on banks to engage in more or less constructive dialogue and work things out,” is an example given by one banker. He attributed this to the Dutch characteristic of striving for reasonableness and fairness, and, perhaps more importantly, the knowledge that the parties will need each other in order to close a deal the next time around.

For larger deals, say from around €400 million upwards, it is usually necessary for foreign parties to get involved. This adds a dose of discipline as transactions become subject to international standards and practices. “That changes the entire character of a deal, which often makes it difficult to put deals of this size together in the Netherlands,” according to one interviewee. “Relationships don’t carry much weight in these types of deals; they are negotiated in a much sharper, more transparent and business-like way.”

We began with an online survey among private equity managers, M&A and leveraged finance bankers and corporate finance advisors. We followed up their responses with roundtable discussions in Amsterdam and London, as well as a series of in-depth one-on-one interviews with market participants.

The results of these investigations are presented in the first three chapters of this outlook, dealing with the climate for private equity, the climate for leveraged finance and trends in private equity transactions, respectively. In the fourth chapter we discuss some of the recent regulatory, legal and tax developments that affect the sector. We are proud to share this outlook with you and would welcome your feedback.

On behalf of the NautaDutilh Private Equity and Leveraged Finance Team:

Gaik Dalenoord, partner Private Equity
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## Table of contents (continued)

New rules on distributions ...................................................... 57
Introduction of non-voting and non-profit participating shares .......... 58
Greater flexibility with regard to share transfer restrictions .............. 58
Power to issue specific instructions .......................................... 58
C. Relevant tax developments .................................................. 59
   Changes to interest deductibility restrictions .............................. 59
   Taxation of carried interest arrangements ................................ 59
   OECD Base Erosion and Profit Shifting Report ......................... 60
   Financial transaction tax .................................................... 60

Appendix I: the AIFMD .............................................................. 61
   IA. Brief recap of the rules in the AIFMD ................................. 61
   The licence ........................................................................ 61
   Notification of acquisitions and control .................................... 61
   Asset stripping .................................................................... 61
   Timelines ........................................................................... 62
   IB. Interesting points in the AIFMD Level 2 Regulation ............... 62
   Exemption based on fund size ............................................... 62
   Remuneration .................................................................... 62

Appendix II: the Flex BV Act and the One-Tier Board Act ................ 66

## 5 Conclusion ............................................................................ 68
   Short profiles ....................................................................... 70
   Methodology ....................................................................... 74
   Disclaimer ........................................................................... 75
The climate for private equity in the Netherlands
The climate for private equity in the Netherlands

“When is the last time you read about a double dip?”, we quoted a confident banker in the previous edition of NautaDutilh’s Private Equity and Leveraged Finance Outlook, published in early July of 2011. The quote served to illustrate the optimism that, albeit surrounded with caution, was prevalent in the Dutch buy-out market in the first half of 2011. Of course, shortly thereafter the sovereign debt crisis broke out and has continued to hold European economies in its grip ever since. In the fourth quarter of 2012, the Netherlands entered the third recession in as many years. In this chapter we will investigate the effect of this “triple dip” on the outlook for the Dutch buy-out market in 2013.

The Dutch private equity market: mostly cloudy with poor visibility...

Apart from a few occasional highlights, 2012 has been a year that most in the private equity community in the Netherlands would like to forget as soon as possible. “The 2012 summer was the quietest I can recall in terms of starting new sales processes,” remarked one participant in our roundtable discussion, to nods of approval from others. Upon which another participant added: “the beginning of the year was not much either.” This sombre assessment is supported by provisional data from the Nederlandse Vereniging van Participatie-maatschappijen (NVP); private equity activity in 2012 (in terms of both initial investments and exits) was about half of that in 2011.

Even with such a low level of activity as the starting point, expectations for improvements in 2013 are not very high. More than half of our respondents (57%) expect no increase in deal volume compared to last year. If deal activity increases at all, as a large minority (42%) of our respondents think it will, it is certainly not expected to happen quickly. Amid the current uncertainty and volatility in the market, it is difficult even to get deals started. “At the end of last year I was in the midst of budget discussions for 2013 with customers who were not even prepared to give their latest estimate for 2012,” says one advisor. “So what on earth am I supposed to approach the market with to get a transaction started?” Of the transactions that do get started, many fail to cross the finish line, hindered by what market participants describe as a “phenomenally high execution risk” (for more on this, see Chapter 3).

Taken overall, these results imply that the sentiment in the private equity community in the Netherlands has become decidedly more negative since we surveyed their forecasts for 2011. Back then, 81% of our respondents expected an improvement for 2011 (and were proven right; the 2011 buy-out volume was almost double that of 20101).

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1 Source: NVP
Expected buy-out volume for 2013 compared to 2012

- 42% Increase
- 50% Stay the same
- 7% Decrease
- 1% Don't know
Among the reasons cited for this robustness is the fact that private equity is well established and represents a sizeable chunk of the Dutch economy: in 2011, private equity had invested a total of €3.9 billion in 1,161 companies that had combined revenues of €83 billion and accounted for 4.9% of total employment and 16% of Dutch GDP. In terms of overall attractiveness to private equity investors, the Netherlands ranks 12th globally, down from 10th place in 2008, mainly due to a lower partial score on ‘Expected real GDP growth’ (see Figure 2).

In terms of risk and reward the mid-market segment is considered a sweet spot by many Dutch private equity firms. Mid-sized companies are not as vulnerable to operational risks as smaller sized ones, whereas compared to multinationals they offer better opportunities for value creation, e.g. through buy-and-build strategies.

Figure 1: In which market segment do you expect most private equity activity?

<table>
<thead>
<tr>
<th>Total deal volume [€]:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>€ 1 billion</td>
<td>■ 60%</td>
</tr>
<tr>
<td>≥ € 350 million, ≤ € 1 billion</td>
<td>■ 33%</td>
</tr>
<tr>
<td>≥ € 100 million, ≤ € 350 million</td>
<td>■ 7%</td>
</tr>
<tr>
<td>≤ € 50 million</td>
<td>■ 6%</td>
</tr>
</tbody>
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international expansion. Moreover, the mid-market in the Netherlands still has a distinctive ‘Dutch touch’ to it that favours local players and serves as an, albeit limited, entry barrier to outsiders. Whereas this cultural influence may be hard to pinpoint, it is believed to result in favourable financing terms (more on this in Chapter 2 on leveraged finance) and better access to deal flow for players with local clout. “Our origin and presence in the Netherlands allow us to maintain long-term relationships with prospective target companies, and help to get us into one-on-one deals,” according to an interviewee.

For all banks with local leveraged finance teams, the mid-market is a sweet spot as well. “Rabobank, ING and ABN Amro all strive for leadership in the mid-market, and you might describe them as relationship banks. That means these three banks will always compete to obtain the lead in mid-market deals.” With this competition comes the willingness to occasionally provide relatively large buy-out loans at relatively low margins (again, more on this in Chapter 2). “A good private equity deal is the best business you can bring in for your organisation,” says a leveraged finance banker from one of the said three banks. “When you finance a buy-out, you provide financing at a time when all other business is put on the table as well. The margins that you forgo on your buy-out loans you can compensate for with this ‘side-business’.”

Who is buying...

Insofar as respondents do expect an increase in deal volume for 2013, the most active type of buyers are expected to be private equity firms, followed by corporates (see Figure 3).

These results signify that private equity firms have strong incentives to buy (‘the need to put fund capital to work’ is often mentioned as a driver for private equity deal volume, see page 17). Whether a private equity firm indeed ends up as a buyer depends on the projections for the value it will be able to create in the prospective portfolio company, and on the amount of leverage it can apply. As some interviewees observe a trend towards somewhat higher debt/equity ratios (“It used to be 50% equity and 50% debt, now it is moving to 40% and 60%”) and leverage, chances are that private equity will account for a larger share of acquisitions in 2013 (more on deal structures in Chapter 2).

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Figure 3: Most active prospective buyers in 2013 and 2011

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1 ABN Amr, Deutsche Bank, ING. NIBC and Rabobank.
Preferred exits for sponsors

Number of respondents (normalized, multiple answers allowed)
According to Preqin data the private equity sector’s “total global assets under management last year rose 4% to $3.2 trillion, the 12th successive year of increase since records began in 2000.” Part of this increase comes from buy-out firms, which have seen the value of their portfolio companies rise to $894 billion, a strong increase since 2008 and up 11% from 2011. This has partly come as a result of the failure of private equity firms to sell the assets they acquired during the boom era between 2005 and 2007. [...] In addition, many of the sales of recent years have been secondary buy-outs [...] while initial public offerings and trade exits have been more difficult. So although they have plenty of assets and a strong incentive to sell (‘exits from portfolio companies’ is regarded as the second most important driver for private equity deal volume, see page 17), buy-out funds are not expected to be as active on the sell side yet. This is not the point at which they expect to get the most for their assets. “Times in which the economy is moving sideways, as we expect it will do for a few more years, do not help to maximize value for us,” says one fund manager. “For family-owned or captive private equity firms, or for firms that have recently raised new funds, there is no incentive to sell right now. This year we have only done exits when we had strategic buyers knocking really hard on our door.” Corporates, by contrast, are expected to become more active sellers in order to raise cash or pay down debt.

A recent study by Ernst & Young reports that 77% of corporates “intend to accelerate their divestment plans over the next two years.” Remarkably, the same study found that only a small fraction of corporates expect to sell to private equity firms, and it concludes that “sellers may be missing an opportunity to secure capital by not taking the time to prepare for these potential buyers who may have significant amounts of capital to deploy.”

Preferred exits for sponsors

For private equity sponsors that are looking to sell parts of their portfolios in 2013, the sale of a company to either a second (or third) private equity firm (‘secondaries’ or ‘tertiaries’) or to a corporate buyer tops the list of preferred exit routes, exactly as in 2011. Indeed, in the third quarter of 2012 the proportion of secondaries rose to 59% of all European private equity deals, its highest level since 2008. However, it may become harder to go down this route: “We are getting very strong pushback from our investors when we try to buy something off a firm with a similar profile to ours,” says one fund manager.
“The way they see it, we are recycling their money, incurring transaction costs and taking 20% off the top during each transaction, while nothing much is going to change for the company. For most firms this route will become increasingly challenging.”

Because ‘full exits’ are difficult to realize on terms satisfactory to private equity sponsors, such sponsors increasingly resort to ‘recapitalizations/refinancings’ as an alternative means of generating a return on their investments. This is particularly true for the US (last year private equity companies borrowed $64 billion to pay out as dividends, almost double the amount in 2011[10]). Europe, said to be traditionally more cautious towards dividend recaps, is set to reach post-crisis record levels as well, with $4.4 billion borrowed for this purpose in the first three quarters of 2012 alone (this is likely to surpass the 2011 level of $4.8 billion, but still falls far short of the 2007 level of $40 billion)[11]. It seems that dividend recaps are becoming popular in the Netherlands as well. “Right now we are working on three different recaps,” says a Dutch leveraged finance banker, referring to the use of this device by Dutch private equity firms at their Dutch portfolio companies. “Investors have to get their returns from somewhere, and now that many can’t find good opportunities to sell they have started looking for other ways. A dividend recap then makes perfect sense. And it can be a perfectly legitimate method as well, provided leverage ratios are not increased too much.”

We have indeed noted an increasing number of deals in which the option to create what is called a “liquidity event” (of which dividend recaps are an example) is agreed upon contractually. A liquidity event gives investors the possibility of realizing an interim return if a company’s performance exceeds the projections in the business plan and/or if the company can be refinanced at better rates or with higher leverage. The new ‘Flex BV’ legislation sets the stage for a possible increase in the number of such liquidity events, as the new rules generally impose fewer formal hurdles for company distributions. At the same time, the responsibilities and liability risks for directors when making such distributions have become more explicit and are expected to result in new dynamics between company boards and private equity investors. (More on the ‘Flex BV’ rules in Chapter 4).

Despite the successful 2012 IPOs of Ziggo (by private equity firms Warburg Pincus and Cinven) and DE Master Blenders 1753[12] (a corporate spin-off from Sara Lee) in Amsterdam, respondents in our survey do not expect many private equity portfolio companies to follow those examples (see page 14). A similarly negative outlook on IPOs can be found in a study by Ernst & Young[13]. This shows that in 2012, 103 private equity-backed IPOs took place, raising $21 billion globally (of which almost 80% was in the US). These numbers represent a drop of nearly 50% compared to 2011. IPO proceeds are expected to drop even further in 2013, as the IPO pipeline continues to become smaller: only 30 companies filed for an IPO in the second half of 2012, approximately half of the number that filed in the first half of the year. And even if the traditional European stock markets continue to climb steadily, most portfolio companies in the Netherlands lack sufficient size (or even the appetite) for an IPO until there is a well-functioning small- to mid-market stock exchange.

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[12] At the time of going to press, John A. Benckiser had announced a non-binding indication of interest in acquiring DE Master Blenders 1753 through a public offer for all the shares.

Which factors will drive an increase in private equity deal volume?

- Macro-economic conditions
- Exits from portfolio companies
- Stockpiled cash of private equity firms/need to put fund capital to work
- Investor confidence (e.g. as a result of number of leveraged loan defaults)
- Convergence of sellers’ and buyers’ price expectations
- Concerns over sovereign debt
- Regulatory environment (e.g. Basel III, AIFM Directive, Dodd Frank)
- Interest rates/search for yield
- Corporate restructuring
- Emergence/re-emergence of CDO, CLO and other structured investment vehicles in the secondary market for leveraged loans
- Downsizing by financial institutions
- The ability of the market to deal with the “Wall-of-debt”

Number of respondents (normalized, multiple answers allowed)
What might drive private equity deals in 2013?

Asked what might drive an increase in deal activity from private equity firms, respondents cited macro-economic conditions first and foremost, which is in line with the opinions of participants in our roundtable discussions.

Besides adverse macro-economic conditions, another important reason for the expected low deal volume that was highlighted in our roundtable discussions is the gap that still exists between the price expectations of buyers and sellers. This gap is maintained in part because the few deals that are completed are done at high multiples. This raises expectations among sellers, just like it would in the housing market: “If you have a fantastic house in tip-top condition in a prime location, you can still sell it the next day. Only now your neighbour won’t sell unless he gets the same price, even if his house is not nearly as good, so he ends up getting stuck with it for a year or more.”

Possible sources of new deals that were mentioned in our roundtables are the banks’ intensive care units, where many companies have ended up in the past few years: “You already see a lot of restructuring-driven deals in the market,” observes one participant.

“The situation is very different from two to three years ago. Nowadays banks deal differently with companies: it’s no longer a matter of keeping the business ticking over, but of taking decisive action. This leads to a lot of companies being put on the market, in parts or in one piece, and ranging in size from very small to quite big. Such companies may very well be healthy from a business perspective, but just have the wrong capital structure.” (More on restructurings in Chapter 2.)

In which sectors might we see private equity deals in 2013?

Asked which sectors of the economy are most likely to see a lot of private equity deals, respondents to our survey provided the following assessment:

Healthcare ranks as the number 1 sector in terms of expected private equity activity in 2013, up from number 3 in 2011. But while the healthcare sector perhaps provides significant opportunities for private investors (especially in peripheral areas of healthcare and smaller-scale health providers), it also poses numerous pitfalls and obstacles. These are set out in more detail in the text box ‘Healthcare’ on page 20.

The strong drop in activity expected for ‘retail & wholesale’ is attributed mainly to the belief that profit margins in the retail sector are under pressure: consumer spending continues to decrease14, while a substantial proportion of the sector’s costs are fixed rental costs. However, views to the contrary can also be heard: “Traditional private equity sectors such as retail, but also manufacturing and food, are quite attractive to invest in right now. As soon as the economy starts to improve, those sectors will be the first to respond and generate returns again,” says one private equity investor.

Business and professional services continue to be seen as sectors that are attractive to private equity investors, an opinion to which Waterland’s successful sale of Intertrust (the sale was pending at the time of our survey) may have contributed. Reasons cited for this attractiveness are the typical high cash conversion rates of companies in these sectors and the benefit they stand to gain from the continuing trend towards the outsourcing of business and professional services.

Financial products and services remain unlikely to see a lot of private equity activity, according to most of our respondents. They believe that the heavy regulatory

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14 Q3 2012 was the fifth consecutive quarter that saw a decrease in the real (i.e. inflation-adjusted) disposable income of Dutch households. (Source: CBS - http://www.cbs.nl/nl-NL/menu/themas/income-en-wealth/publicaties/artikelen/archief/2013/2013-04-01-01-ne-s.htm)
and political influences on this sector will deter most investors, despite the opportunities that the sector provides (see also the text box ‘Private equity investments in financial institutions’ on page 55). “I’m a big believer in financial services,” said one private equity manager in our roundtable discussions. “The supply of assets that big banks and insurers will have to divest is going to be massive. The industry is in need of capital and could use some efficiency improvements, both of which private equity could contribute to. Only a handful of investors with specialized teams could do it, and only certain businesses that are not too capital intensive, such as wealth management and specialist insurance companies, lend themselves to the traditional private equity model. But even within those restrictions you can find incredibly attractive investment opportunities.”
Trend: Healthcare

Barring major changes in government policy, healthcare costs in the Netherlands are predicted to increase to 31% of GDP by 2040, up from the current level of around 12%\(^\text{15}\). Far-reaching measures will be required to curb this growth, as it is driven by unstoppable forces of demographic change, technological progress and unlimited consumer demand. Yet even if healthcare costs can be kept in check, sizeable amounts of capital will be needed to finance growth, innovation and the overall transformation of the healthcare sector. It has been calculated that in the next six years, an additional €11 billion in capital will be needed on top of the current levels of bank financing and internally generated funds\(^\text{16}\). The healthcare sector thus provides the major ingredients of an attractive investment case: substantial growth prospects, the potential for efficiency improvements and a need for fresh capital. In this light, it should come as no surprise that healthcare scores first in our survey on the list of sectors in which private equity investors are interested.

However, this number 1 ranking should be qualified to some extent. Our research shows that, currently, investors are mainly interested in peripheral areas of healthcare (e.g. suppliers, services and IT) and in the smaller-scale healthcare providers, e.g. private clinics and focus clinics as well as chains of independent healthcare suppliers in primary-care areas such as psychology, dentistry and general practice. In other words, private investors seem to be less focused on the larger-scale traditional general hospitals for now. The main reasons given for this are the complex organizational and governance structures of such hospitals and the increasing power of healthcare insurers. Respondents said that the strong influence of medical specialists, combined with the rights and powers of the mandatory supervisory council and patients’ council, makes it difficult for private investors to implement organisational changes. In addition, the work processes and operational management of hospitals are so complex that it is extremely difficult to make a proper business case.

A further obstacle for private investors is the extensive and sometimes unpredictable impact government decisions have on the healthcare sector, for example on the determination of what is included in the basic health insurance package. A case in point, even if it turned out to be a storm in a teacup, is the recent threat by accountants not to issue unqualified audit opinions for the 2012 financial statements of Dutch general hospitals. The hospitals’ income statements were considered to be insufficiently reliable, mainly because they were unable to deal with all the complexities introduced by the multiple new policies that hospitals had to implement in 2012. According to PwC: “It has therefore never been more difficult to predict hospitals’ revenues and results.”\(^\text{17}\)

Another barrier is that certain Dutch healthcare providers, including all ‘traditional hospitals’, are prohibited from distributing profits. This, however, is about to change. The government is currently preparing legislation that will allow healthcare providers to distribute profits as long as certain requirements are met. It is our experience that the prohibition as such is not perceived as being a great hindrance, as it is commonplace in the market to structure around it in various ways. Having said that, the (conditional) lifting of the ban is believed to be the beginning of a ‘climate change’ in the sector, which will make it more socially acceptable, and thereby more attractive, for private investors to make a profit on investments in this sector. That would be quite a change from only four years ago, when responsible government officials declared, in reference to private investors, that “there is no longer any room for cowboys in healthcare.”\(^\text{18}\)

\(^{15}\) Source: Zorgkapitaal (http://www.zorgkapitaal.nl/trends/13/vergelijking niet belangrijk (factor in stijgende zorgkosten).  

\(^{16}\) Source: Zorgkapitaal (http://www.zorgkapitaal.nl/trends/18/11-miljard aan extra financiering in de zorg noodzakelijk).  

\(^{17}\) Source: PwC - Seminar ‘Zicht op opbrengsten’ (http://www.pwc.nl/nl/assets/documenten/pwc-presentatie_pwc.pdf).  

The climate for leveraged finance in the Netherlands
“It is absolutely possible to do a 10-to-15 billion-dollar deal now. [...] The capital is available,” we quoted a confident David Bonderman, founding partner of private equity firm TPG Capital, in our 2011 outlook. By the end of 2012, no such deal had closed. The largest private equity-backed deal of 2012, the buy-out of a US oil and gas company, tipped the scales at ‘only’ $7.2 billion, although by the end of the year a buy-out of US electronics retailer Best Buy estimated at nearly $10 billion was reported to be in the works. Then, in early February 2013, US private equity firm Silver Lake announced the buy-out of Dell (by the end of March competing offers had been made by Blackstone Group and Carl Icahn). The computer maker has been valued at over $24 billion, making this the largest post-crisis private equity deal by far. It clearly seems the US buy-out market has turned the corner.

The landscape for US jumbo deals is a world away from the market for buy-outs in continental Europe, and not just geographically. To begin with, US capital markets are far more liquid and much better developed than those in Europe, with its fragmented jurisdictions and its traditional reliance on banks as a source of credit. To illustrate this point: in the US, banks are responsible for only 25-30% of lending to corporations, with the remainder coming from the bond markets. By contrast, in Europe this picture is reversed: there is €8 trillion of corporate debt on bank balance sheets, but only €1.3 trillion outstanding in the bond markets19. Compared to their US counterparts, European banks thus have a much more vital role in corporate lending. Alas, they have also been much slower in cleaning up their balance sheets, which limits their capacity to fulfil this vital role. Moreover, in the coming years their role in corporate lending may be even further diminished as a result of the new Basel III regulations.

19 Source: Barclays, as reported in The Economist - ‘Filling the bank-shaped hole’, 15 December 2012.

The climate for leveraged finance in the Netherlands
European private equity firms have seen their access to debt adversely affected by another development: the collapse of the European collateralised loan obligations (CLO) market. In 2007, CLOs bought around two-thirds of the €170 billion of leveraged loans issued in Europe that year. In 2008, the market froze up completely and has remained practically frozen ever since. Only now, in early 2013, are there reports of the forthcoming launch of new CLOs in Europe (see also the text box on page 34).

In this chapter we will investigate what all of this means for the availability of leveraged finance in the Dutch market, and how this will affect the buy-out activity of private equity firms.

The availability and pricing of leveraged loans

“For high-quality assets, there will always be capital available,” was the firm assertion made by a Dutch leveraged finance banker covering the mid-market. And since assets that come on the market these days tend to be of the high-quality variety (lesser assets are very often simply not put up for sale; more on this in Chapter 3), the availability of financing, though limited, is not considered by our roundtable participants to be a major obstacle to getting deals done in the Dutch mid-market.

Indeed, since only a small number of high-quality assets come on the market, all banks with local leveraged finance teams are keen to get involved when an opportunity presents itself (if only to have a shot at the ‘side business’, as mentioned in the previous chapter). In addition, the major Dutch banks all seek to strengthen their position in the mid-market and place a premium on market share and customer relations. This leads to fierce competition and, in the words of one banker, “to risk perceptions that have become somewhat clouded because of banks’ close and long-time relationships with their sponsor and corporate clients. Banks have thus tended to underestimate risks.” The remarkable result is that, despite the small number of banks involved, the prices and the terms and conditions for leveraged loans in the Netherlands are often more attractive to borrowers than those in the UK and US markets, in which far more banks are active.

As long as only Dutch banks are involved, buy-outs can benefit from these favourable circumstances. There is thus a size limit on the deals to which this applies. This (somewhat theoretical) limit is reached when all five banks in the Dutch mid-market join in a club-deal and put up the maximum amount of senior debt they are willing and able to provide. According to participants in our Amsterdam roundtable discussion, a maximum of around €200 million in senior debt can be made available in this way, “but only if all the pieces fall into place: a strong company, a healthy sector, good pricing and all the rest.” Assuming that senior debt accounts for 50% of total financing, the maximum deal size with only Dutch banks involved is around €400 million. “Below that threshold financing is relatively easy, above that it is significantly more difficult to put debt funding together. That is an important reason why you hardly ever see any domestic private equity deals worth over €400 million.” Possible solutions to address this funding gap will be discussed below.

This ‘maximum deal size’ has already come down in recent years as banks’ lending abilities have shrunk and a number of foreign banks have left the Dutch market. It may drop even further as banks continue to face economic and regulatory pressures to reduce the risks on their balance sheets and strengthen their capital buffers. According to participants in our Amsterdam roundtable discussion, the impact of the new Basel III regulations and possible future losses in banks’
What will be the maximum amount of senior debt a single bank will be prepared to lend?
The benign leveraged finance climate in the Dutch mid-market is being transformed due to other changes as well. One banker summarizes these as “a move towards tougher, more disciplined Anglo-Saxon practices, with less room for relationship banking,” resulting in “a more transparent and professional” business environment. These changes come in response to the lessons banks have learned from the many covenant resets they have had to negotiate, and the “significant write-offs” of leveraged loans in some cases. The change is towards “more objective” risk assessments, which have a clear upward effect on prices: “The prices of leveraged loans have been much too cheap, so our margins have been absurdly low. Private equity expects to make a return of at least 20%, while we have been charging only 3% for their debt. I can assure you that in our business the risks they run are not more than 6 times higher than ours.” Prices for leveraged loans are thus increasing, something that is also reflected in the survey results. For 2013, the margin over EURIBOR is expected to be at 3.8%, up from 3.2% for 2011 (weighted averages).

This is in line with the rough estimates given by one Dutch banker: “In the past pricing was at EURIBOR + 2%, now it’s + 4%, and we’re moving slowly towards UK levels where it’s + 5%. And to give you an idea of how far off we were: in the US it’s LIBOR + 5%, with a LIBOR-floor of 1.5%, even if the actual LIBOR is only 0.25%.” The views arising from our survey on senior debt margins beyond 2013 are more mixed: against 31% who expect a further increase, 25% expect a decrease and 38% expect no change. Interestingly, most bankers in our survey expect senior debt margins to either increase further or stay the same, whereas on the sponsor side most respondents expect either a decrease or no change.

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**Figure 6: Pricing expectations for senior debt**

![Diagram showing pricing expectations for senior debt from 2011 to 2013.](image)
either,’’ says one banker. ‘‘With debt-equity ratios at 50-50 it is difficult for private equity firms to make returns that exceed their internal hurdle rate. They need more leverage to be able to compete with strategic buyers, who can often count on synergy benefits.’’ The rationalizations behind these somewhat more aggressive financing standards are that ‘‘transactions that are done generally involve good-quality assets’’ and that ‘‘for banks, leveraged loans have an appealing risk-return profile.’’ In the US, the trend towards more aggressive deal financing structures is much stronger already. In the fourth quarter of 2012 the average equity contribution in large buy-outs reached a post-crisis low of 33% (down 10 percentage points from the first quarter, and only slightly above the 30% average in 2007)\(^3\), driven by the ‘‘buoyant US high-yield and leveraged loan market.’’

A small majority (54%) of our respondents do not expect the level of mezzanine debt in buy-outs to increase this year or the next, while 32% think this level may increase. Several interviewees pointed out that it is generally difficult to use mezzanine debt in Dutch mid-market buy-outs: ‘‘That is related to the lack of transparency in debt pricing in many such deals. Mezzanine pricing is hard to square with that, certainly if it is to be provided by foreign investors,’’ said one banker. Another interviewee pointed to the fact that a relatively large number of private equity firms in the Dutch buy-out market are family-owned and have little appetite for mezzanine debt: ‘‘These firms have so much cash available and they feel no pressure from outside investors. They’d rather put more of their own money into a deal than pay 12% for a mezzanine loan.’’

\(^3\) Source: Thomson Reuters, as reported in The Financial Times - ‘‘Buyout groups using more debt to fund deals’’, 26 December 2012.
Average equity contribution to European LBOs

Source: S&P CIQ LCD
Leverage ratios: Not through the roof

Leverage ratios in European buy-outs have been steadily rising for the past four years, according to S&P data, but are still nowhere near the peak levels of 2007.

Figure 7: Average Total Debt/EBITDA ratios in European LBOs

(Source: S&P CIQ LCD)

Half of our respondents expect the average leverage ratios used in Dutch buy-outs to lie in the range of 4 to 5, neatly in line with the European levels shown above. A third think these ratios will increase after 2013, in what would be a continuation of the trend visible from the European data. Other, more numerous respondents (51%) think leverage ratios will stabilize after 2013, supporting the observation of one veteran market participant: “Dutch mid-market buy-outs are never really levered through the roof. There may be a few exceptions with 7 times leverage that create a lot of publicity, but ratios in the bulk of the buy-outs have been hovering between 3 to 4 times for the past ten years.”

Figure 8: Expected leverage ratios in Dutch LBOs
Multiples: We pay good money for good quality
With both the equity contributions and the leverage ratios in European LBOs relatively stable over the past four years, it follows that the valuation of the companies in question has held up as well, as can be seen in Figure 9. The valuation (expressed as a multiple, i.e. purchase price/EBITDA) has varied only slightly at a multiple of around 8.5 (left axis), despite the dramatic drop since 2008 in the number of LBOs included in the data set (right axis)\(^2\). These high multiples support the observation (discussed further in the next chapter) that the buy-outs that do close successfully mostly involve well-performing companies, or “high-quality assets” in the jargon of those financing or investing in them.

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\(^2\) With regards to the number of LBOs, S&P only include “deals that have syndicated loans attached to them, so it typically excludes the smaller deals that have just bilateral loans.”
Repairing the damage in LBOs

But what about the companies that have seen their performance decline during the recent string of financial, economic and looming monetary crises? There are certainly many such companies. According to one interviewee, no fewer than 25% of all Dutch SMEs have ended up in the sickbays of banks: some for observation, with only mild complaints or worries about the future; others beyond hope for surviving intact.

The attitude of banks in dealing with such companies is changing. At the onset of the financial crisis in 2008, it was the banks themselves that were hit the hardest. Companies responded by cutting costs, saving cash and strengthening their balance sheets. In the case of the companies that did get into difficulty, banks were rarely willing to demand severe restructurings (and incur further losses themselves by doing so). Instead, they often opted for the ‘amend & pretend’ tactic: resetting loan covenants, extending repayment terms, maybe adding penalty interest payments or waiver fees and in the meantime pretending that in the future everything would be alright again.

But not anymore. “In 2008 banks might have had hopes for a speedy economic recovery that would solve most of their clients’ problems. By now, everyone is ready to face reality: economic growth in Europe will at best be very slow for the next few years,” says one restructuring expert. Add to that the fact that many companies’ buffers have eroded over the last four years, and that banks’ financial restructuring and recovery departments have added a lot of manpower and experience, and it seems inevitable that the number of restructurings will increase significantly, according to several interviewees.

“Companies that have already had a covenant reset and now need to negotiate another round of refinancing stand little chance of success, if only because their banker can’t sell that internally.” Instead, banks are expected to more often demand firm measures and persuade or force companies to divest parts and strengthen their capital structure. But it need not always be that drastic. In less critical cases, some prodding from the bank might, for example, convince the company’s management to finally give up its resistance to a merger proposal. “Banks’ financial restructuring and recovery departments could well prove to be the most important source of deal flow this year,” speculates one M&A advisor. Several interviewees stress, however, that not everything that comes out of the banks’ sickbays will be ‘damaged goods’. “You will see assets of all sizes and qualities come on the market. Many might have a perfectly solid business model but the wrong capital structure to support it. For example, non-core parts or parts that have strong growth prospects but require too much capital to realise those.”

Of our respondents, 63% foresee an increase in the number of leveraged loan defaults and LBO restructurings, whereas 35% expect a similar number as in 2012. But whether private equity portfolio companies will see relatively more restructurings than corporates or family-owned companies remains to be seen. Several interviewees challenge the notion that portfolio companies are generally more vulnerable than others:

• “Portfolio companies are not more likely to run into financial distress to begin with. They may be leveraged more highly at the time of a buy-out, but their debt is paid down over time and the average leverage ratio of a Dutch mid-market portfolio company is currently only around 2 times EBITDA.”

• “Private equity firms are usually quick to adjust to changing circumstances and take firm measures if and when needed. In that respect, they are at least on a par with corporates, and certainly better than family-owned companies.”

In this, the above interviewees are supported by the findings in a British academic research paper from 2011:

“Overall, these results suggest that – contrary to some commentators’ expectations – PE-backed buyouts are
not more likely to fail than matched private companies and listed companies. In fact, productive efficiency and profitability was stronger than matched private companies and listed companies during the recession period. The failure rate for PE-backed buyouts was lower than for non-PE-backed buyouts, and no worse than that for the population of companies as a whole.”

A particular strategy that specialist private equity firms may employ at other sponsors’ portfolio companies that do end up in need of restructuring is what are referred to as ‘loan-to-own’ transactions (or ‘debt-for-equity’ conversions). A recent example is the takeover of the Estro Groep, formerly known as Catalpa, by US firms KKR and Bayside. They acquired the Dutch daycare centre operator by buying up debt from other lenders at a hefty discount and then converting it into equity. Half of our respondents (52%) expect to see more such transactions this year. “In the second half of 2012 we have been advising numerous funds that are looking at distressed buy-outs which have already had a covenant reset,” says one interviewee. “These funds have a lot of dry powder to invest and are prepared to do so aggressively in the debt structures. I certainly expect to see more debt-for-equity conversions this year.”

The wall of debt
Opinions on the impact of the ‘wall of debt’, i.e. the peak in the amount of debt falling due, are sharply divided among our respondents. A significant proportion (26%) regard it as a non-issue and do not foresee any significant problems for companies that need to refinance their debt in the coming years.

Remarkably, in our Amsterdam roundtable discussion the issue was dealt with quickly and shrugged off: “These debts will just be rolled over. If not, we will always find another solution.” “Just rolling over debt” indeed seems to be a common way of dealing with the wall of debt, as a recent report on European leveraged loans by Fitch Ratings26 shows. “Since Q4 of 2010, 26 Private Equity Portfolio Company Performance Through The Recession’ - Wilson et al., 17 March 2011.
The **wall of debt**: European leveraged loans

![Graph showing changes in the wall of debt from 2012 to 2017 with data from Fitch](chart)

- What the wall of debt looked like in Oct 2010
- What the wall of debt looked like in Sep 2012
the amount of debt falling due in the period 2013-2015 has been reduced from €160 billion to approximately €90 billion, meaning that around €70 billion of debt maturities have been repaid or termed out.” (See also page 32.)

Of the remaining €90 billion due in the next three years, around €7 billion is due in the Benelux countries, according to Fitch. Most Dutch mid-market companies are not expected to be directly hit by the wall of debt. However, they could still feel the ripple effects that would be caused if Dutch banks were hit.

Fitch points to 2014 as the year when refinancing problems may come to a head in Europe. In 2014 both the European Central Bank’s funding support to banks (in the form of its Long-Term Repurchase Operations, or LTROs), as well as the re-investment period for many CLOs created in 2006-2007, will expire. This “may leave leveraged credits without viable refinancing options,” warns the rating agency.

In follow-up interviews that we held, several bankers and financiers took the issue equally seriously and stressed its urgency. “You can wait for the first victims to fall,” said one interviewee. “For instance, I know of a portfolio company that needs to refinance over €400 million of debt this year, and they won’t be able to do it. And there are more examples like that, including well-known names.”

Fund the gap!

This brings us back to the point made in the introduction to this chapter about the dominant role of banks in providing credit to European firms, and their limited ability to continue fulfilling that role. As The Economist put it recently: “Banks everywhere are under pressure from regulators, creditors and shareholders to refashion themselves into safer, smaller entities. Non-bank finance companies are turning the travails of these shrinking banks to their advantage. Nowhere are their opportunities greater than in Europe.”

As the responses to our questions regarding the wall of debt already suggest, not everyone is ready to face this situation. “I think many in our industry are still in denial about the fact that our role as banks will fundamentally shrink. Banks will need to focus on bread-and-butter financing of working capital for example, and become more of an intermediary between their clients and other sources of capital,” says one banker. “If ten years from now we look back, I think we will recognize this period as the time when the foundations for a deeper, better developed European debt market were laid. It is already happening, but it needs a trigger to really take off. The point at which banks feel the full effects of Basel III might be that trigger.”

A deeper debt market would require the return to life of European CLOs (see text box ‘New signs of life for European CLOs’ on page 34), as well as the further development of the European high-yield bond market. Recent reports suggest that this market is indeed developing rapidly, so rapidly in fact that concerns about a ‘bubble’ are being voiced: after a record amount of €32 billion of European high-yield bonds were issued in 2012, 2013 was off to the quickest start ever, with €10 billion issued in the first two months alone. It would also involve other providers of debt, such as the credit arms of certain private equity firms or the funds of specialist lenders like the London-based Intermediate Capital Group (ICG). ICG is in the process of raising a senior debt fund with a target size of €1 billion. On its website ICG clearly states where the need for such a fund is coming from: “We believe the market opportunity for senior secured loans is favourable to meet the expected wall of refinancing and demand for LBO senior capital over the short to medium term. The opportunity is further supported by the declining availability of capital from typical senior secured loan lenders such as banks and CLOs.”

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Senior debt funds such as that of ICG are one way to address the mismatch between the demand for and supply of European corporate debt. Another way would be to directly tap into the large pools of capital managed by pension funds, insurers and sovereign-wealth funds that are in search of attractive yields. One of the main problems in that regard, according to several interviewees, is the lack of expertise, systems and procedures on the side of such institutional investors. “Because banks have always kept it to themselves, mid-cap corporate debt is an asset class with which those investors are totally unfamiliar. Does it fall under ‘alternative investments’ or under ‘fixed income’? These are the sort of fundamental issues and strategic questions they need to solve before they can start investing in corporate debt.” Furthermore it was questioned by roundtable participants whether the mid-market offers attractive investment opportunities for big institutional investors under the current conditions: “pricing is too low, tickets are too small and liquidity is too limited.” Another obstacle is the lack of a rating system that would enable institutional investors to invest in debt instruments that are both less creditworthy and less liquid than the corporate or sovereign bonds with which they are familiar. In our roundtable discussions, it was suggested that such a rating system should be developed jointly by banks and the “Big 4” accounting firms.

Then there is the issue of pricing. Whenever supply falls short of demand, prices can be expected to increase. The implications for European companies and private equity alike cannot simply be shrugged off.

New signs of life for European CLOs

One of the main engines that drove the boom in leveraged buy-outs during 2006 and 2007 may be sputtering back to life in Europe. In February, London-based Cairn Capital sold a €300.5 million CLO, a structured investment vehicle that packages and securitizes leveraged loans (and other high-yield, high-risk loans). Cairn’s CLO was the first of its kind in Europe since 2011, and there are reports that several other managers are currently preparing to launch CLOs of their own29.

Even if those other CLOs actually materialise, market activity would still be far below the 2007 level. That year CLOs absorbed around two-thirds of the €170 billion of leveraged loans issued in Europe30. Since then, a grand total of two new European CLOs have been launched. In the US, the market has turned around more quickly and more decisively, with $54 billion of new CLOs issued in 2012 (around half the 2007 volume)31.

There are several obstacles to overcome before the European CLO market can make a similarly strong comeback. One is of the chicken and egg variety; buy-out activity is down partly because the CLO market has been frozen, and because of the drop in buy-out activity the volume of newly-issued leveraged loans is insufficient to enable the structuring of new CLOs.

The second is the result of new regulatory measures. Under the EU Capital Requirements Directive, CLO managers are now forced to keep some ‘skin in the game’, in the form of a 5% equity stake. That requirement makes it substantially less attractive for many of them to set up new funds. “So far it has proved almost impossible to set up a new CLO in Europe because of a lack of transactions and because of regulation,” said one interviewee. “And the ongoing uncertainty surrounding the euro hasn’t helped either. Investors are still wary about investing in Europe.” The successful launch of two new European CLOs may signal that the situation is about to change. If so, a vital route for channelling institutional investors’ money into financing buy-outs would be reopened.

30 Source: S&P Capital IQ LCD.
31 Source: S&P Capital IQ LCD.
Trend: Private equity co-investments, or dropping the ‘L’ in LP

“There is an incredible push from pension funds and other investors to get in on our deals,” a private equity manager said at one of our roundtables. “I have seen people wanting to commit 300, 400 or 500 million equity tickets to deals, and on some deals there was even competition among investors.” He was referring to co-investments, an increasingly popular practice among private equity investors (usually referred to as limited partners, or LPs). In a co-investment, LPs directly provide part of the equity financing in an acquisition instead of – as is more typically the case – investing via a fund structure.

This observation is supported by the results from a study published by Preqin32, which found that of all the investors in private equity included in its survey, “43% are actively seeking co-investment rights when committing to funds, and a further 11% are considering such opportunities.” For a majority of LPs (61%), their allocation to co-investments is or will be at the expense of their private equity fund allocation.

The potential benefits from co-investments to investors seem clear enough. “They love to invest in a way that doesn’t take 20% carry off the top and won’t cost them any management fees,” said one roundtable participant. Besides higher returns and lower fees, the Preqin report also lists “better control over investments”, “strengthening GP relationships” and “gaining knowledge of industry sectors” as reasons given by LPs to co-invest. The increased interest in co-investments among LPs comes at a time when most private equity firms are struggling to raise new funds, and may be witnessing a shift in power towards LPs. However, although co-investments can be considered a threat to the traditional private equity model, our roundtable participants saw potential benefits for private equity firms as well:

- Co-investments provide firms with the opportunity to forge much stronger relationships with their investors:
  “When you have done two co-investments with an LP, they are going to be there for the next round of fundraising.”
- They allow a private equity firm to do bigger deals than it would be able to do on its own, for example when a big investment opportunity requires commitment of a higher percentage of the fund’s capital to a single company than the fund’s rules allow.
- They enable a firm to avoid partnering with one or more other firms, thereby avoiding the control issues that can arise in ‘club deals’ between multiple firms. Different private equity owners may have very different views with respect to exit strategies, add-on investments, company strategy, etc. The assumption here is that LPs will take a backseat and leave the steering wheel in the hands of the private equity firm when it comes to navigating such issues.

As anyone working in the financial sector will know, there is no such thing as a free lunch. With the great promise of co-investments comes the possibility of great disappointment as well. Almost all of the sources we talked to about co-investments voiced some concern over a possible tendency among LPs to overreach. Selecting private equity managers to whose funds you want to commit your capital requires quite different skills, and usually holds less risk, than directly investing equity in a single company. For one, it is likely that the company in question is about to undergo significant changes in which shareholders will need to get involved and which may end up in the public arena. Investors should think carefully before dropping the ‘L’ in LP.

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Transaction Trends

Retail chain HEMA, online department store Wehkamp and education and training institute NCOI are only the most widely known (and broadly publicized) subjects of failed sale processes in the Netherlands. Numerous other companies have shared a similar fate. In recent years it has become exceedingly difficult to bring the sale of a company, or parts of a company, to a successful close.

Only in very clear-cut cases can sellers expect anything resembling a straightforward sale process. “For an asset that ticks all the boxes, buyers will tumble over each other and you can still set up a competitive auction,” says one M&A advisor. “But everything has to be just right: recent performance, cash flows, market position, growth prospects, management, you name it.” At the other end of the spectrum, ‘fire sales’ of distressed assets also tend – out of necessity – to be completed relatively easily.

In this polarized market, selling a company that neither ‘ticks all the boxes’ nor qualifies as ‘distressed’ involves “phenomenally high execution risks,” in the words of one M&A advisor. For such companies lying between the two extremes, sale processes become a protracted hurdle race in which new and unexpected obstacles may pop up at any time, in some cases even within sight of the finish line. “I was involved in a recent transaction where the share purchase agreement had already been signed, but where the deal failed to close. At the very last minute the banks did not agree to the financing. A couple of years ago that would have been simply unheard of,” says one banker.

In this chapter we will describe how these execution risks affect the way in which M&A transactions are prepared for, executed, negotiated and documented.

A clear shift in preferred sale processes

The difficulty in completing almost any sale transaction these days is reflected in our respondents’ view on sponsors’ preferred sale processes. In their opinion, the preference of sponsors has clearly shifted away from the ‘one-size-fits-all’ approach of a controlled auction to the ‘tailor-made’ approach of a one-on-one sale. This is only partly due to the absence, in many cases, of a sufficient number of eager buyers to line up in an auction; it is also a result of the aforementioned high execution risks. “If you start an auction and it then fails, the company involved will be contaminated. Nobody will want to touch it any longer, and you will typically have to wait two to three years before you can make another attempt to sell it,” says one M&A advisor. The prudent way to sell a company these days is to stay below the radar and first gauge the situation based on the reactions of a small and carefully selected number of potential buyers: “Whisper around, have a cup of coffee here and there, send up a trial balloon. You might still fail, but at least your company won’t have been on the market and its reputation will be undamaged.”
A clear shift in preferred sale processes for sponsors
Apart from allowing reputations to remain intact, a one-on-one sale process (or two, three or four of them in parallel) also offers much better prospects of closing a deal. “The current success rate of auctions is actually really bad, even for hot targets. This has a lot to do with the fact that many sellers approach an auction with exaggerated price expectations, but there is also a different dynamic at play. If you know you are one of twenty parties that received the investment memorandum in the mail, you tend to look at the opportunity only half-heartedly in the first round. If you know that there are only two or three real competitors, you get more serious: you are prepared to dedicate more time and resources, do a due diligence, hire advisors, and so forth.”

Due diligence: Less margin for error
In 2011, 47% of respondents thought due diligence was going to be increasingly important, whereas 52% thought it was not. In this year’s results the balance tipped towards greater caution and higher risk aversion in doing transactions. A majority of respondents (56%) think due diligence processes will become more important; 41% think they will not.

Our own observation is that there is a clear trend towards more due diligence, both in depth and in scope, and by both corporate and private equity buyers. The latter tend to do only a “high-level” due diligence at first, but carry out much more extensive investigations once they have obtained exclusivity in negotiations.

In sale processes, vendor due diligence will continue to play an important role, according to our respondents. This is particularly true with respect to financial issues (91% of the respondents expect such issues to play an important role), and to a somewhat lesser degree for legal (53%), tax (72%) and commercial (69%) issues as well. With the shift away from controlled auctions towards more one-on-one sales, one could expect sellers to be less inclined to absorb the costs of a due diligence. However, according to our interviewees, sellers often still conduct a vendor due diligence even if they are eyeing only one or two potential buyers. They do so as part of the careful preparations that sale transactions require nowadays, and it enables them to consult with banks and assess upfront the availability of financing for the acquisition of their company.

Participants in our roundtable discussions were surprised to see that, in the Netherlands, buyers sometimes still accept a disclosure of the entire data room; this, after all, is quite a seller-friendly feature. On the side of lenders there seems to be no major change compared to 2011: they continue to predominantly rely on the due diligence reports of sponsors.

Bridging the valuation gap
As long as economic uncertainty remains high and growth prospects remain low, buyers will continue to find it difficult to agree with sellers on the “right” valuation of a company, and hence to arrange financing for an acquisition. Below is the assessment of our respondents on how valuation and/or funding gaps might be bridged.

The big picture remains the same as in 2011: vendor loans, earn-outs and the retention by the seller of a minority stake are among the four methods expected to be used most frequently for the bridging of valuation/funding gaps. These three methods can be considered to be buyer-friendly, since they require the seller to keep “its skin in the game”. In doing so the seller accepts some of the responsibility for the future success of the company in question, thereby mitigating the risks for the
buyer. Particularly where the seller is a private equity firm, these methods are somewhat unattractive – at least in theory – because they result in less than a full exit. Such firms will therefore need to be flexible and innovative in neutralising these disadvantages.

The higher score (compared to 2011) for ‘asset-based lending’ might reflect the fact that banks are looking for ways to increase the maximum amount of acquisition loans they are able and willing to provide. At our Amsterdam roundtable, a Dutch banker specifically mentioned asset-based lending as a form of commercial lending or “side business” that would allow banks, once they had secured a mandate, to be “more flexible with respect to their final take appetite”.

Stapled finance (where a seller pre-arranges an acquisition loan for the benefit of the purchaser) seems to be out of fashion (see also the text box ‘Trend: the pre-cap’), while payment-in-kind (PIK) loans33 (another feature of the pre-credit crunch heyday of private equity) might be expected to make a re-appearance.

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33 Payment-in-kind loans are riskier type of loans where interest accrues and is only paid upon maturity of the loan.
**Trend: The pre-cap**

“We haven’t seen one in the Dutch market yet, but I can see them happening here,” a banker told us. He was referring to ‘pre-caps’, which seem to be the latest fashion for sellers who want to entice potential buyers by offering support in financing an acquisition.

In the more commonplace ‘dividend re-cap’, a private equity owner re-leverages a portfolio company with fresh debt, usually taking a dividend in the process. In the case of a dividend pre-cap the owner does the exact same thing, but with the express aim of offering the company to the next private equity owner with an attractive and stable capital structure in place.

Technically, the current owner negotiates the credit agreements to permit the future sale of the company without triggering the ‘change of control’ provisions usually included in these agreements. Such provisions would normally put the loans into default in the event of a change of control, thereby requiring the buyer to obtain new financing.

In doing a pre-cap, current owners not only take advantage themselves of the availability of cheap credit at the time, but also pass this advantage on to the future owners. This might ease the sale of their company at times when credit is not available under equally favourable terms.

Pre-caps can be seen as a form of pre-sale stapled financing. “The market is somewhat fed up with stapled financing,” said one banker. “It is usually too ‘soft’, surrounded with endless conditions and almost never used.” According to this perception, stapled financing is merely a promise by M&A bankers to put their balance sheet to work for the relevant client in hopes of obtaining a sale mandate. With a pre-cap, they are actually required to put their money where their mouth is.
Focus areas in negotiating acquisition documents

- Purchase price mechanism (locked-box, adjustment mechanism, earn-out)
- Conditions precedent: financing/’certainty of funds’
- Deal protection (e.g. signing and closing on the same day, unconditional closing break fees, etc)
- Recourse (e.g. escrow, deferred payment, bank guarantee, insurance)
- Representations and warranties
- Conditions precedent: no material adverse effect
- Limitation of liability: thresholds for making claims, baskets and caps on claims
- Duration of warranties
- Restrictive covenants
- Disclosure of information against warranties
- The security to be provided by the seller
- Conditions precedent: material breach of agreement/representations and warranties
- Limitation of liability: definition of ‘losses’ in case of a breach (e.g. in- or excluding indirect and/or consequential losses)

Number of respondents (normalized, multiple answers allowed)

2013 | The Netherlands private equity and leveraged finance market - an outlook 42
Negotiations and documentation: Acquisition

When it comes to negotiating acquisition documents, interviewees note a clear difference between private equity and corporate buyers in their ability to execute transactions. “If you want to put it in black and white, then private equity firms are highly effective transaction machines and corporate buyers are totally unpredictable black boxes,” says one M&A advisor. “Private equity buyers are often able to take risks, be flexible and decide quickly, whereas corporate buyers are hampered by their own internal rules and bureaucracies.”

This is reflected, for example, in their different preferences as to which purchase price mechanism to use. For private equity buyers the ‘locked-box’ is the mechanism of choice, unless there are large and unusual fluctuations in the target company’s working capital. On the other hand many strategic buyers, and certainly those from the US, simply can’t handle locked-box processes, as they consider them too risky. An M&A advisor confirmed this observation: “Every auction we set out with a locked-box mechanism, but many times we quickly end up using closing accounts instead.”

In the current market, there is clearly less focus on ‘logistical’ conditions precedent in sale and purchase agreements and an increased focus on conditions in financing agreements. This creates a certain tension. In the heyday of private equity, there would often be a laundry list of ‘logistical’ conditions precedent to be fulfilled before a deal could be closed, a consequence of the intense competition in transaction processes aimed at quick signings. Nowadays you see much less of that on the M&A side. This is related to the high execution risks mentioned earlier; both sellers and buyers consciously try to limit the chances of a deal failing after signing. There is a tendency to limit logistical conditions to the minimum of ‘must-have’ regulatory clearances and a focus, on the buyer’s side, on getting the M&A deal terms in sync with the terms of financing to the greatest extent possible.

The increased focus on conditions in financing agreements is clearly illustrated by a comment we received: “Given the present uncertainty in the market, you see an endless array of conditions precedent relating to the financing. I have been involved in a deal where we were unable to close because the banks refused to finance after current trading had begun to slip. Hence all those financing-related conditions precedent and the difficulty in successfully negotiating them.”

Looking at our respondents’ expectations regarding the appearance of seller-friendly features in deal structures and/or acquisition documentation, it seems that this year the balance of power is seen as shifting towards buyers: fewer ‘locked-box’ and ‘certainty of funds’ provisions are anticipated. In addition, a greater focus on ‘hard’ adjustments is expected, as buyers attempt to avoid overpaying: post-closing purchase adjustments (instead of locked-box mechanisms), conditions precedent enabling the buyer to walk away if certain conditions are not met, and security rights (withholding part of the purchase price or having part of the...
purchase price deposited in escrow). In 2011 buyers were perceived to be more willing to rely on ‘soft’ safeguards, such as warranty protections without security rights.

New in 2012 was that we saw transactions, particularly in the upper end of the market, involving parties that required material adverse change (MAC) clauses as protection against exits by certain EU member states from the eurozone or, worse, the complete collapse of the euro. This is yet another clear example of how the M&A market remains heavily influenced by the continued unpredictable economic circumstances that cause a gradual shift towards more buyer-friendly deal terms.

Negotiations and documentation: Finance

The overall picture for 2013 resembles that for 2011 albeit that - contrary to what was generally expected in 2011 - sponsors seem to have somewhat improved their negotiating stance towards lenders. An explanation for this may be the fierce competition banks face, particularly in the Dutch mid-market (see Chapter 2). A banker jokingly stated that “Except for pricing, credit documentation nowadays again seems to resemble pre-credit crunch documentation.” The main focus point for both lenders and sponsors remains the determination of the amount of debt that can be carried by the portfolio company. In addition, lenders still focus on control through financial and non-financial covenants and on events of default, while sponsors strive for maximum flexibility. Finally, financial obligations such as interest, fees, mandatory prepayments, excess cash, clean-down and amortisation requirements obviously also trigger debate between lenders and sponsors. Provisions typically associated with the credit crunch, such as increased-cost (Basel III), market-disruption and defaulting-lender provisions do not seem to bother market parties much anymore. Credit agreements are still documented on the basis of models published by the Loan Market Association (LMA), often in the form of a ‘lite’ version and typically governed by Dutch law (particularly in the mid-market).
Figure 16: Focus areas in negotiating finance documents

- Structuring (debt/equity and leverage ratios)
- Covenants / covenant headroom
- Pricing (margins and fees)
- Financial ratios
- Mandatory prepayments / excess cash / cash sweep / clean down
- Events of default
- Limitations on distributions to sponsors
- Security
- Due diligence and representations
- Decision making among lenders (e.g. majority-lender decisions, all-lender decisions)
- Amortisation
- Subordination and release of junior debt
- Inter-creditor arrangements
- Undertakings to provide information
- MAC event of default
- Market flex
- Guarantees
- Market MAC
- Mitigation of the effects of Basel III and other increased costs
- Limitations on transfers
- Prepayment penalties / ‘soft call provisions’
- FATCA
- Hedging
- Legal opinions
- Market disruption
- Defaulting-lender provisions
- Agency provisions

Number of respondents (normalized, multiple answers allowed)
**Sponsor-friendly features**

As compared to the 2011 results, it is interesting to see that equity cure rights have apparently become more acceptable. This applies not only to cure rights that require equity to be applied towards a reduction of borrowings, but also where equity is to be applied towards cash flow or, to a somewhat lesser extent, towards EBITDA. An explanation for this may be that the continued economic uncertainty makes it increasingly likely that portfolio companies are forced into covenant breaches; private equity sponsors seek to prevent these (and the waiver fees they need to pay in order for banks to forgive such breaches) by obtaining the right to inject additional equity if and when needed.

Covenant headroom (which ranked, taken generally, as the number 1 ‘sponsor-friendly feature’ in 2011) was not included in this form in this year’s survey. A more specific version of this feature (‘more than 25% headroom over the base case’) was not expected to appear frequently in deal structures / finance documentation.

As was the case in 2011, ‘Mulligans’, fundable term sheets and second lien loans are still in last place, and are not expected to make a re-appearance any time soon. Payment-in-kind loans have in the meantime slowly advanced from the back into the middle of the pack.

**Figure 17: Sponsor-friendly features expected in deal structures/finance documentation**

- ‘Certain funds’ (in non-public deals)
- Equity cure rights where equity is applied towards reduction of borrowings
- Non-amortising bullet loans
- Equity cure rights where equity is applied towards cash flow
- ‘Snooze and lose’ clause
- ‘Yank the bank’ clause
- Equity cure rights where equity is applied towards EBITDA
- PIK loans
- Reverse market flex
- ‘Mulligan’ clause (no event of default unless two breaches of the same covenant)
- Fundable term sheets
- Second lien
Hotspots between senior and mezzanine lenders

As predicted in our 2011 Outlook, subordination and release provisions continue to receive priority from mezzanine and senior lenders. Meanwhile, in the wake of litigation on restructurings such as those of IMO and European Directories, some of the concerns of mezzanine lenders regarding the LMA’s model inter-creditor agreement have been addressed. The revisions in the new model have generally been welcomed by such lenders, but a number of key issues still remain open (and must therefore be further negotiated by the parties). This is because many of the revisions have been incorporated in the new model only as optional clauses, and not as recommended clauses.

In the context of enforcement by senior lenders, the position of mezzanine lenders has been somewhat improved. This is because the model now contains an optional clause obliging the security agent to obtain a fair market value on an enforcement disposal as opposed to an obligation only to use reasonable care to obtain a fair market price). In addition, there are optional clauses setting out methods that will be deemed to satisfy the fair market value requirement. These include delivery to the security agent of a fair-value opinion from an independent financial advisor and a disposal made pursuant to an auction or other ‘competitive sales process’. In particular, the term ‘competitive sales process’ is ambiguous and may trigger debate.

Other possible areas of conflict that have been identified by market practitioners are: the basis for the valuation (whether on a going concern or break-up basis), the cost of the fair-value opinion, the identity of the advisor and approval or consultation rights for mezzanine lenders in this regard, the timeframe within which the opinion must be obtained and the caps on the liability of advisors providing the opinion. On the whole, the position of mezzanine lenders in the event of a senior lender-led enforcement is still quite weak.

For example, under the new model mezzanine lenders still do not even have a consultation right prior to enforcement. Furthermore, they have a very limited say regarding the acceptance of non-cash consideration by the security agent (for which the new model now explicitly provides). However, they do receive some protection from the requirement that the value of any non-cash consideration be determined by an independent financial advisor.

Other remaining hotspots pertain to, among other things, the ability of mezzanine lenders to recover the costs of obtaining professional advice in the context of a restructuring, mezzanine payment stops and equity cure rights for mezzanine lenders.

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34 For instance, ‘Loan Market Association issues revised Intercreditor Agreement’, by Morgan Lewis, 21 September 2012 and ‘Themes underlying the 2012 changes to the LMA Intercreditor Agreement and implications for Mezzanine Creditors’ by Ropes & Gray, 19 October 2012.
Hotspots in negotiations between senior and mezzanine lenders

- Contractual vs. structural subordination
- Standstill provisions
- Release provisions in inter-creditor arrangements/minimum requirements for enforcement sales
- Permitted payments
- Senior headroom
- Equity cure rights for mezzanine lenders/debt-for-equity swap by mezzanine lenders

Conflicts of interest (e.g. separate agents for senior and mezzanine lender or right to remove the mezzanine agent)
- Limitations on voting rights in the event of insolvency proceedings
- Valuation mechanisms
- Ability of senior lenders to increase senior margin
- Restrictions on amendments
- Reimbursement of cost and expenses incurred by mezzanine lenders
In the 2011 edition of this outlook, we wrote that the private equity sector was well on its way to becoming a regulated industry. Attempts in the past to self-regulate had proven to be ‘too little too late’, and in the wake of the financial crisis, politicians everywhere were quick to react to the public outcry for more regulation, supervision and transparency. In the meantime, pressure to change is coming not only from outside, driven by political motives, but also from parties much closer to the industry. Limited partners are putting pressure on fee-structures which were largely untouched for the past decades. The industry is ripe for a rethink: the private equity terms and conditions were created in the US market at a time when funds could generally raise a maximum of USD 20 million in capital, whereas now there are funds that raise billions. The consequences of these trends and pressures are still unfolding. On the regulatory front, the past two years have brought greater, but as yet incomplete, clarity on some of the changes that are of particular relevance to the private equity sector.

Amid the deluge of regulatory measures designed to rein in the financial sector in Europe, the Alternative Investment Fund Managers Directive (AIFMD) arguably will have the greatest impact on the private equity sector. It was put together under great pressure and does not deserve any bouquets. In the early days of its inception it was referred to as “the French dressing on what was already a dog’s breakfast of a directive”35. A mere three years later, private equity fund managers (and others in the alternative investment industry) will, unless they are exempted, be operating in a regulated environment as from 22 July 2013. That much is clear about the AIFMD. It remains uncertain, however, exactly how the Directive will affect the way business is conducted and transactions are done in practice. Furthermore, the private equity sector also has to deal with other new or amended measures, such as CRD IV, MiFID II, Solvency II, the UK Bribery Act, the Short Selling and CDS Regulation and the revised Market Abuse Directive, just to name a few.

Europe is not alone in taking steps to further regulate the sector. In the US, for example, investment fund managers have been under an obligation since March 2012 to register with the powerful Securities and Exchange

The scale and pace of these regulatory developments make it difficult, if not impossible, for individual fund managers or even the larger investment teams to digest and comply with all of them unassisted. Creating a compliance culture therefore requires proactive leadership from senior fund management. The setting up of risk-management and compliance functions now needs to be a top priority for private equity. Time will have to be spent on raising awareness both within the small community of the fund itself and at portfolio-company level. This is the only way by which fund managers will be able to properly address the regulatory requirements and be prepared for any sudden surprise visit by regulatory inspectors.

However, it is not all doom and gloom. Earlier in this outlook, we took a closer look at the Dutch healthcare sector (see page 20), which offers promising investment potential and in this chapter we include a section on private equity investments in financial institutions (see page 55). In February this year the European Commission published an evaluation report\(^\text{37}\) on what is known as the ‘Antonveneta Directive’ (the name refers to the regulatory-scandal ridden saga of the Italian bank’s takeover by ABN AMRO in 2005). This Directive sets out evaluation criteria to be applied by national regulators when assessing a proposed acquisition in the financial sector. With its relatively large domestic financial sector, the Netherlands has a steady number two ranking among all EU countries in the number of requests made to the national regulatory authorities for

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36 See for example the speech given in January 2013 by Bruce Karpati, Chief of the SEC Enforcement Division’s Asset Management Unit (AMU) [http://www.sec.gov/news/speech/2013/spch012313bk.htm].

37 http://ec.europa.eu/preLex/detail_dossier_real.cfm?TC=NL&dossier=203396
the assessment of proposed acquisitions in that sector, according to the Commission’s evaluation report.

Clearly, there is a relatively active market for investments in financial institutions in the Netherlands, and the Dutch regulatory authorities have extensive experience in assessing and otherwise dealing with them as a result. It is interesting to consider whether this experience would at least mitigate the regulatory obstacles to private equity investment in such institutions (see the text box ‘Private equity investments in financial institutions’ on page 55) and thereby increase the interest already expressed by private equity investors (see Figure 5 on page 19) in such investment.

In addition to the aforementioned new regulatory requirements, there are also several country-specific legal and tax developments affecting the private equity industry in the Netherlands. Due to the complexity and large number of the various EU-level and Netherlands-specific changes, we will limit ourselves to briefly discussing the following in, respectively, parts B. and C. of this chapter: (i) the changes in the rules governing Dutch BVs (and the increased flexibility of this corporate form) as a result of the recent entry into force of two new acts, and (ii) a number of relevant developments in the area of tax.

This chapter also contains two appendices: Appendix I, with details on the AIFMD, and Appendix II, on the relevant aspects of two new acts affecting Dutch BVs. These serve as ‘quick reference guides’ to the respective new rules and regulations, setting out their main features and their impact on the private equity sector.

First, part A., in which we will guide you through the expected impact of the AIFMD upon its implementation in the Netherlands this summer.

A. The Alternative Investment Fund Managers Directive - AIFMD

“The AIFMD, that’s just one of those compliance issues,” said one private equity manager. “It’s annoying, we will probably have to report a bit more, but I have no idea yet on what. People in the compliance team will have detailed models for dealing with it, but I don’t,” he continued.

This statement seems to exemplify the attitude of many of those we surveyed. While the knowledgeability of our respondents (self-assessed), has improved since 2011, half of them still consider their knowledge of the AIFMD as ‘poor to very poor’ (and this is not even counting those who ‘don’t know’).

A recent survey by KPMG38 found that nearly half of the alternative investment fund managers surveyed “have not yet taken any concrete steps to analyze the specific impacts the AIFMD will have on their businesses or to make any changes in their operations”. The reality, however, is that any further delay in preparing for the AIFMD may cause serious hiccups, the most immediate being an inability, as from mid-July this year, to raise new funds until the requisite licence has been obtained. Pursuant to the transitional rules, fund managers that already operate in the Netherlands under the current private placement regime will have to submit their licence application no later than 21 July 2014. Fund managers who fail to take timely action run the risk, especially as July 2014 approaches, of ending up on the regulator’s waiting list.

Another challenge faced by fund managers is the fact that further details on the implementation of the Directive continue to trickle out, which means that it is still a moving target. As the Dutch financial authorities put it in January this year: “Let’s be honest. It’s not exactly ‘mother’s finest’, this AIFM Directive.”39

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38 KPMG Financial Services – ‘Last boarding call – An overview of the alternative industry’s preparedness for AIFMD’, December 2012.
How would you describe your knowledge of the 'AIFM Directive'?
Ugly though the history of its inception may be, the Directive does bring advantages to fund managers. A good example is the EU-wide fundraising passport which can be obtained via a fairly simple notification procedure in the EU member state where the licence has been granted. This will make it possible for a fund manager to raise capital from professional investors throughout the EU without being hindered by different local rules. The most significant practical nuisance, on the other hand, is the requirement that a depositary be appointed to safe-keep the assets of investors. There is widespread doubt as to whether this rule offers any benefits for the private equity sector. This is because the aim of the rule is to protect investors from fraud and misappropriation, whereas private equity assets, being illiquid by nature, are inherently far less vulnerable in this regard compared to other types of ‘alternative’ assets.

The AIFMD will have a profound impact on the private equity sector. As the Directive applies only to funds that exceed a certain size (see Appendix I for details), it might obstruct entry into or further growth in the private equity market. In addition, because certain types of funds such as family-owned funds, sovereign wealth funds and, for the time being, non-EU funds are exempt from the AIFMD, the private equity playing field could become a lot less ‘level’. This aspect may be particularly relevant in the Netherlands, where several family-owned funds account for a sizeable proportion of the market. Furthermore, because the Directive adds to the cost and complexity of doing business, it could lead to consolidation among fund managers.

The AIFMD will also make itself felt on the level of individual transactions. For example, it introduces temporary restrictions on asset stripping (see Appendix I for details). It also requires greater transparency towards regulators and employees regarding strategic plans for portfolio companies where the wider disclosure of such plans may render them infeasible from the start. The AIFMD could thus negatively affect the returns private equity firms are able to generate from their investments, and lead firms to decline certain transactions.

In our opinion, any tendency among private equity fund managers to underestimate either the AIFMD’s impact or the timelines set for compliance with it, would be misguided. Again, the impact of the AIFMD will be profound: on the structure of private equity funds, on the way they conduct their business, and on managers’ remuneration as well. The new regulatory regime will commence on 22 July 2013, and both of the relevant Dutch regulators, the AFM and the DNB, have recently made it very clear that there is no hint whatsoever from Brussels that this implementation date will be postponed. As of 22 May this year, requests for a licence or registration can be submitted to the AFM via its digital portal. Fund managers who are hopeful that they can evade the Directive or find shortcuts around it, are bound to be disillusioned. The regulators clearly intend private equity managers to take the AIFMD seriously and face up to its consequences.
Private equity investments in financial institutions

“We follow where the trouble is. It’s all about restructuring,” the Financial Times recently quoted Wilbur Ross, a “turnaround veteran”, to explain why the private equity investor has set his sights on the European banking sector. His firm WL Ross & Co has already backed Richard Branson’s Virgin Money in its 2011 acquisition of Northern Rock’s retail operations from the UK government. A pair of US private equity investors, JC Flowers & Co and Apollo, have reportedly bid for 316 of Royal Bank of Scotland’s retail branches. Closer to home, Dutch banks have also attracted attention from private equity firms. NIBC has been held by JC Flowers & Co since 2005 and in 2009 DSB Bank claimed to be in talks with Texas-based Lone Star Funds just before the bank went down. Very recently, CVC was involved in talks to rescue the banking and insurance group SNS Reaal before the government bailed it out.

Clearly there is a case to be made for private equity investments in European financial institutions, not just for ‘non-balance sheet’ services such as asset and wealth management and debt portfolios, but in core banking and insurance activities as well. Many banks and insurers are in search of new capital to strengthen their balance sheets and since private equity has ‘dry powder’ worth hundreds of billions of euros to deploy, such investments would be a matter of matching capital demand and supply. Financial institutions that want to divest certain activities, or are forced to do so by regulators, will not find many other potential buyers. The same is true for governments that, at some point, will need to sell the institutions they bailed out. Strategic buyers will not have the necessary resources, and public exits through an IPO may continue to be difficult. Private equity firms could well be an attractive new home for such assets. They could inject a welcome dose of financial discipline and entrepreneurial spirit, as well as offering time to recover and develop new business models, shielded from the pressures of meeting quarterly earnings expectations.

However, while the opportunities may be large, there are clearly some formidable obstacles as well. One of the biggest challenges is posed by the earnings models of financial institutions. These are in the process of being completely redesigned, and the resulting uncertainty is incompatible with the desire of private equity firms to work with stable and predictable cash flows. From a more formal perspective, investors must take into account the regulatory approvals that will be required when acquiring an interest in a European institution.

Only a small number of investors possess the specialist skills and knowledge that are required to govern such complex institutions, many of which continue to suffer from a lack of transparency. From a regulatory perspective, private equity investors in systemic financial institutions would be venturing into terra incognita. It is unknown which demands and conditions will be imposed by regulators on private equity firms investing in such critical institutions, for example with respect to the duration of their investments, the institutions’ capital structures and guarantees to secure the public interest.

The large political influence over, and the heated public debates surrounding, the financial sector present additional obstacles to outside investors. While the negative public opinion on remuneration policies in the financial sector may be regarded as a mere annoyance, unexpected political measures could have more damaging effects, as the investors in daycare company Estro (formerly Catalpa) have seen. Business cases could collapse due, for example, to repeated changes in the tax treatment of mortgage interest deductions or to the sudden raising of a banking tax when politically expedient. Until there is a somewhat more stable economic and political climate, many private equity investors may prefer to limit their investments in the financial services industry to the peripheral areas such as asset management (Carlyle/AlpInvest).
B. More flexibility for Dutch BVs: what’s in it for private equity?

The rules applicable to Dutch private limited liability companies (BV) have been considerably relaxed as a result of the recent entry into force of two new acts. Significant improvements under the acts include the abolition of certain formalities that complicated the structuring of transactions and the introduction of a large variety of new structuring possibilities. On 1 October 2012 the Flex BV Act entered into force, followed on 1 January 2013 by the One-Tier Board Act. This section does not aim to provide a complete description of all of the changes under the two acts, but is only intended to highlight the main changes that are relevant specifically for private equity investors. Additional information on this subject is provided in Appendix II at the end of this chapter.

Abolition of financial assistance rules

From an acquisition financing point of view, the most important - and very welcome - change for parties seeking to acquire a Dutch BV, or a stake in such a company, is the abolition of what were known as the financial assistance rules. Until 1 October 2012, there were stringent restrictions on the provision by a BV of financial assistance for - in brief – the purpose of the acquisition of shares (or depositary receipts) in its own capital. Loans were permitted only up to an amount not exceeding the company’s distributable reserves, and all other forms of financial assistance were completely prohibited. These restrictions were especially cumbersome in relation to the financing of acquisitions where not only the borrower itself but also the target company and its subsidiaries were required by the banks to provide collateral to secure the financing. However, this does not mean that the provision of financial assistance by a BV will always be smooth sailing in the future. Rather, the responsibility of determining whether a BV may provide financial assistance will shift further to the company’s management board, which will need to assess the possible implications on the same basis as for any other transaction. A board not acting with due care in making its assessment may risk personal liability for the board’s members. In addition, a transaction involving the provision of financial assistance may still be challenged where it is considered to be ultra vires. Consequently, despite the abolition of the financial assistance rules some uncertainty will remain; albeit originating in other areas of Dutch corporate law.

New rules on distributions

As long as a BV will continue to be able to pay its due and payable debts there is now (in the absence of statutory reserves or reserves required to be maintained under the articles of association) far greater scope for such a company to make distributions. Subject to the above condition, a distribution can be made even when it will result in negative equity. In principle, this opens up...
new opportunities for private equity investors, who generally prefer investing in cash flow-rich companies. However, the AIFMD’s anti-asset stripping rules seem to curtail – at least for a 24-month period following the acquisition of control over a company – the possibility of making distributions that would result in the BV’s equity being lower than its issued capital (more on these rules in Appendix I). These anti-asset stripping rules will probably lead to more pre-closing restructurings, as well as the use of new workarounds designed to circumvent this obstacle. Fund managers and company management boards may find that they will need to hire legal and financial experts to guide them through the new maze of rules resulting from the recent legislative (and regulatory) changes.

**Introduction of non-voting and non-profit participating shares**

Another new feature is that a BV can now issue shares without voting rights or shares without the right to participate in the company’s profits. Before the entry into force of the Flex BV Act, the separation of the economic rights to shares from the voting rights was achieved through the (common) practice of issuing depositary receipts for shares through a trust office foundation. We do not expect the introduction of shares without voting rights to lead to the disappearance of the depositary receipts/trust office foundation mechanism; in fact we think that the latter will continue to be popular in private equity transactions. This is because holders of shares without voting rights will still have meeting rights, and because the consent of such shareholders (unlike holders of depositary receipts) will be required in order to pass resolutions without a meeting being held.

**Greater flexibility with regard to share transfer restrictions**

Under the new BV rules, the parties have more freedom to structure the share transfer restrictions as desired. It is no longer mandatory to have a ‘blocking clause’ in the articles of association. Where such a clause is included, application of the statutory rules on the determination of the price of shares (price to be determined by one or more experts) is not obligatory; the articles may set out different rules for this purpose. This makes it possible to include ‘good leaver/bad leaver’ arrangements, together with a specified price determination mechanism, in the articles. The articles may also include a lock-up provision. The advantage of including such a restriction in the articles over including it in a shareholders’ agreement is that any transfer of shares in violation of the restriction will not be merely a breach of a contractual agreement, but will be invalid pursuant to statutory corporate law. By contrast, the advantage of a shareholders’ agreement is that it remains private, whereas a company’s articles of association are a public document. It follows that whether it is better to include certain provisions in the articles or in the shareholders’ agreement will depend on the circumstances of the case in question.

**Power to issue specific instructions**

Finally, it is now possible to include a provision in a BV’s articles of association requiring the management board to follow specific instructions issued by another corporate body of the company, e.g. the shareholders or the holder(s) of specific shares. The management board must comply with these instructions, unless this would be contrary to the interests of the company. Previously, there was only a power to issue instructions regarding the company’s general policy. Under the new rules the management board can, for example, be instructed to conclude or terminate certain contracts, suspend payments, appoint or dismiss personnel, or establish or close down departments. Where a power to issue specific instructions is provided for in the articles of one or more subsidiary BVs, this gives a parent private equity fund an additional legal tool for pursuing group policy objectives.
C. Relevant tax developments

Changes to interest deductibility restrictions
Two major changes to the Dutch Corporate Income Tax Act 1969 entered into force on 1 January 2013, both relating to the deductibility of interest payments. They are particularly relevant in the context of cross-border transactions and reorganizations, and should be taken into account when investing in or via the Netherlands.

Out with the old: abolition of thin capitalization regime
The Dutch thin capitalization regime has been abolished. Prior to 2013, the Dutch Corporate Income Tax Act 1969 contained a provision that restricted the permissible maximum debt-to-equity ratio (as a rule, the maximum ratio was 3:1 for domestic corporate taxpayers). Interest payable on debt in excess of this ratio was generally not deductible for corporate income tax purposes. However, the provision was found to adversely affect taxpayers that were not otherwise engaged in any tax structuring (mostly small and mid-cap companies), and has now been repealed altogether. The fact that the maximum debt-to-equity ratio no longer applies to Dutch companies may open new debt funding opportunities for companies investing in the Netherlands.

And in with the new: introduction of new restriction on interest deduction
While the thin capitalization regime has been abolished, a new statutory restriction on the deductibility of interest has been introduced. This new rule deviates from the general principle that in the Netherlands, interest expenses may be utilized to offset taxable profits. The new restriction is intended to further combat ‘abusive’ debt financing, supplementing existing measures such as the anti-base erosion rules and the other restrictions on the deduction of interest in respect of acquisition debt.

Under the new statutory restriction, interest on ‘excessively’ leveraged acquisitions of (Dutch and foreign) participations qualifying for the participation exemption is non-deductible to the extent such interest exceeds €750,000 in any given year. Basically, a company is deemed to have made excessively leveraged acquisitions under this provision insofar as the combined acquisition price of all its participations exceeds the company’s total shareholder equity according to its fiscal balance sheet. An interest deductibility restriction (for interest above €750,000 in any given year incurred on the excess leverage) is the ‘penalty’ for being excessively leveraged. The provision contains a formula for calculating the amount of interest that relates to the excess leverage. Under that formula, the amount of such interest in a given year is calculated by dividing the average excess leverage in that year by the average total debt level in that year, and multiplying the outcome by the total amount of interest paid in that year.

A potentially significant exception applies to interest paid to acquire (or increase) a participation intended to expand a group’s operational activities. Provided that the interest has not already been deducted elsewhere within the group and that the financing is not predominantly tax driven, the deductibility of interest payments made to finance the expansion of business activities should not be limited by this new rule.

Taxation of carried interest arrangements
There have not been any significant changes in the taxation of carried interest arrangements in the Netherlands since 2009, when rules targeting ‘excessive remuneration’ were introduced. However, the current political climate in the Netherlands is not altogether positive vis-à-vis those that are perceived as high-earners. That is particularly true for managers and executives of financial institutions and investment funds and others working in sectors that are commonly blamed for the current economic and financial crisis. As a result, the discussion about how their remuneration (including carried interest arrangements) should be
taxed is ongoing in the Netherlands, but no bills are currently pending. In this respect, close attention is being paid to the relevant developments in the US and the UK, including the bills in the US to treat carried interest as services income.

OECD Base Erosion and Profit Shifting Report
In addition to efforts of the European Union to curb cross-border tax evasion and tax avoidance, the Organization for Economic Cooperation and Development (OECD), commissioned by the G20, undertook a study addressing base erosion and profit shifting (BEPS). The OECD’s first BEPS report was released on 12 February 2012. This report addresses the concern that governments lose revenue because profits are shifted to low-tax jurisdictions and do not currently have the appropriate cross-border legal tools to counter this development.

Two of the goals identified in the report are to propose more effective anti-avoidance measures to be included in domestic law or international agreements and to provide rules on the treatment of intragroup finance transactions (for instance with respect to withholding taxes and restrictions on deductibility). It is not yet clear whether, and if so which, actions will be taken at national or supranational level based on the OECD’s findings in the report. However, it is apparent from the report that governments are addressing this issue and that things may move more quickly than expected in the coming years.

Financial transaction tax
Based on a proposal by the European Commission, several EU member states (including Germany, France and Belgium) may introduce a financial transaction tax (FTT) in 2014. The proposed tax is separate from the bank levy introduced by some member states (including the UK and the Netherlands). Under the current FTT proposal, certain transactions between financial institutions would be subject to tax at a rate of at least 0.1% of the consideration paid or the market value (if higher) for non-derivative instruments such as shares and bonds. In the case of derivatives, the applicable rate would be at least 0.01% of the consideration or notional amount referred to in the derivative contract.

The FTT remains controversial among EU member states and there is currently no unanimous support for an EU-wide tax of this type. In October 2012, the European Commission therefore proposed using the ‘enhanced co-operation’ mechanism to enable member states to elect to implement such a tax on a more individual basis. This was authorised by the EU Council in January 2013, resulting in the adoption by the Commission of the current, revised FTT proposal. This proposal must be unanimously approved by the member states that wish to participate in the FTT (currently 1140), and must be reviewed by the European Parliament before coming into force.

The introduction of the FTT may raise the costs of debt funding, as it is expected that banks will try to pass on the costs of the tax to lenders and other clients.

The Netherlands is not among the countries that have elected to participate in the FTT.

40 Germany, France, Italy, Spain, Portugal, Greece, Austria, Belgium, Estonia, Slovakia and Slovenia.
Appendix I: the AIFMD
This appendix consists of two parts. Part IA provides a brief recap of the rules set out in the AIFMD itself, while part IB addresses some interesting points from what is known as the AIFMD Level 2 Regulation, published by the European Commission on 19 December 2012.

IA. Brief recap of the rules in the AIFMD
The licence
The manager of an alternative investment fund must obtain a licence. In order to do so, the manager must provide the relevant supervisory authorities with information on, among other things, the following subjects:

• the persons that will actually carry out the management;
• the identities of any direct or indirect shareholders of the manager that hold at least 10% of the shares or voting rights in its capital, or that are otherwise in a position to exercise significant influence over its management;
• a programme of activity;
• the remuneration policy;
• arrangements (if any) made for the delegation or sub-delegation of management activities to third parties;
• the funds that will be managed, including information about their investment strategies;
• the appointment of the depositary for the funds that will be managed; and
• the information which the manager is required to provide to potential investors.

Notification of acquisitions and control
The AIFMD also contains specific rules for managers of alternative investment funds that acquire major holdings in or control of a company. These rules do not apply to the acquisition of control of:

• small or medium-sized companies;
• special purpose vehicles whose purpose is to purchase, hold or administer real estate.

If the proportion of voting rights held by a fund in an unlisted company reaches, exceeds or falls below the threshold of 10%, 20%, 30%, 50% or 75%, the manager must notify the supervisory authorities in its home member state of this fact.

Asset stripping
The AIFMD also contains specific rules that apply if control of a company - whether listed or unlisted - is acquired. These rules include restrictions on the sale of assets (‘asset stripping’). In short, the manager of an alternative investment fund that has acquired control of a company may not, for a period of 24 months following the acquisition, facilitate, instruct or support any distribution, capital reduction, share redemption and/or acquisition of own shares by the company or vote in favour of any such act. During that period distributions are, for starters, only permitted to the extent that the company’s net equity exceeds the issued capital plus the non-distributable reserves (the “balance sheet test”). In October 2012 a similar test was abolished – from a company law perspective – for distributions by Dutch BVs and replaced by a more flexible ‘distribution test’ (see Appendix II). Now, less than a year later, the AIFMD will re-introduce the balance sheet test for private equity. The main difference this time around is that the requirement to apply the test is directed at fund managers instead of BV management boards. Furthermore, it applies only for a 24-month period and the power of enforcement is vested in the regulatory authorities. For BVs, the question in practice is whether the respective results of the corporate distribution test and the regulatory balance sheet test will coincide. In certain scenarios these tests might lead to different conclusions as to whether a distribution is feasible at all. When there is doubt we expect the BV’s management to engage financial and legal advisors to assist them in creating a paper trail and negotiating the appropriate allocation of personal liability risks.
Timelines
The AIFMD entered into force on 22 July 2011 and EU member states have two years to transpose it into national law. Assuming timely implementation at national level, this means that the new regulatory regime will commence on 22 July 2013. Managers that are active as such before 22 July 2013 must apply for a licence within one year of that deadline (i.e. no later than 21 July 2014). Managers of closed-end funds whose subscription period for investors closed prior to the AIFMD’s entry into force (i.e. 22 July 2011) and that will be terminated before 22 July 2016 may continue to manage such funds without a licence under the Directive. They are, however, required to make certain information available to the regulator(s). Finally, a specific regime applies to managers and funds located outside the EU.

Restrictions on delegation
The AIFMD imposes significant restrictions on the delegation of management activities by the manager of an alternative investment fund. The manager must notify the relevant regulatory authorities and provide a justification of the proposed delegation structure. If portfolio management or risk management is delegated, the Directive generally requires the delegate to be appropriately authorised under a relevant European directive to perform asset management activities.

Remuneration
The AIFMD sets out a list of remuneration principles for private equity funds. For example, a substantial portion of any variable remuneration paid to the fund’s manager(s) and employees must consist of shares or units of the fund itself. In addition, the payment must be deferred over an appropriate period of time. In February 2013, ESMA, the pan-European regulator, published detailed further remuneration guidelines. Some of the clarifications in the ESMA guidelines are helpful; others, like the definition of carried interest, are far from clear. According to this definition, it would for example be necessary for the invested capital plus a hurdle (a minimum rate of return) to be repaid to the investors before variable remuneration can be paid. This is a rigid interpretation by ESMA which ignores the fact that, in many cases, there are other carried-interest structures in place which perfectly balance the various interests already. Because it has long been the practice of the private equity industry to align their interests with the other parties involved in their investments, it should not be too hard for firms to maintain their current remuneration policies and still be in line with the Directive. The real effort will lie in synchronising those policies with the more detailed requirements set out in the ESMA guidelines.

IB. Interesting points in the AIFMD Level 2 Regulation
The AIFMD Level 2 Regulation provides more detail on the rules set out in the AIFMD with regard to, among others, the following subjects:

Exemption based on fund size
The AIFMD sets out a ‘de minimis’ exemption. This provides that – unless such a manager has opted in voluntarily – a manager falls outside the scope of the AIFMD if it directly or indirectly manages funds whose assets under management have a total value not exceeding €100 million. In the case of funds without leverage, the threshold for the exemption is €500 million. Managers that are exempt from the AIFMD based on their fund’s size must still register in their home member state and provide certain information to that country’s regulatory authorities. Many market participants expect sophisticated professional investors to demand AIFMD compliance even from the managers of smaller funds, effectively forcing such managers to opt in. Where a fund manager chooses to opt in, the AIFMD will become applicable in its entirety.
Figure 18: The AIFMD and Venture Capital Funds Regulation timeline
22 July 2013
European regime applicable for EU managers

22 July 2013
AIFM implementation legislation enters into force

21 July 2014:
Deadline for managers active on or before 21 July 2013 to submit licence application to AFM

22 July 2015
Election of European or national regime for managers from third-countries (non-EU) (expected)

22 July 2018
European regime applicable to managers from third countries (non EU) (expected)

22 May 2013:
AFM Digital portal open for licence requests

21 July 2014:
Deadline for managers active on or before 21 July 2013 to submit licence application to AFM

22 July 2011
AIFMD entry into force

22 July 2013
European regime applicable for EU managers

Q2 2013:
Publication Venture Capital Funds Regulation (expected)

Q1/Q2 2013:
EC endorses regulatory technical standards (expected)

Before 22 July 2013
Publication final implementation legislation and decrees (expected)

22 July 2013
AFM implementation legislation enters into force

22 July 2015
Election of European or national regime for managers from third-countries (non-EU) (expected)

22 July 2018
European regime applicable to managers from third countries (non EU) (expected)
Valuation
The AIMFD contains provisions on the valuation of alternative investment funds. The fund manager must put appropriate and consistent procedures in place for the proper and independent valuation of the assets of each fund under its management. In technical advice issued by ESMA on the provisions, a number of principles have been identified to guide the manager through the valuation process. Consequently, the valuation policies and procedures will be more demanding than they used to be.

Assets must be valued and the net asset value must be calculated per unit or share (or equivalent) of each fund and disclosed to investors at least annually. Such valuation must also be carried out on the occasion of each issue or subscription or redemption or cancellation of units or shares. Open-ended funds must carry out such valuations at a frequency which is appropriate to the assets held by the fund and the frequency with which it issues and redeems shares or units. As a result of the AIFMD, it is possible that funds which used to carry out a valuation exercise once a year will have to go through every single portfolio more frequently, e.g. every quarter.

The valuation may be performed by an external valuator, but also by the manager itself, provided there is functional independence between the valuation function and the portfolio management function. For many funds, valuation by the manager might not be an option. In such a case, this will result in significant additional costs, especially for the initial valuation.

Appendix II: the Flex BV Act and the One-Tier Board Act
The table on the next three pages, which can be used as a quick reference card, sets out the changes that are most relevant for private equity-related transactions and briefly explains their implications.
<table>
<thead>
<tr>
<th>Subject</th>
<th>What has changed?</th>
<th>How does this affect or benefit private equity?</th>
</tr>
</thead>
</table>
| Capital structure | • Non-voting shares and non-profit participating shares permitted. Not possible to issue shares that have neither voting rights nor profit rights | • Increased possibilities for the structuring of participation by portfolio company's management: special profit-participating rights, special veto rights  
• Downside is that non-voting shares always have meeting rights in a general meeting, which may not be ideal in the event of participation by employees/management. Shareholders may not want employees/lower management to be present at shareholders’ meetings (see below)  
• Abolition of the rules on the provision by a BV of financial assistance to third parties for the purchase of shares in the company’s own capital  
• Abolition of various restrictions on a BV's ability to buy back its own shares  
• Abolition of the lengthy (used to take more than two months) procedural requirements for reduction of a BV's capital | • Debt push-downs and statutory mergers between bidco and target are no longer needed in order to get around the financial assistance rules  
• Dividend recaps and other forms of financial restructuring are facilitated by these changes |
| Depositary receipts (equity with only economic rights granted to persons; shares are usually held by “friendly” foundation) | • Depositary receipts only have meeting rights if this is laid down in the articles of association (should be included in articles when they are next amended). Such rights must be recorded in the shareholders’ register | • Depositary receipts without meeting rights are often used in PE transactions in order to let management/employees participate in the profits of the company without giving them any voting/meeting rights: end of risk that holders of such depositary receipts get unwanted voting/meeting rights. This is still an advantage compared to non-voting shares, whose holders will always enjoy meeting rights  
• Depository receipts can be transferred by private deed, while non-voting shares will always need to be transferred by notarial deed |
| Share transfer restrictions | • No longer mandatory  
• Determination of price up to shareholders  
• Following restrictions now allowed in articles of association:  
- Lock-up provision (usually up to five years)  
- Tag-along provisions, as well as good leaver/bad leaver provisions | • A share transfer in violation of the articles of association is null and void, while a violation of a similar provision in a shareholders’ agreement only leads to a breach of contract and e.g. liability to pay damages  
• A disadvantage is that these (often very detailed and commercially sensitive) arrangements become public through inclusion in the articles |
<table>
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<th>Subject</th>
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<tbody>
<tr>
<td>Board(s)</td>
<td>• One-tier board system (single board with executive and non-executive members) now provided for by statute</td>
<td>• Allows for a US/UK-style governance structure</td>
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<td>• Amended rules on liability of board members</td>
<td>• Formal introduction of a clear division of duties between board members in articles of association or board rules may limit responsibilities/liability of individual board members (a management board member will be liable in full unless he/she can prove that the mismanagement was not attributable to him and that he/she was not negligent in acting to prevent its consequences)</td>
</tr>
<tr>
<td></td>
<td>• Appointment of board members by individual shareholders possible</td>
<td>• A right to appoint board members directly in the articles is stronger than a combination of a right of nomination plus a voting agreement</td>
</tr>
<tr>
<td>New conflict of interest rules:</td>
<td>• A conflict of interest has consequences only in respect of the internal decision-making. Any board member who has a personal interest that directly or indirectly conflicts with the interests of the BV may not participate in the deliberations and decision-making. If he/she does so, the decision will be voidable and the board member can be held liable to the BV</td>
<td>• The transaction with the third party will remain valid. A management board member with a conflict of interest can therefore still represent the BV even if the current articles of association (based on the old conflict of interest rules) expressly prohibit this</td>
</tr>
<tr>
<td>Specific instruction rights</td>
<td>• Articles of association may provide for the right of a party to give specific instructions to the management board (as opposed to only general guidelines, which was the old rule). In principle, such instructions must be followed by the management board</td>
<td>• Management board members must not follow such instructions if they are contrary to the interests of the company and the enterprise connected with it. This rule can potentially create tensions between a company’s management board and the shareholders</td>
</tr>
<tr>
<td></td>
<td>• The possibility of giving specific instructions to the management board creates greater flexibility for shareholders to exert control over/direct management actions. For tax reasons – especially substance requirements – it is not advisable to give specific instructions to trust/service providers acting as ‘resident directors’ of a company</td>
<td>• Extensive use of this right may result in the relevant party being considered a de facto management board member, thus leading to unwanted liability</td>
</tr>
<tr>
<td>Quality requirements/contractual obligations</td>
<td>• Requirements as to certain qualities on the part of shareholders may be laid down in the articles of association</td>
<td>• A disadvantage is that these arrangements become public through their inclusion in the articles</td>
</tr>
<tr>
<td></td>
<td>• Contractual obligations of shareholders (e.g. additional liability up to a certain amount or an obligation to provide a loan or enter into a tolling contract) may be included in the articles</td>
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<tr>
<td>Subject</td>
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</tr>
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<tr>
<td><strong>Distributions</strong></td>
<td>• A shareholders’ resolution to make a distribution will only take effect if the management board approves the distribution</td>
<td>• Since it is not often the case that there are reserves required to be maintained by law or under the articles of association, it has become much easier to make a distribution (provided the distribution test is met). A company's equity may become negative (or even significantly negative) as the result of a distribution: watch out for minimum-equity requirements in bank facility documentation. It is also likely that the AIFMD's anti-asset stripping rules will curtail the possibility of making distributions for 24 months (Appendix IA on asset stripping).</td>
</tr>
<tr>
<td></td>
<td>• Management board to perform balance sheet test and distribution test (see below) when deciding whether to grant approval</td>
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<tr>
<td><strong>Balance sheet test</strong></td>
<td>• Distributions are allowed if the BV's net equity exceeds the reserves that must be maintained by law or under the articles of association</td>
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<td></td>
<td>• If there are no reserves required to be maintained by law or under the articles, the balance sheet test is not applicable</td>
<td></td>
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<tr>
<td><strong>Distribution test</strong></td>
<td>• Management board may only refuse to grant its approval if it knows or should reasonably foresee that the company will not be able to continue to pay its due and payable debts following the distribution</td>
<td>• Cash-flow forecasts can be very helpful in making such decisions. Company risks such as potential litigation, termination of contracts, etc. should be taken into account</td>
</tr>
<tr>
<td><strong>Liability</strong></td>
<td>• Management board members are jointly and severally liable for a deficit caused by a distribution made in conflict with the balance sheet and/or distribution test</td>
<td>• Although we believe that this is merely a codification of case law, it does increase the need for management boards to clearly set out all the considerations underlying a decision to approve a distribution</td>
</tr>
<tr>
<td></td>
<td>• Shareholders are liable for a deficit if they knew or should have reasonably foreseen that the company would not be able to continue paying its due and payable debts following the distribution</td>
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</tbody>
</table>
Conclusion

Private equity deal activity in the Netherlands in 2013 is generally not expected to increase significantly compared to the already low level of 2012, and therefore the slump in the Dutch market that began in the second half of 2011 is expected to continue. Nevertheless, the Dutch private equity sector remains well positioned to benefit when economic uncertainty subsides and investor confidence increases, especially in the mid-market, where value can be created even without strong economic growth and without great reliance on financial engineering. One particular source of new deal flow could be companies that have ended up at banks’ recovery and restructuring departments or where companies are forced, whether by their banks or otherwise, to change or narrow their focus. Such companies have begun to act more forcefully in initiating divestments and mergers in which private equity firms could play a role.

Although their ability to finance leveraged buy-outs is under pressure, Dutch banks still consider leveraged finance an attractive business. This is particularly true in the mid-market, which forms the main battleground for competition between the Dutch banks. Maintaining relationships with corporate clients and private equity sponsors remains an important consideration for banks in financing buy-outs. So although margins on leveraged loans are attractive compared to those on ordinary corporate loans, it is the side business which often makes the financing of private equity investments worthwhile. This dynamic, which seems typical for the Dutch leveraged finance market, appears to be...
changing, however. Some signals point to a more disciplined and transparent way of doing deals, more in line with international standards and leading to more extensive documentation and higher – some say ‘healthier’ – margins and fees for banks.

M&A transactions generally involve high execution risks these days, and private equity deals are no exception. Only ‘high-quality assets’ and fire sales of distressed companies are capable of leading to straightforward and quick transaction processes. For anything in between, a successful closing requires more extensive, detailed and time-consuming preparations. In any deal, care in selecting and approaching potential buyers and perseverance in dealing with the uncertainty and volatility of the current business climate are key to achieving a successful closing. It remains to be seen what effect a continued slow pace of deal activity and a lack of exit opportunities will have on the Dutch private equity sector, although any such effect may vary depending on the type and life cycle of the respective fund. In the meantime, there has been an increase in transactions such as ‘dividend recapitalisations’ and ‘bolt-on acquisitions’, the aim of which is to maintain the potential for healthy returns and/or increase value for private equity funds in a market which seems, for now, to still be moving sideways.

A major change in this already unpredictable market will be brought about by the AIFM Directive, which will transform the private equity sector into a regulated industry as from 22 July of this year. One challenge in this respect is that there is still uncertainty regarding the interpretation and practical implications of certain aspects of the Directive. Furthermore, our research indicates that many parties in the private equity sector have simply postponed preparing for compliance with the AIFMD and potentially underestimate its impact.

The continued restraints on European banks’ lending capacity in the near future, and the fact that capital markets on this side of the Atlantic are not as well developed and liquid as in the US, present a funding challenge to many European companies, particularly those above the mid-market. This opens the door for and necessitates the further development of the European debt market (including the high-yield bond market) and the re-emergence of the European CLO market. In the meantime, there are signs that providers of ‘private debt’ (i.e. institutional investors, whether investing directly or through funds of specialised lenders) are gearing up to jump into the funding gap. Banks can be expected to assume more of an intermediary role in bringing these debt providers and companies together in transactions. On the equity side there is a significant amount of private equity capital that needs to be put to work. Also, ‘limited partners’ such as insurers and pension funds are moving into the market by increasingly doing direct investments/co-investments themselves.

Our research shows that certain regulated industries such as healthcare and financial services are in need of additional capital, and thus potentially offer great opportunities for private equity investors.

However, at present there are huge obstacles to investments in these industries, given their complexity and the heavy influence that politicians and regulators have over them. Nevertheless, it may just be a matter of time until these obstacles are removed in order to enable the private sector to contribute towards meeting the enormous challenges faced by such industries.
NautaDutilh Private Equity and Leveraged Finance Team

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- Ranked #1 in Chambers 2013 ‘M&A’
- Law Firm of the Year: The Netherlands, IFLR Europe Awards 2011 and 2012
- One of the Most Innovative Firms in Corporate Law by The Financial Time LAW 50
- Netherlands Corporate Deal of the Year 2012, acting for Intel in the Intel/ASML transaction

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Methodology
At the end of 2012, NautaDutilh circulated a survey among approximately 1,100 private equity practitioners, M&A and leveraged finance bankers as well as corporate finance advisers active in the Dutch private equity and leveraged finance market, of whom more than ‘8 percent’ completed the survey. In addition, we interviewed a number of private equity and leveraged finance experts and asked them to give their perspectives on ‘the new norm’ in the current market.

Although these interviews allowed us to verify certain key developments and trends identified in the survey, NautaDutilh is solely responsible for the contents of this publication and the views contained in this publication expressed are solely our own.

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