CUATRECASAS

Market Trends in Iberian Private Equity Transactions

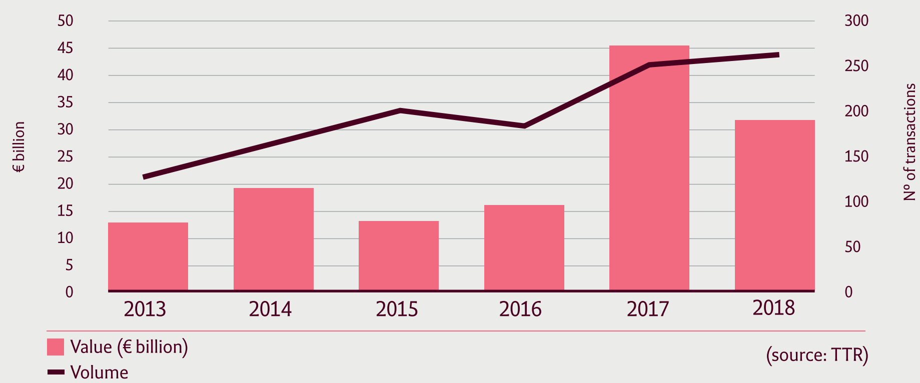
2019 Edition

Private Equity market outlook Spain 2018

The Spanish private equity sector has been growing consistently in recent years. In 2018, there was a record high in investment volume for the second consecutive year, showing the Spanish market's strong growth rate. There is a similar trend across Europe, which has the highest growth rate since the recession.

Although sources such as Spanish Venture Capital & Private Equity Association (ASCRI) and TTR apply different criteria for recording and assessing different transactions, they all confirm this trend. According to the data TTR registered for Spain, there were 267 transactions with a total value of €31.9 billion, representing a 6% increase in the number of transactions and a 30% decrease in the value of those transactions (see graph). Over the past five years, the CAGR has been 20.2%.

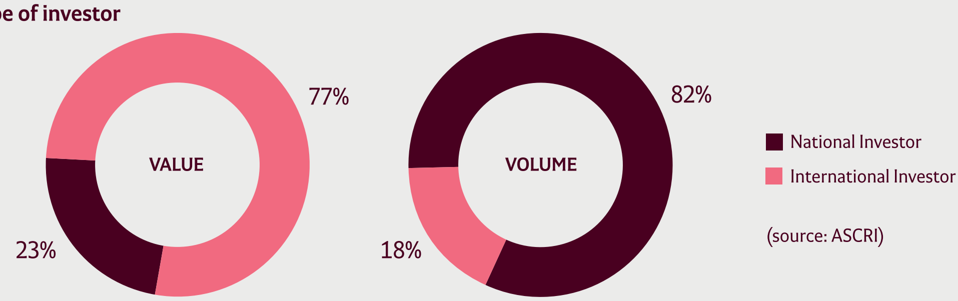
2013-2018 Spanish private equity investments



(source: TTR)

As reflected in the estimated data gathered by ASCRI, in 2018, international investors represented over 77% of total investment value. However, 82% of transactions involved national investors, which shows that international investors focused on bigger deals, while national investors focused on a larger number of smaller transactions. (See graph)

Type of investor

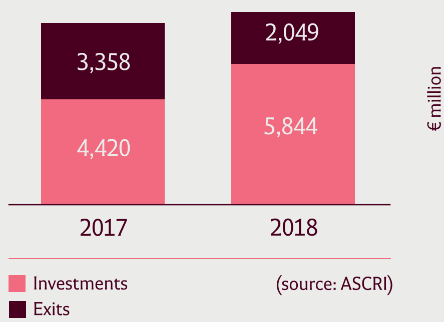


(source: ASCRI)

Middle-market transactions also played a prominent role in galvanizing this sector in Spain with a total volume of €1.5 billion, divided among 56 investments, reaching record figures. Eight large transactions (over €100 million) valued at €3.7 billion (63% of total volume) were completed.

Disinvestment decreased by 39% compared to the previous year, reaching a value of €2 billion. These sales were mainly to other private equity entities.

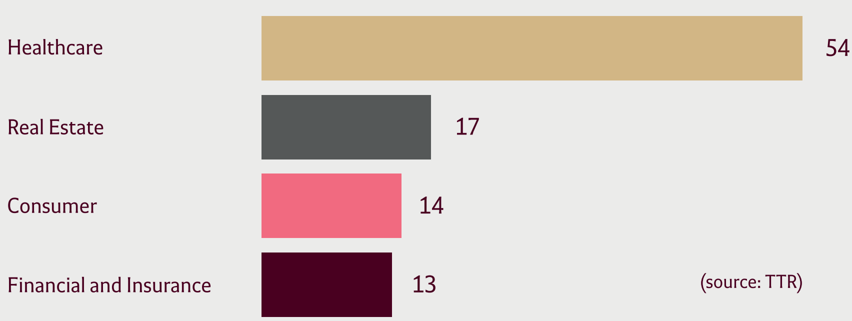
Value of private equity transactions in Spain 2017 vs 2018



Regarding sectors, healthcare/cosmetics experienced strong growth in transactions. Other sectors such as real estate, consumer goods, and finance and insurance were also active in terms of the number of transactions.

ASCRI also confirms this trend, indicating consumer products, hotels and leisure, medical and healthcare, logistics and transport, and financial services as the sectors with the most activity.

Industries (numbers of deals) TTR



Market Trends in Spain

Significant trends in Cuatrecasas deals

Study overview

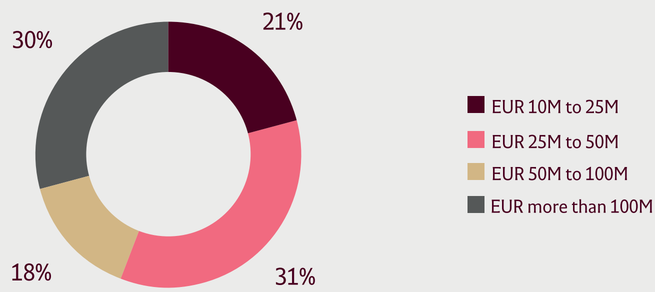
Investments are very diversified among different sectors

As the private equity sector continues to boom and broke records in 2018, this study, an overview of market trends in private equity transactions in Spain, analyzes the most significant deals on which Cuatrecasas advised.

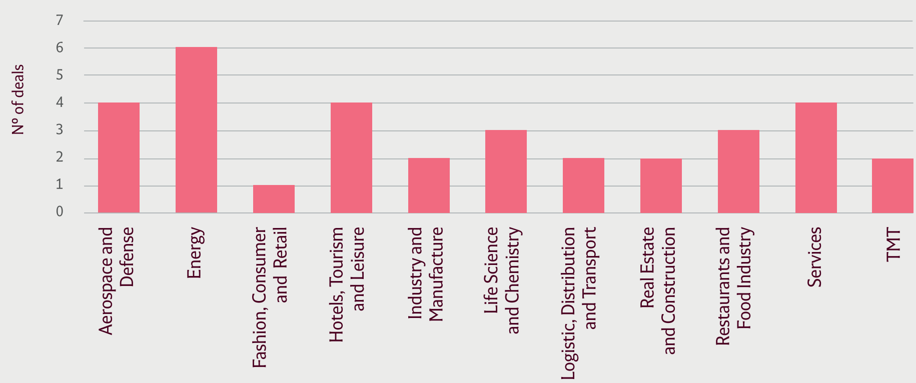
The study analyzes 33 private equity deals signed in 2017 and 2018 with transaction values over €10 million. The study does not include venture capital transactions, as they have their own features and market trends.

The trend continues and most deals had a transaction value between €10 and €50 million (57% in 2018) followed by large deals (over €100 million).

Transaction Value



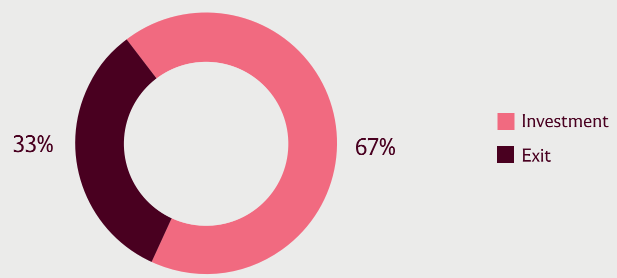
Target Industry



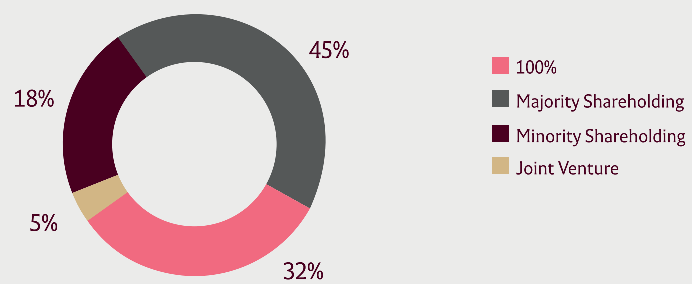
Although in 2018 the energy sector saw only half the number of transactions as in 2017, it continues to be the most active sector and usually involves a large deal, but the investment was generally very diversified. All transactions in the energy sector in 2018 were secondary buyouts.

Exits represented one-third of the deals, and in 2018, 80% of the exits were secondary buyouts. However, the most typical transaction continues to be a private equity fund buying 100% of the capital stock of the target company or taking a majority shareholding.

Investment vs Exit



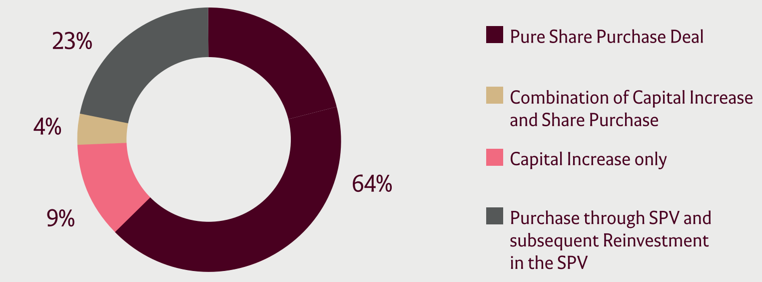
Majority vs Minority



In contrast with venture capital transactions, where pure share purchase deals are rare and usually take a minority shareholding in the company through a capital increase, within the private equity framework, almost 65% of the transactions were structured through a pure share purchase deal rather than a capital increase (9%) or a combination of capital increase and share purchase (4%).

Instead of buying a majority shareholding directly, in 22.7% of the transactions, the private equity fund bought the target company through an SPV and then the seller (or some of the sellers) reinvest in the SPV through a capital increase. This is for many reasons, but mainly tax, indebtedness and regulatory reasons.

Investment Structure



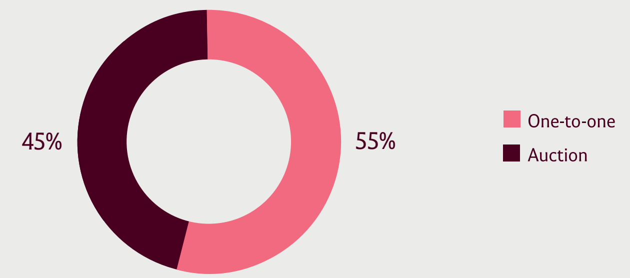
Deal process

Exit transactions are usually run as auctions

Since 2017 and 2018 were sellers' markets, the number of private equity transactions run as auctions increased considerably (45%) compared to 2016, where only 13.3% of the transactions were beauty contests with multiple potential bidders.

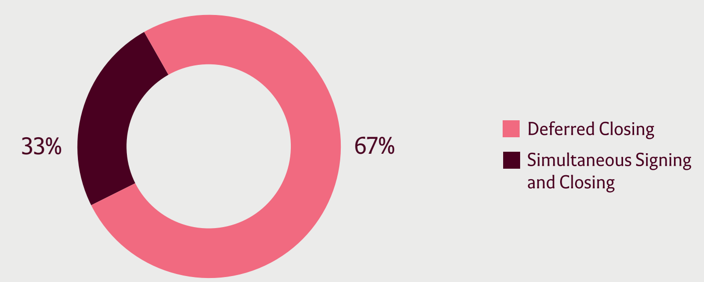
For exit transactions, the percentage of auctions increases to more than two-thirds, and when the exits are secondary buyouts, it reaches 80%.

Auctions process



The majority of transactions (67%) had a deferred closing, mainly due to fulfilling conditions precedent, although the percentage in 2018 decreased with respect to 2017.

Simultaneous Signing and Closing vs Deferred Closing

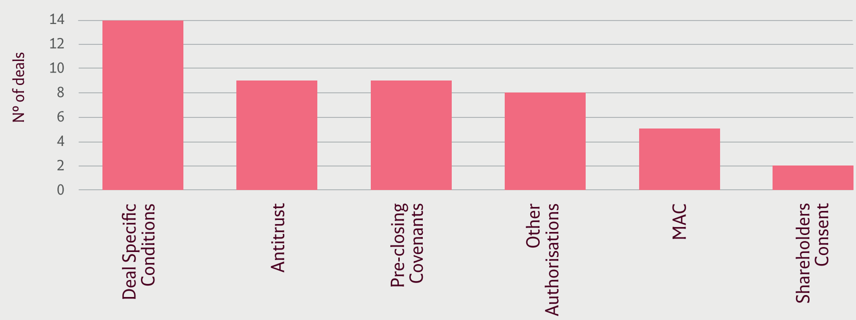


67% of the transactions had a deferred closing, mainly due to the fulfilment of CPs

The transactions include a range of conditions precedent, the most common being (i) approval by the antitrust authorities; (ii) other regulatory authorizations; (iii) fulfillment of pre-closing covenants (such as corporate restructuring, carve-outs, repayment of credits or termination of contracts); (iv) absence of MAC during the interim period; and, mainly, (v) more ad hoc conditions precedent related to the deal, third-party waivers (lenders or other side's consent due to change of control clauses), execution of financial agreements, fulfilment of financial agreement conditions and lack of legal proceedings, which could jeopardize the transaction.

Fifty-five percent of the agreements requiring antitrust clearance included a hell-or-high- water provision.

Types of CPs



90% of deals over €100 million included deferred closing with conditions precedent

Occasionally, there is still a break-up fee in case the closing does not occur. The percentage of the purchase price to be paid as a penalty varies, but it is never more than 25% of the purchase price, and it is usually below 10%.

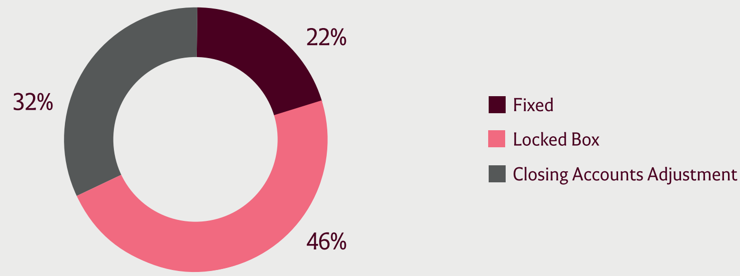
The use of conditions subsequent is unusual, mostly because once the transaction is closed and the property transferred, it is difficult to return to the stage before the purchase was completed.

Consideration and pricing mechanisms

As in traditional private M&A transactions, completion accounts and locked-box are the two pricing mechanisms typically used together with the fixed price.

Although both mechanisms have their pros and cons for both parties, completion accounts adjustment is considered buyer friendly, while locked-box is seen as seller friendly.

Pricing Mechanism



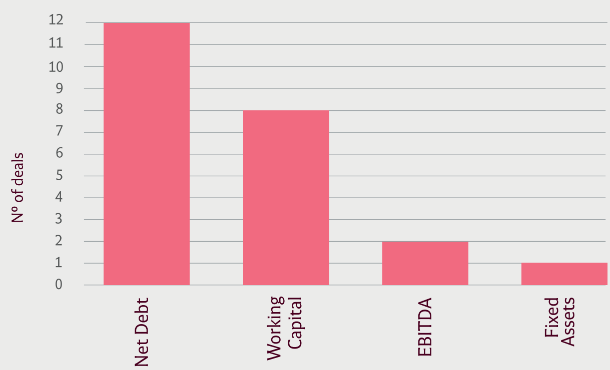
Locked-box mechanism has become most used pricing mechanism

In line with other countries, use of the locked-box mechanism has significantly increased in recent years. It is now being used in 46% of transactions, most likely because 2017 and 2018 were both sellers' markets (it was used in 53% of deals in 2018, compared with 40% of deals in 2017).

Since the financial risk transfers to the purchaser on the locked-box date and the purchaser can benefit from the profits generated from that date, while the price is paid at closing, the seller has different ways to seek compensation (usually by charging interest on the purchase price during the locked-box period). However, despite being a common practice in other jurisdictions such as the UK, it is still infrequent in Spain.

Seller's liability under leakage compensation is usually capped at the amount of leakage received and, in 41% of the transactions, it was increased by the agreed interest accrued from the date of leakage (usually around 8% or 9%) plus any tax impact accrued. The most common limitation period is 6 to 12 months.

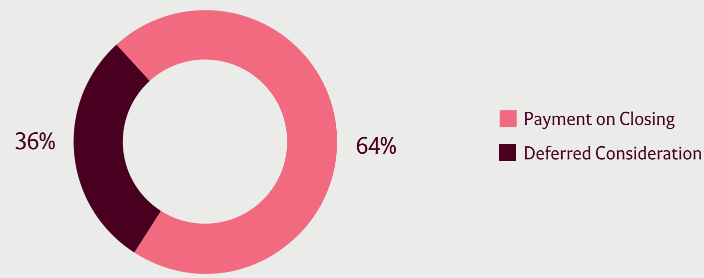
Closing Accounts Adjustment



Even though the locked-box mechanism has become the most used pricing mechanism, the completion accounts mechanism was still agreed in 32% of the deals, in which net debt and working capital were the most widely used financial parameters for the post-closing adjustment.

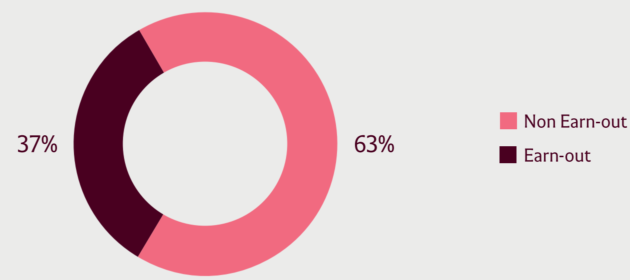
In complex transactions, we sometimes see a mechanism combining locked-box and completion accounts, although this is still infrequent. Regardless of the pricing mechanism chosen, cash consideration is the norm.

Deferred Payment



Up to 36% of transactions include payment of deferred consideration and 37% of them are earn-outs. However, if we focus only on 2018, this percentage rises to 57%, with 62% of them being earn-outs.

Earn-out



In 2018, 57% of deals had a deferred payment and the use of earn-outs increased considerably.

Where an earn-out is agreed, sometimes there are covenants to protect the seller.

Warranties

R&Ws are negotiated in SPAs under standard M&A practice. The agreed remedies for breach of R&Ws are the buyer's only remedy for breach of fundamental warranties or business warranties.

Unlike venture capital transactions, where indemnification can sometimes be in cash or, at the investors' discretion, the target company's shares, warranty payments in private equity transactions are almost always cash.

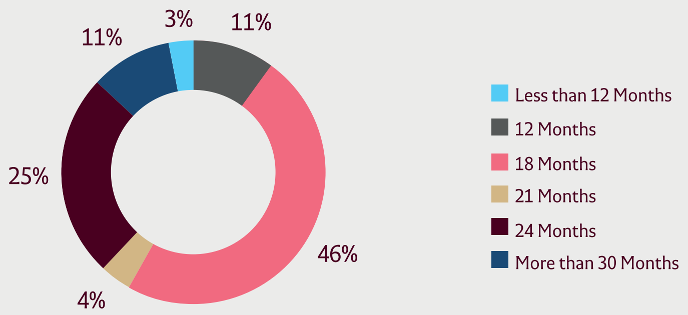
Warranty limitations

SPAs are usually limited quantitatively and temporarily.

Eighteen-month limitation period continues to be most used

The 18-month limitation period continues to be the most used, but the trend in 2018 leaned towards longer limitation periods (24 months or even more). It is common practice to subject specific issues to time barring as provided by law or regulations, mainly in tax, labor and social security matters, but also often in criminal, environmental and administrative matters, as well as damages related to the breach of a fundamental warranty.

Limitation period

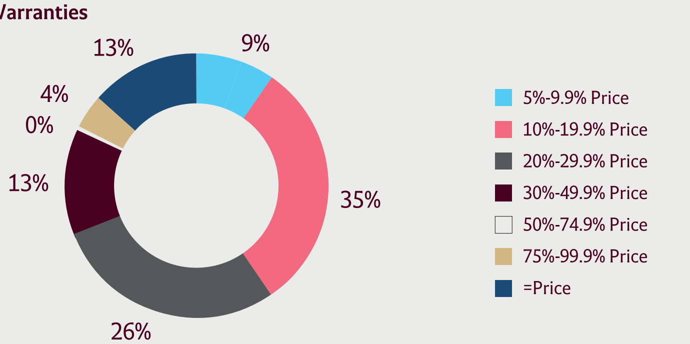


Liability cap for business and tax warranties is 10% to 20% of the purchase price

There are usually upper and lower limits on monetary limitations.

Liability for business and tax warranties is generally capped (usually under 50% of the purchase price), in contrast to fundamental warranties, which are either limited to the total price or not limited at all. The most common liability cap for business and tax warranties is 10% to 20% of the purchase price.

Liability Caps-Business Warranties



In more than 80% of exit transactions, they either agree a W&I insurance, or the private equity fund does not provide reps other than the fundamental warranties

In 2018, only 44% of cases agreed an exempt amount, due to the exponential growth of W&I insurance

All transactions in which the seller does not grant reps other than the fundamental warranties are either private equity funds' exits, or transactions in which a W&I insurance has been agreed. In all transactions the private equity fund was investing in, the industrial seller granted business and tax warranties (unless a W&I insurance was agreed).

Regarding lower limits, in 46% of the deals, the seller was not obliged to indemnify for losses if the amount, considered individually, was less than a certain amount (de minimis exclusion or de minimis amount). In 86% of the cases, a set of claims of an identical nature or origin was considered an individual claim for this purpose. Generally, where a de minimis exclusion is included, a basket is also agreed.

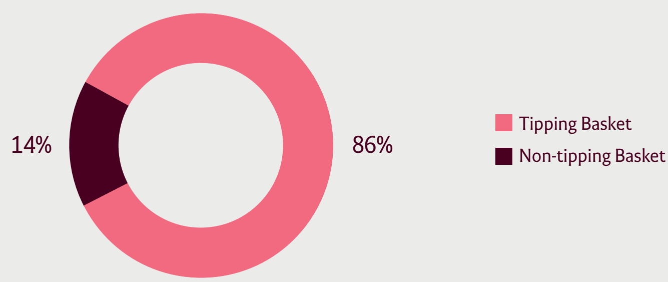
In these cases, the seller will not be liable for damages unless the aggregate amount of the claim, together with all the claims (each over the de minimis amount) exceed the basket.

Sixty-five percent of transactions included a basket, determined either as a specific amount or as a percentage of the purchase price. Of this 65%, most (86%) took the form of tipping baskets and 14% of non-tipping baskets.

In the cases where an exempt amount was not agreed, it was usually because the seller did not give business warranties or a W&I insurance was included.

The amount of the basket is usually below 1% of the purchase price (0.55% on average) and de minimis below 0.1% of the purchase price (0.034% on average).

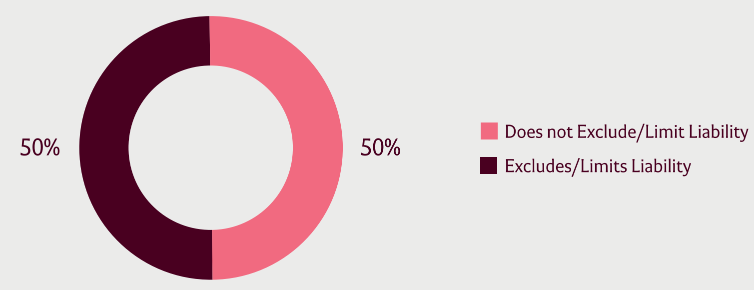
Basket



Buyer's knowledge

The impact of a buyer's actual or deemed knowledge on claims for breach of warranties is usually negotiated in SPAs in Spain. Up to 75% of SPAs state whether the buyer's knowledge of an inaccuracy in a representation and warranty limits the seller's liability for breach of warranties. Of this 75%, half of the transactions do not include limitations on the buyer's remedies if that buyer was previously aware of an inaccuracy or breach. In the other half, the buyer's knowledge excludes or limits the seller's liability.

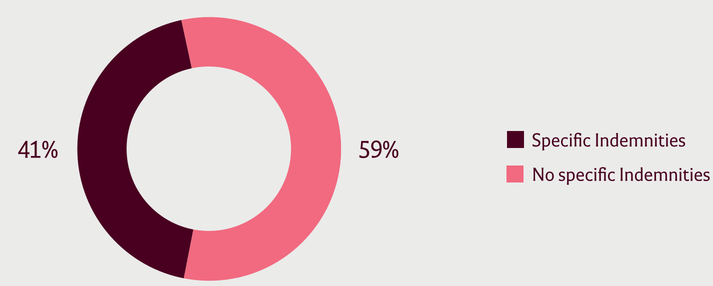
Buyer's Knowledge



Specific indemnities

Specific indemnities are ad hoc indemnity remedies negotiated when the risk of a specific loss is high, but not 100% certain. They are not usually subject to any limitation and do not have to follow the claim procedure negotiated under the SPA. Specific indemnities were included in 41% of transactions for several reasons.

Specific Indemnities

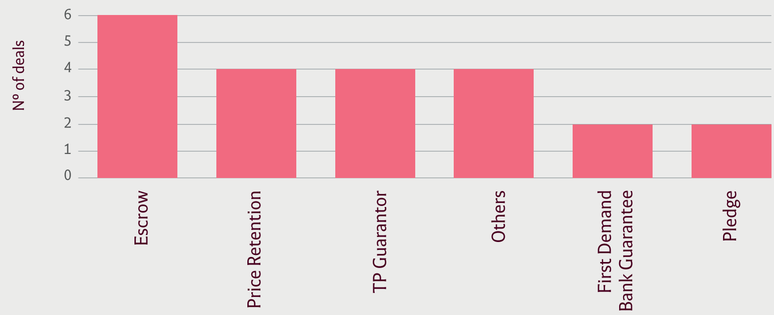


Buyer's remedies against seller's liability

It is common to include in the SPA a buyer's remedy to seek security against the seller's liability. In 2018, more than 92% of SPAs included a buyer's remedy. Regarding classic buyer's remedies, escrows continue to be most used.

However, one of the clearest trends in 2018 was the increased use of W&I insurance. Used in half the transactions, it is becoming the most used buyer's remedy in private equity.

Sellers' Guarantee



W&I insurance

W&I insurance continues to grow: it was used in half the transactions in 2018 (85% of these within the framework of a clean exit)

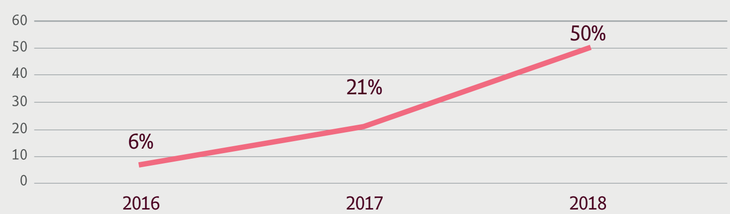
Since 2016, the Spanish market has started following the new trend emerging in the M&A market worldwide: seeking warranty remedy through W&I insurance.

While in 2016, it was used only in 6% of transactions, in 2017, this increased to 21% of deals and, in 2018, it was 50%. All are buyer-side policies and in most cases negotiated within the framework of an auction process or exit transaction.

Seller-side policies do not tend to be the best option because of the general exclusion of actual knowledge. That is why sometimes there is a "seller to buyer flip," meaning that the seller starts the process of negotiating the policy, but the purchaser finalizes it. This is common in auction processes. W&I insurance has become important in the private equity sector, as it allows the private equity fund to make a clean exit while disinvesting.

In 85% of the W&I insurance in 2018, the seller made a clean exit, which means that if there is any inaccuracy in the seller's R&W, the buyer's only remedy will be against the W&I insurer under the W&I policy: the buyer will not have any action against the seller. However, in a clean exit, it is common for the purchaser to have an action against the seller in cases of fraud, wilful misconduct and breach of fundamental warranties.

W&I Insurance



Average premium is 1% to 2% of sum insured

W&I insurance coverage depends on the policy negotiated, but usually it does not include:

- matters the insured party has actual knowledge of (i.e., matter discovered during the DD process)
- matters outside the DD scope
- anti-bribery, anti-corruption, anti-money laundering and tax evasion warranties
- fines and penalties (at least criminal penalties)
- purchase price adjustment and locked-box mechanisms
- forward-looking warranties
- environmental liability
- transfer pricing, and joint and several tax liability for belonging to a corporate group
- asset's condition
- product liability
- seller's covenant or commitment related to managing the business during the interim period

Average premium is 1% to 2% of sum insured. It can be less, or more, but it never exceeds 3.3%.

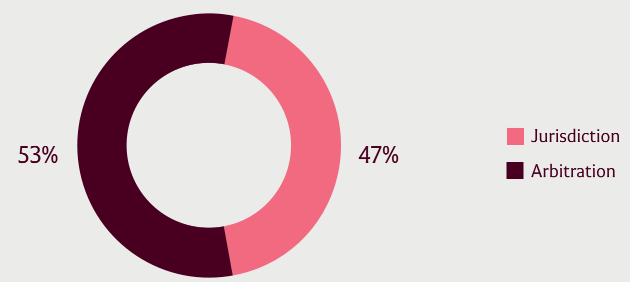
Dispute resolution

In 53% of transactions, parties chose arbitration

In 53% of transactions, the parties opted for arbitration as the dispute resolution mechanism to solve conflicts arising from the agreement, a slight increase over previous years.

Madrid is the common seat of arbitration, chosen in 85% of transactions. The arbitration proceedings are mostly managed by the Court of Arbitration of the International Chamber of Commerce ("ICC"), or by the Madrid Court of Arbitration.

Dispute resolution



Financing

Overview

The liquidity and variety of financing products available to borrowers to carry out private equity transactions have provided a very attractive opportunity for private equity players and have helped invigorate the Spanish market. In addition to banks, credit funds are actively tapping the Spanish market (some are opening Spanish offices). Due to their high degree of specialization and their speed of execution, these funds have become increasingly attractive for borrowers, who are progressively turning to them to finance their acquisitions, even though, despite being more flexible, this alternative is sometimes more expensive.

Liquidity and variety of financing products offer attractive opportunities

However, bank financing is still the main source of financing for private equity transactions and, with the "credit crunch" now behind us, it has become easier for Spanish and international buyers to gain access to bank financing. Competition from credit funds and the availability of alternative financing products have led banks to offer less demanding terms and conditions than in previous years, as well as a faster decision-making process during the financing negotiations. Banks can offer more competitive conditions to borrowers than credit funds, which typically need higher yields when entering into financing transactions. This has been seen as an opportunity, not only for buyers to obtain financing from banks under more favorable conditions, but also for buyers who performed mostly equity-financed private equity transactions before 2013, and who are now leveraging their investments to take advantage of the greater availability of bank financing.

Apart from bank financing, common financing resources for private equity transactions include pure equity, shareholder loans, vendor loans and other kinds of debt (e.g., issuance of high-yield bonds, which are becoming increasingly significant in Europe).

Bank financing is still the main source of financing for private equity transactions

Financing structure

The financing structures used in Spain have changed in recent years as a result of the extension of the financing products available to borrowers. While there are still many traditional senior and mezzanine facilities, the variety of financing sources available (mainly provided by non-bank entities) has caused a proliferation of bridge-to-equity, second-lien, hybrid-equity-like and unitranche facilities. However, the most common bank financing structure is a senior tranche combined with second-lien finance or mezzanine finance, or both. It is also common, especially in ordinary banking facilities, to subscribe several hedging instruments that cover the risk of either interest rate variations or exchange rate variations. Unitranche, in turn, is also making its way into the Spanish acquisition finance market and unitranche lenders have become increasingly active in the market over the last few years.

We may see an increase in activity in debt security instruments

In contrast, debt security instruments are still not widely used in Spanish transactions. Generally, only large investment grade borrowers will be able to tap the market and raise financing through bonds or notes in the capital market. However, many of the restrictions in our corporate law that prevented private limited liability companies (*Sociedad de Responsabilidad Limitada*) from accessing the capital markets have been eliminated, so we may see increased activity in this field.

Facility agreement

Generally, where banks act as lenders, a syndicated loan is entered into by the buyer (which is usually a special purpose vehicle, or "SPV") and several lenders, both Spanish and foreign. In contrast, credit funds usually finance these transactions on a bilateral basis, without involving other banks or private equity funds, in some cases still relying on double luxco or similar structures.

Facility agreements are usually subject to Spanish law, are written in Spanish, and do not follow a standard format. LMA-based models and English are sometimes used, especially when the financing is granted mostly by foreign creditors or by credit funds.

The most common clauses in facility agreements:

- Conditions precedent, such as the valid execution of the SPA and the simultaneous execution of the security documents.
- Affirmative undertakings, such as the use of the facility for the purposes for which it is granted, compliance with all laws related to the debtor's business, and the maintenance of the pari passu ranking.
- Negative undertakings, such as the prohibition on giving security interests (negative pledge), change of business, change of control, and limitation on incurring additional indebtedness.
- Information commitments, including periodic obligations (such as monthly management reports) and immediate obligations (such as keeping creditors informed of relevant matters affecting the debtor's business).
- Financial covenants, such as net financial debt/ EBITDA ratio, debt service coverage ratio or other ratios that may ascertain the debtor's performance.
- Mandatory and voluntary early prepayment: Mandatory early prepayment may be total or partial, and takes place, for example, when a change of control occurs. Voluntary early prepayment can only be carried out following the conditions under the facility agreement.
- Majorities regime, when the facility is granted on a syndicated basis.
- Events of default: The occurrence of an event of default (such as the debtor's failure to pay an amount) does not automatically imply the execution of the guarantees. Instead, the majority of creditors will agree to enforce the guarantees if an event of default occurs.

Intercreditor agreements

We are also seeing a growing number of intercreditor agreements being entered into by banks and credit funds, with commercial banks normally holding the working capital lines and being senior to credit funds. These intercreditor agreements, which are generally subject to Spanish law (while, in some cases, following the LMA standard format), have become more complex. In addition to the typical turnover and voting provisions, they now include call/ put options in favor of the credit funds (as junior creditors) to acquire at par the senior debt (held by the banks) after an event of default under the senior facility or the junior lenders' right to cure the breach of the senior financial covenants, to keep the capital structure stable.

Security interests

The repayment of the facility agreement is usually secured with both personal and *in rem* security interests granted by the debtor and its guarantors. The most common personal guarantee is the joint and several first-demand guarantee, while the most typical *in rem* security interests include mortgages over real estate, and pledges over the debtor, the SPV or the target's shares, or both, and over the credit rights arising from the debtor's bank accounts.

Financial assistance prohibition

When negotiating the security package for the financing of the private equity transaction, the parties also have to be aware of the financial assistance prohibition. This implies, for example, that the target's assets cannot be used to secure the financing.

In recent transactions, financial sponsors and lenders have been exploring new alternatives and strategies that might achieve an effective debt push down without violating the financial assistance prohibition, involving dividend distributions and similar structures. These strategies need to be carefully analyzed to ensure compliance with the applicable regulation.

Personal guarantees and corporate benefit

Unlike other EU jurisdictions, there is no specific obligation for a company to justify that it is acting for corporate benefit when granting a guarantee or security, although it is advisable to do so, especially to avoid a potential claw back in insolvency proceedings of the guarantor.

Parallel debt

The difficulties and costs arising from assigning security interests have led several jurisdictions to develop alternative frameworks to make it easier for creditors to assign their credit rights and the security interests attached to them. One of these frameworks is the parallel debt agreement, under which the guarantor recognizes an independent and separate payment obligation in favor of a security agent, for an amount and a maturity equal to the obligations arising from the facility agreement.

Spanish law does not recognize this framework. If the secured obligations are governed by Spanish law, there is a risk that they may imply a fiduciary relationship unsupported by a real credit of the agent against the project company. However, if the secured obligation is governed by foreign law and the parallel debt structure is valid and enforceable under that law, the Spanish security interests may secure parallel debt structures. This approach has already been followed in several crossborder transactions (especially when the security interests granted do not require registration), but it may be complicated to implement when it relates to security interests that require registration.

Tax

Overview

The main tax topics in the current private equity environment can be summarized as follows:

- The need to meet BEPS-related standards when structuring the acquisition or sale of Spanish targets, particularly when the use of non-Spanish vehicles is in place.

  It has become essential to ensure the intended tax treatment upon exit, not only that foreign investment structures meet the minimum substance requirements, but also that there is a clear business rationale for their existence other than the application of tax benefits. This matter deserves careful attention, since Spanish tax authorities are placing particular focus on it.

- The need to rethink the financing of the acquisition of the targets

  Spain, following BEPS lines, has introduced severe limitations on the tax deductibility of interest expenses, particularly— but not only—when the financing will be used to purchase companies. This leads to reconsideration as to the traditional debt/equity structuring of private equity deals.

  Moreover, the tax deductibility of interest on profit participating loans has been limited, and strong anti-hybrid mismatches rules have been enacted. This means that the financing environment through debt has become tougher.

- The Spanish participation exemption regime

  Spain has extended its participation exemption regime to include, within the scope of the exemption, gains derived from the sale of Spanish companies, even when they do not correspond to undistributed profits of the sold entity (gains from non-Spanish companies were formerly included in the participation exemption regime, but not from Spanish companies). In addition, tax deductibility of losses from those transactions are now subject to major limitations.

- Managers' compensation

  The Spanish tax authorities seem reluctant to consider ratchets or income from carried or performance shares as income from capital. There is currently a risk of income or gains from these instruments being considered as highly taxed salary income, which makes it necessary to conduct a close analysis of each mechanism on its own merits to structure, in a tax-compliant and safe manner, the proceeds managers will receive.

  However, in 2019, one of the Basque Country's provinces, Guipúzcoa, approved a specific regulation on carried-interest income. In certain circumstances, this income may be qualified as a dividend.

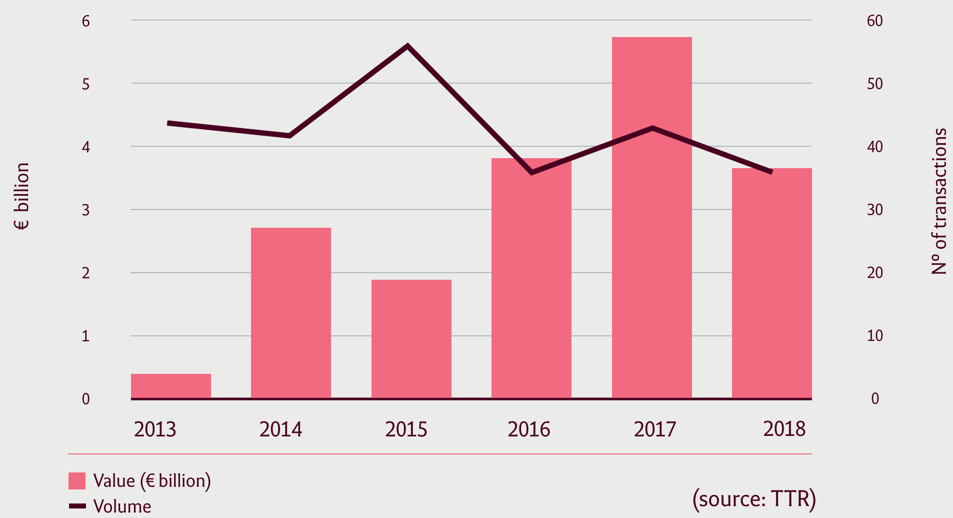
Relevant tax topics are, among others, the need to meet BEPS-related standards when structuring the transaction and the need to analyze the proceeds (such as ratchets) that managers will receive

Snapshot Portugal

Market outlook

The aggregate volume of mergers, acquisitions, private equity and venture capital in the Portuguese market was €22.6 billion in 2018, an increase of 76.1% over 2017, according to the data TTR registered for Portugal. However, regarding private equity, there were 36 investments with a total value of €3.36 billion, which was a 28% decrease in the number of transactions and a 51% decrease in the value of the transactions with disclosed value.

2013-2018 Portugal private equity investments

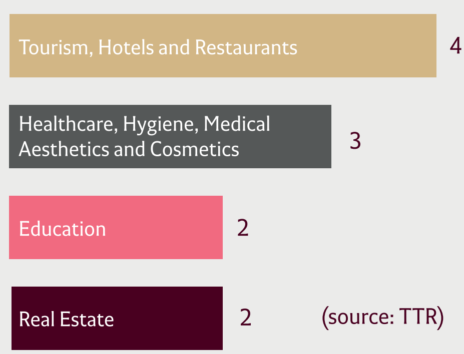


(source: TTR)

According to TTR, the leading subsectors in PE deals in 2018 were tourism, hotels and restaurants, education and real estate

Aggregated data of M&A, private equity and venture capital shows that crossborder inbound acquisitions focused on the following sectors, in order of preference: real estate, technology, financial and insurance, tourism, and hotels and restaurants.

Sectors (number of deals)



(source: TTR)

Total inbound acquisitions (160) clearly outperform outbound acquisitions (49), with Spanish investors being the most active bidders in crossborder activity in Portugal, with 49 deals, followed by the United Kingdom (25), the United Stated (23) and France (21).

In addition to the local PE firms, UK, German, Spanish and US firms seem to be the most relevant players

Local particularities

While deal process does not vary substantially across Iberia, there are certain legal particularities in Portuguese Law that have to be taken into account in the structuring and implementation of a PE transaction.

Shareholding funding

Public limited liability companies ("Sociedades Anónimas" or "SAs") require a minimum share capital of €50,000.00, and Quota companies ("Lda") do not require a minimum share capital.

The contributions of the shareholders can be allocated in full to the share capital or be partly allocated as share premium (ágio), both accounted for as equity. Subject to certain exceptions, the share premium (ágio) is subject to the legal reserve's regime and can only be used to (i) cover part of the losses evidenced in the balance sheet that cannot be covered by other reserves; (ii) cover losses from previous years which cannot be covered by the profits of the financial year or by other reserves; (iii) to increase the share capital; up to the mandatory amount of the legal reserve.

Shareholders loans (suprimentos) are subordinated debt and require that the credit has a continued basis, which is deemed to exist when the maturity term exceeds 1 year.

Shareholder funding is often made by supplementary capital contributions – regulated for Quota companies, but used also in SAs – which are cash contributions accounted as equity, not bearing interest and which reimbursement requires that the equity of the company does not fall below the sum of the share capital and legal reserve and that the shareholder has already paid in full its quotas/shares. The credits derived from the supplementary capital contributions are transferred with the corresponding quota/shares and are generally priced at their nominal value.

Liability of shareholders

Quota companies can be held by two or more shareholders. In case a quota company is held by a single shareholder, it may be exposed to a potential liability for debts of the company in case of insolvency, provided that there was patrimonial confusion between the shareholder and the company, and should be subject to the specific legal regime of sole shareholder companies which entails certain disclosure obligations.

Public limited companies (SAs) must be incorporated by five or more shareholders, unless they are incorporated by a single shareholder that must be a corporation. There are specific liability rules for the companies in a group relationship exposing the dominant company to the losses of the subordinated company that should only apply to companies with registered offices in Portugal.

Financial assistance

In Portugal, there is a general prohibition of financial assistance expressly provided for SAs. The potential application of this prohibition to Quota companies is controversial.

Although there is no specific legal regime on leveraged mergers subsequent to an acquisition, forward and reverse mergers are generally used in Portugal, among other alternative transaction structures, to transfer partially the debt of the acquisition to the free cash flow of the target company.

Forward and reverse mergers are generally used in Portugal

Personal guarantees and corporate benefit

In Portugal, a company must justify that it is acting for corporate benefit when granting a guarantee or security in favor of a third party, unless there is a group or controlling relationship with the company benefiting from the guarantee or security.

Disclosure obligations

Under the Portuguese Companies Code, a company with a shareholding of 10% or more in another company (Target) must disclose to the Target all acquisitions and disposals of equity, as long as its shareholding remains above the 10% threshold.

Build-up strategy and minority shareholdings

When a company with registered offices in Portugal directly or indirectly reaches a shareholding of 90% or more in another Portuguese company (Target), it must notify the Target within 30 days, and it is entitled to start a "squeeze-out mechanism" to acquire the Target's remaining equity. To trigger this mechanism, the majority shareholder must present a bid over the minority shareholdings within six months following the 30-day notice, for compensation in cash or in kind (purchaser's shares or bonds), the value of which must be confirmed by an independent chartered accountant. If the controlling shareholder does not initiate the squeeze-out mechanism, the minority shareholders may request the purchase offer and exercise a put option right, for compensation to be agreed on with the majority shareholder or, failing that, to be determined by a court.

Legal highlights

Recent changes in Portuguese law may impact the PE market as follows:

Debt to equity

New law fosters the conversion of debt into equity, with a view to support the companies with an equity lower than its share capital restructuring their balance sheet, but applicable only to companies whose turnover (with reference to the accounts presented in the previous tax year) is equal or higher than €1,000,000. Previous legal framework required agreements between the creditors and the shareholders and was limited to insolvency proceedings.

This new regime allows the conversion into equity in a stressed or distressed scenario with specific mechanisms to overcome any shareholder opposition

Loan-to-own strategies are now supported by this regime and will probably foster M&A activity in stressed, distressed or special situations scenarios.

Sales of business

General employment law provides for the automatic transfer of the employees affected to the business in case of transfer of business. Recent changes in employment law impose additional disclosure and consultancy obligations by both the transferor and the transferee that should be addressed in the structuring of a sale of business.

Essentially, the law provides for the employee's right of opposition to the transfer of the employment contract to the purchaser in certain circumstances (e.g., when it can cause "serious harm" to the employee for lack of solvency of the acquirer, or in case the employee does not trust the work organization policy of the purchaser). In those circumstances, upon transfer of business, the employees may also terminate the employment contract with right to a compensation to be paid by the purchaser. The transferor and the purchaser are now jointly responsible for the employees' credits arising from the breach or termination of the employment contract, as well as the corresponding social contributions due until the date of the transfer, assignment or reversal, for the two years following the transfer.

Regulatory

Decree-Law 56/2018, of July 9, significantly changed the legal framework applicable to private equity in Portugal.

Before this law entered into force, one of the criteria applicable to determine whether an investment could qualify as private equity was that it should not exceed a maximum duration of 10 years. With the removal of this time limit, private equity firms now benefit from a more flexible regime, allowing them to manage their assets based on market conditions and cycles.

Market trends

New funds and local GPs

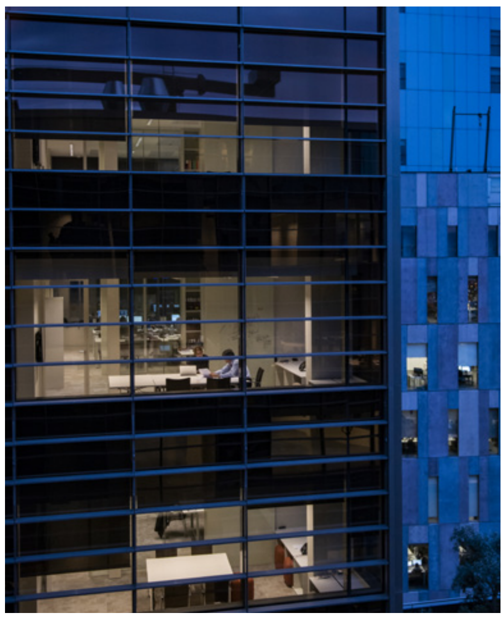
There is an increase in local players as 20 new private equity funds and 2 new private equity companies were registered in Portugal in 2018.

Co-investment

Relevant international PEs have started co-investment with local players, valuing the local knowledge of the assets. An interesting example is Morgan Stanley Infrastructure Partners and Horizon Equity Partners joint purchase of a 75% stake in Towers of Portugal, a company which comprises 2,961 sites previously operated by Altice Portugal (deal value €495 million).

Minority versus majority investments

According to the 2017 Annual Private Equity Report issued by the Portuguese Market Securities Commission, 78% of shareholdings owned by PE firms, whether in companies or in other funds, are minority stakes.



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