Your Dentons Europe Private Equity Trends Monitor

Third edition: December 2020

Your Dentons Europe
Private Equity Trends Monitor

The Dentons' Europe Private Equity team is delighted to announce the launch of the third edition of our **Private Equity Trends Monitor**, which provides you with an up-to-date overview of the latest and anticipated trends across the European private equity sector in the wake of the COVID-19 pandemic.

Dentons' Europe PE group continues to closely follow the development of COVID-19 and its impact on PE deal activity. Our lawyers on the ground in each of our core markets regularly monitor and assess the situation and report on trends and developments as the situation continues to evolve.

We have asked our teams to respond to the following four questions:

1. *How has COVID-19 impacted deal flow in the European private equity sector?*

2. *Do any particular industries seem to be insulated from the adverse economic effects of the pandemic?*

3. *Are downward economic protection clauses/ measures (including MAC clauses) becoming more prevalent in transaction documents?*

4. *Are you seeing any distressed deals so far?*

This is the last edition in a series of three updates that were produced this year. The team is planning on releasing additional updates in 2021.

Country	How has COVID-19 impacted deal flow in the European private equity sector?	Do any particular industries seem to be insulated from the adverse economic effects of the pandemic?	Are downward economic protection clauses / measures (including MAC clauses) becoming more prevalent in transaction documents?	Are you seeing any distressed deals so far?
Benelux	In the Benelux, PE deal flow is picking up again, especially in markets less affected by COVID-19. This will be further powered by long-term low interest rates and a significant increase in investments in alternative investments, such as PE funds, by pension funds and insurers. It is expected that this "dry powder" will continue to grow by 10% per year in the coming years. In Luxembourg, there is also strong growth of private debt funds. Assets under management of Luxembourg private debt funds have soared by 36.2% compared to last year.	As a result of the positive vaccine news, more traditional sectors such as financials, industrials and energy have seen a large rebound. However, within these traditional sectors, we are also seeing large restructurings being announced and large write-offs of stranded assets. Sectors that did well during the first wave continue to do well now, like tech/medtech, renewable energy, the leisure industry and life sciences.	We note that pre-pandemic PE terms are re-emerging, including acquisition financing. As noted in our previous edition, we also continue to see a rise in earn-out arrangements. The trend of large signed deals being cancelled and litigated has continued as several new M&A-related claims are currently being litigated in Dutch courts. Such litigation has not (yet) been much seen in Belgian or Luxembourg courts.	It is expected that more bankruptcies may occur during the second quarter of 2021. The biggest restructuring currently taking place in the Netherlands is that of large Dutch retailer HEMA. This trend is reflected in Belgium, where the largest ongoing restructurings are taking place in the fashion (FNG Group) and household retail sectors (Mega World). Although it is not clear yet what the economic impact of the second COVID-19 wave will be, positive news around vaccines has given corporates and entrepreneurs a hopeful perspective. Businesses are beginning to speak with their vendors and banks about their future plans again.
CEE	Deal flow has remained unexpectedly strong through 2020. Infrastructure, e-commerce, technology and food and agro transactions have made up for the overall slowdown that we observed in the mid-market and lower mid-market in the first nine months of the year. The fourth quarter brought new hope and new opportunities that should make the PE market busy towards year-end and the beginning of 2021.	Online retail, which was relatively underdeveloped as compared with Western Europe and North America, has been expanding exponentially. The more successful online food retailers are seeking growth equity to fund the geographic buildout of their operations. There has been an influx of US technology companies refreshing their technology portfolio through the acquisition of emerging CEE technology and services companies. Also, alternative energy and infrastructure continue to draw significant interest from infrastructure funds and asset managers.	It has really depended on the transaction. In competitive auction processes or transactions involving global PE players, as usual, there are no downward economic protection clauses. However, in semi-distressed transactions or transactions without any competitive tension, some buyers are able to elicit conditions precedent protecting them from significant deterioration in the target's economic position.	While there have not been too many distressed deals resulting from COVID-19 so far, quite a number of hotel and retail assets affected by the pandemic are being prepared for sale, and funds focused on CEE distressed hotel assets are being established. This foreshadows a large number of deals in these sectors in H1 2021.
France	The French PE market remains very active, year-end is as always very busy but many sale processes are also being launched for 2021. The level of dry powder remains high, which should positively affect deal flow in the next few months. Financial sponsors, however, increasingly focus on sectors seen as resilient, notably infrastructure and life sciences, and also on build-up opportunities for their successful portfolio companies.	The sectors we have seen to be less affected include infrastructure, telecoms and life sciences. Infrastructure funds are increasingly present. Life sciences is very active in all segments from pharma to diagnostics, IA solutions, biotech, health facilities (where infra funds can also invest) and health at home services.	Earn-out structures are increasingly used, although more common on transactions involving strategic players rather than PE investors. MAC provisions are more heavily/precisely negotiated and sellers often negotiate to exclude COVID-19 related events.	Together with our restructuring team, we see an increasing number of distressed deals and deals driven by debt renegotiation. We see a lot of amicable bankruptcy proceedings set up to facilitate distressed deals.

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Germany	Deal flow involving PE funds is accelerating again. Many PE funds are currently looking for opportunities and there is a lot of dry powder in the market. More and more new and follow-up funds are getting closed these days. Still, at the peak of the second COVID-19 wave, there remain uncertainties when making forward-looking valuations. But buyers seem to be flexible about overcoming those obstacles by a variety of instruments, such as earn-outs and vendor loans.	The industries that seem to be the least affected include services, software (eg. learning apps, HR software, online insurance brokerage, engineering services), pharma and healthcare and tech/medtech. We also see other deals in the market that seem to indicate that the private equity industry is bouncing back to a more "normal" environment. Latest deal announcements or rumors about contemplated transactions included investments in the following markets: bicycles, asset management service providers, optical fiber networks and services and garden houses.	Given that the PE market has become used to the COVID-19 background, sellers are less inclined to accept any sort of deal insecurity coming from MAC clauses or similar contractual arrangements giving the prospective buyer a right to rescind the acquisition contracts. Buyers deal with this situation by way of a more hands-on approach during due diligence and a closer monitoring of current trading developments just until shortly before signing.	While a number of firms have applied for insolvency protection – some of which were in distress even before the crisis – we have not seen any notable distressed deals involving PE. Some managers of PE portfolio companies hope to buy out some of their competitors at the beginning of 2021. But there is also a certain fear that the number of insolvencies will surge in 2021, in particular if suspensions of parts of the Insolvency Act are lifted again.
Italy	Most of the deals that were put on hold during the firstwave were resumed and have eventually been completed. The general feeling is that the M&A market is still active, partly because – in contrast to the 2008 global financial crisis – the COVID-19 outbreak has so far not caused a substantial credit crunch. Although PE funds are certainly more cautious than industrial players with regard to new investments, their scouting is still pretty active, and they can usually make decisions faster than industrial investors. Moreover, some players are starting to look forward with some optimism to the second quarter of 2021, when they hope to complete new deals (helped, hopefully, by an easing of the COVID-19 pandemic).	PE funds are particularly active in the food and healthcare sectors. The logistics business seems also to be quite active (particularly in the B2C segment, although B2B is peaking up again). Other industries that seem less affected by the pandemic so far are telecoms and energy/utilities. The real estate market is generally suffering more than other sectors but new investment opportunities are being targeted. An important investment in the hospitality sector was completed very recently. Finally, as China is somewhat ahead in respect to Europe and the US in managing the COVID-19 outbreak, we are seeing some new interest from Chinese investors in the Italian market.	Deals that were already in an advanced stage before the first wave have been secured against a reduction of the purchase price. Some clients have been able to successfully invoke the application of MAC clauses in SPAs that have already been signed, and have obtained a reduction of the purchase price, while in most cases the invocation of a MAC to exit from a deal has been unsuccessful (also due to the fact that, in certain sectors e.g. healthcare, the negative impact of the COVID-19 outbreak has so far been temporary and limited to the first lockdown period during March-April, and some players are now experiencing an increase - rather than a decrease - in revenues).	So far the number of distressed deals has not increased in a substantial manner compared to pre-COVID-19 levels, although the general feeling remains that they are very likely to rise in the near future (in particular, for those players operating in B2C retail sectors and/or when certain protective measures adopted by the Italian government, such as the ban of dismissals, will cease to be effective).

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Spain	PE and private M&A activity has come back to normal levels in Q4, and there is a significant number of transactions going on with a strong interest to complete before year-end.	We continue to see deals in the healthcare sector, such as in testing laboratories and hospitals, but these are not significant enough to constitute a trend. Most recent deals include energy (renewables) and telecoms, as well as a wide array of operating businesses that have not been particularly impacted by COVID-19.	MAC clauses are still not found in private equity deals in Spain (other than in LBO financing facilities). COVID-19 exceptions have become standard in W&I insurance policies, but insured parties specifically request their removal as an enhancement of the policy, and we see many insurers willing to underwrite on that basis subject to high-level commercial due diligence.	We still do not see true distressed deals yet, although we see increasing interest in certain real estate assets particularly impacted by COVID-19 e.g. hotels. Spain is also experiencing a remarkable reshaping of the financial sector. In addition to the merger between CaixaBank and Bankia, BBVA and Sabadell have also contemplated a merger (which is currently on hold). If implemented, this merger would lead to the second largest retail bank conglomerate in Spain.
Turkey	PE deal flow is still low, though strategic investors remain active but deals go at a slower pace. Despite the general slowdown, our team continues to see some activity, with two deals closing in the summer in technology and healthcare devices, including the sale of the first Turkish unicorn Peak to Zynga for a total consideration of US$ 1.8 billion, a record for a Turkish tech start-up. Our teams from Turkey and the US advised Hummingbird Ventures on the sale.	A number of industries have been declared by the government to be affected by the pandemic and granted certain force majeure type protections. Chief amongst these are the construction, tourism, agriculture, automotive, logistics and food and beverages industries. The healthcare industry is – not surprisingly – more resilient. Other resilient businesses include online shopping and gaming.	COVID-19 based MAC discussions continue to be on the rise, with EBITDA or turnover reductions being proposed as new MACs. There have been confirmatory due diligence reviews and an increase in warranties and indemnity insurance. Investors are yet to reject transactions that are already in negotiation phase but there is a trend to slow down deals.	There have been no distressed deals so far, though there are a number of classic liquidation or restructuring transactions, in particular around the restructuring framework agreements signed by banks as part of a larger regulatory effort.

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UK	For UK-based PE firms, 2020 has been a year marked by resilience and versatility as they pivoted to meet the challenges and avail of the opportunities arising from COVID-19. They have generally adapted very well to new modes of operating, some of which will likely endure post-pandemic. After a record contraction in Q2, deal activity rose sharply in Q3. However, the pandemic has continued to have a chilling effect on total deal volume and value for the year, both of which remain significantly below pre-COVID-19 levels. The largest UK transaction in Q3 saw KKR acquire Viridor Waste Management for €4.7 billion. Q3 also witnessed the largest UK IPO by market capitalisation since 2013 – The Hut Group, debuted on the London Stock Exchange with a valuation of £5.4 billion. London has consolidated its reputation as a global fintech capital, retaining its place as the second most popular destination for global fintech investment. Looking ahead to 2021, general optimism among LPs, significant liquidity in credit markets, pent-up need to deploy record amounts of dry powder, the relative affordability of UK assets and the UK roll-out of the COVID-19 vaccine all bode well for a gradual return to higher levels of deal activity. However, further regional lockdowns, rising unemployment, reduced consumer spending, the termination of the UK government's Coronavirus Job Retention Scheme in March and the short-term consequences of Brexit could dampen recent deal momentum.	As expected, countercyclical or acyclical industries have proved more resilient in withstanding the adverse economic effects of the pandemic and are therefore garnering attention from private capital. These sectors include technology (including biotech, medtech and cybersecurity), pharmaceuticals and healthcare, consumer products, infrastructure (as long-life PE funds target infrastructure-like assets), energy (primarily renewable energy, power, cleantech and energy transition projects), and e-commerce and logistics. Unsurprisingly, PE firms with investee companies in the real estate, leisure, hospitality and retail sectors have been most affected by the impact of the pandemic. Whilst government support schemes, such as the Coronavirus Business Interruption Loan Scheme, have provided welcome support for these businesses, little respite for them is expected in the near term given the ongoing pandemic, the lead-time in rolling out vaccines and the economic headwinds likely to follow the end of the Brexit transition period.	MAC or MAE clauses remain very uncommon in private acquisitions in the UK. However, the UK High Court recently considered issues concerning the construction of an MAE clause in a sale and purchase agreement in *Travelport Ltd and others v Wex Inc.* In reaching its decision, the High Court considered that: i. there is no presumption that an MAC/MAE clause should be narrowly interpreted and its words should generally be given their natural and ordinary meaning; ii. a buyer is required to discharge the burden of proof as to whether a MAC /MAE has occurred or been suffered whereas a seller must establish whether and to what extent a particular change or effect falls within a carve-out in order to prevent the buyer from invoking the MAC/MAE clause; and iii. where the seller establishes that a particular change or effect does fall within a carve-out, the buyer must prove whether and to what extent an exception to such carve-out is applicable.	Other than deal activity involving retail businesses, hotels and shopping centers, we have not yet seen the significant increase in the number of distressed deals in the UK that was widely expected as the pandemic's ill effects endured. This may be partly explained by the fact that UK-llisted companies have raised more than £26bn of fresh capital to date this year; the highest amount raised since 2009. Companies experiencing distress have deployed this capital to repair their depleted balance sheets as they seek to weather the storm. In contrast, other companies have raised new capital to fund growth or capitalize on the opportunity to gain market share. In recent months, we have seen an increase in opportunistic plays and speculative bids for targets, particularly those considered to be in distress, debt-laden or undervalued. We have also seen seasoned distressed debt players looking at opportunities in the UK financial sector, which could expect to see an increase in M&A activity and further disruption in 2021. Perhaps unsurprisingly, having proved less attractive in 2019, distressed and turnaround strategies are falling back into favour with LPs.

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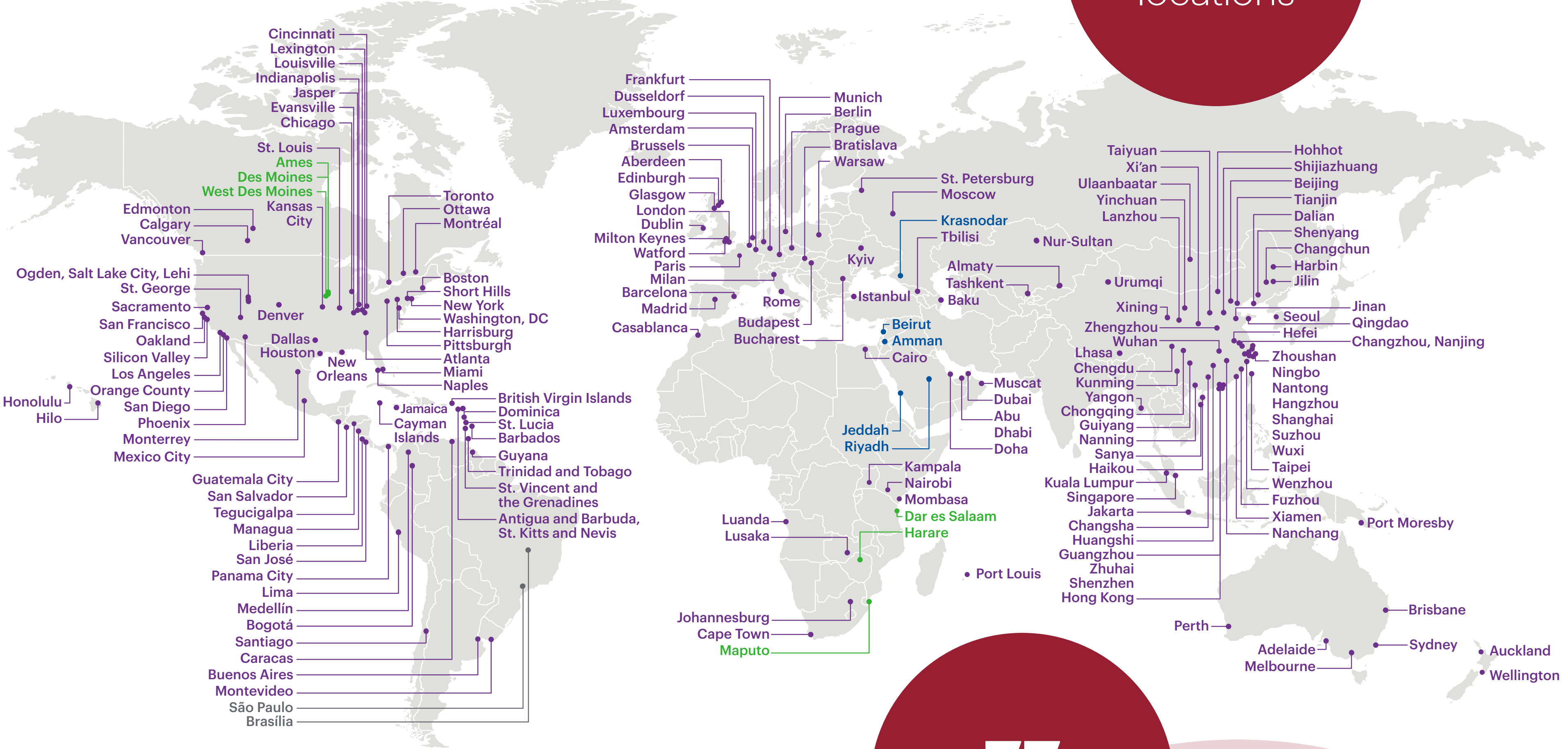

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countries

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