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WHAT PRIVATE EQUITY INVESTORS EXPECT

THE LEGAL PERSPECTIVE

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Private Equity

What is this presentation about?

- It is not intended to be a comprehensive checklist
- It is intended:
 - to identify some issues that are usually significant in private equity investment deals
 - to give you a flavour of issues that are usually contained in the legal contracts in private equity investment deals
 - to help you decide if private equity investment is what you want and is right for your business

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Private Equity

Would your company be attractive to a private equity investor?

- “Lifestyle” v “Entrepreneurial” businesses – “Lifestyle” businesses are companies whose main purpose is to provide a good standard of living and job satisfaction for the owners. “Entrepreneurial” businesses can be distinguished from others by their aspirations and potential for growth.
- Future growth - As a rule of thumb, unless a business can offer the prospect of significant turnover growth within 5 years, it is unlikely to be of interest to a private equity firm or business angel.
- USP – Does your company have a product or service with a competitive edge or unique selling point (USP)? What distinguishes you from your competitors?
- Management team – Do you and/or your management team have the relevant industry sector experience? Do you have a clear team leader and a team with complimentary areas of experience, such as management, marketing, finance etc?

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Private Equity

What is Equity?

- It is the share capital in the company
- Sometimes it has preferential rights, e.g. preferred rights on dividends and distribution of capital
- Usually it is the base capital which the company needs to trade e.g. ordinary shares
- It is entitled to the profit of the company after all the other liabilities have been paid
- But, it is the last to be repaid if the company fails

Private Equity

All of which is unlike Debt or Borrowings which:

- Can be secured on specific assets
- Is paid its interest before any payment to the equity holders
- But, which is not entitled to share in any of the profit of the company
- Debt funding has the advantage over equity as the lender will not be entitled to any share in any of the profit of the company
- However, the disadvantage of debt funding is that if the company defaults on its repayments the lender can put your business into an insolvency process. Any secured debt will have a higher priority for repayment than that of general unsecured creditors and is referred to as "senior debt"

Private Equity

What sources of equity funding are there?

- Friends and family
- Business angels – high net worth individuals on their own or as part of a syndicate. They tend to invest in the early stages of high growth businesses. Typically, they may invest between £10,000 to £150,000.
- Private Equity Funds
 - Public sector – e.g. Finance Wales
 - Private sector – e.g. private equity funds
- Private Equity Funds can be
 - Size specific
 - Sector specific
 - Geographically restricted

Private Equity

What does a Private Equity Investor want the legal contracts to include?

- **Dividend rights**
 - Preferred dividend on his/her shares
 - Restrictions on management dividends
 - No dividends at all unless and until certain targets met
- **Board representation**
 - Chairman – the right to appoint a non-executive chairman
 - Casting vote – an equality of votes, investor has the deciding vote
 - Board control on certain matters
 - Observer rights – the right to appoint someone to observe at board meetings

Private Equity

What does a Private Equity Investor want the legal contracts to include?

- **Management Process**
 - Regular management accounts to be provided
 - Regular management and board meetings
 - Control over who the auditor of the company is
- **Rights of veto**
 - Increases in management remuneration
 - Changes to the business
 - Borrowing money
 - Buying or selling key assets
 - Entering into key contracts

Private Equity

What does a Private Equity Investor want the legal contracts to include?

- Control over timing of the sale of the company
- Investor needs an exit within 3 to 7 years
- His/her share of profit ratchets up if that timetable is not achieved
- Right to be informed of any approach for the purchase of the company at all

Private Equity

What does a Private Equity Investor want the legal contracts to include?

- Formal management contracts
- Employment agreements
- Salary review procedures
- Bonus scheme targets
- Notice period (not more than 12 months and usually 6)
- Possibly performance targets to be met
- Restrictive covenants to prevent competition with the company:
 - Non-competition covenant
 - Usually lasting 1 year

Private Equity

What does a Private Equity Investor want the legal contracts to include?

- All key assets are owned by the company and not the managers individually, especially intellectual property rights (“IPR”)
- Warranties (legal promises) are given to the investor by the managers confirming:
 - Accuracy of accounts
 - Ownership of key assets by the company (e.g. IPR)
 - That there are no claims outstanding against the company
 - That there are no challenges to the IPR of the company
 - That the key contracts with suppliers/customers are in place
 - That all employment terms have been disclosed to the investor
 - Due Diligence! (investigation into the business) – personal as well as business

Private Equity

How does a Private Equity Investor usually operate?

- He/she backs management – have you got the right management team in place?
- In an industry they know, and the investor thinks will allow the business to grow substantially. This means that the investor can bring valuable skills, experience and contacts to the business to help the business grow
- But if management fails, he/she reserves the right to change management
- He/she provides industry and business expertise
- He/she wants the money back, with profit, so that it can be invested in the next deal
- He/she is happy that you all get rich together

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Some helpful tips to make your business attractive to a private equity investor

- Prepare a sound and well researched business plan; this is your calling card and investors see hundreds each year
- Ensure that you have the right management team with a proven track record; good managers can make a bad business work but bad managers can ruin a good business
- Ensure that your company has a product or service that provides a unique selling point or other competitive advantage; if it is unattractive no one will buy it

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Private Equity

What do you do next if you are considering private equity investment?

- If you need equity finance, get expert financial and legal help! This will:
 - Guide you to investors who are genuinely interested in your type and size of business; there are hundreds of potential investors, all with their specific criteria
 - Help make sure that the deal you are offered is fair and reasonable
 - Help make sure the deal you agree is accurately recorded in contracts
 - Help you prepare THE critical document; a comprehensive business plan incorporating realistic financial projections

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Questions?



Then please contact
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