

Private Equity in France: Focus on available exit routes

Private equity involves the association of one or more entrepreneurs and one or more financial investors who provide financing to unlisted companies and even sometimes listed companies.

For the year 2018, the amounts invested in private equity in France reached 14.7 billion euros^[1], making France the second country in the European Union after the United Kingdom.

In private equity transactions, investors are expected to exit in the short or medium term. Several exit routes are available to capital investors: trade sale, transfer to the management team, sale to another investment fund or initial public offering.

The objective of private equity transactions is to finance the start-up phase, development, transfer or acquisition of a company.

Private equity encompasses several categories of transactions that are generally classified as business lines. Just to name a few:

- venture capital which helps finance technology-intensive companies during the creation or start-up phase,
- growth capital which is targeted at companies that have reached profitability and wish to develop new products, increase their production capacity or their sales force,
- buy-out capital which consists in the acquisition of a company by a team of managers from inside or outside the company together with capital investors.

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Main key sectors that attracted private equity investments include industrial goods and services and chemicals (4.6 billion euros), consumer goods and services (3.6 billion euros), medical and biotechnologies (1.9 billion euros), IT and digital (1.8 billion euros) as well as financial services and transport (1.3 billion euros).

In private equity transactions, investors are expected to exit in the short or medium term. Several exit routes are available to venture capital investors: trade sale, transfer to the management team (known as “management buy-out” or “MBO”), sale to another investment fund (known as secondary “leveraged buy-out” or “LBO”), initial public offering (“IPO”).

While the myth of an IPO remains widespread, in practice it only concerns a marginal percentage of divestitures.

As a matter of fact, the most common exit route for private equity investors is the sale of their shares to another investment fund via a secondary LBO. One of the main difficulties associated with this exit strategy arises from the divergence of financial interests that may exist between the private equity investors, who wish to maximize the value of their investment when exiting the company, and the remaining shareholder(s), who seek(s) a new financial partner who shares the same vision for the development of the company. Secondary LBOs accounted for 34% of private equity divestitures in France between 2009 and 2018.

Trade sale is the second most common exit channel. This type of divestitures indeed accounted for 23%^[3] of private equity divestitures in France between 2009 and 2018. For capital investors, it consists in divesting to a buyer generally involved in the same business activity as the company, or in a related activity, with the objective of building a common industrial project. The acquirer generally wishes to control 100% of the company’s share capital. As such, the main issue at stake in this type of exit is the proper alignment of the financial interests of the capital investor and those of the other selling shareholders so that none of them be adversely affected by the sale.

There is also a third type of exit route, although less popular than trade sale or secondary LBO: the sale by the capital investors of their shares in the company to the management team. This divestment method accounted for 9%^[4] of private equity divestitures in France between 2009 and 2018 in France. This type of sale is simpler to formalize than a sale to a third party since the seller and the buying manager(s) worked together for several years. In addition, the purchasing managers know the company inside out. The main challenge is for them to raise the necessary financing to pay the purchase price. In addition to obtaining a bank loan, buyer managers often apply to an investment fund that will participate in the acquisition alongside them while remaining a minority shareholder.

As for the IPO, although it is often regarded as an Eldorado, it is in practice very rarely implemented. Only 2% of private equity divestiture transactions between 2009 and 2018 reportedly resulted in an IPO in France. This is partly due to the fact that the holdings of capital investors in France are almost exclusively made up of start-ups and small- and medium-sized businesses. Indeed, more than three out of every four companies using

private equity are very small businesses and medium-sized businesses^[5].

However, the complexity, constraints and costs associated with an IPO are often difficult to reconcile with the profile of these companies. Going public implies in return a number of transparency obligations and listed companies are therefore subject to periodic and ongoing reporting requirements to the French Financial Market Authority (*Autorité des Marchés Financiers*).

[1] Study on the activity of the French private equity players (*Etude Activité des acteurs français du capital-investissement, 30^{ème} édition, 28 mars 2019*), published by France Invest

[2] Study on the activity of the French private equity players (*Etude Activité des acteurs français du capital-investissement, 30^{ème} édition, 28 mars 2019*), published by France Invest

[3] 2018 Key figures, French Venture Capital Guide (*Chiffres clés 2018, Capital-Innovation français*), published by France Invest

[4] *Ibid*

[5] Study on the activity of the French private equity players (*Etude Activité des acteurs français du capital-investissement, 30^{ème} édition, 28 mars 2019*), published by France Invest

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