market intelligence

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Private equity

Global interview panel covering key economies led by Bill Curbow

Global valuations at an all-time high

Activity levels • Keynote deals • Financing trends • 2016 forecast
Europe • North America • Asia-Pacific • Latin America

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GETTING THE DEAL THROUGH

market intelligence

Welcome to *GTDT: Market Intelligence*.

This is the second annual issue focusing on global private equity markets.

Getting the Deal Through invites leading practitioners to reflect on evolving legal and regulatory landscapes. Through engaging and analytical interviews, featuring a uniform set of questions to aid in jurisdictional comparison, *Market Intelligence* offers readers a highly accessible take on the crucial issues of the day and an opportunity to discover more about the people behind the most interesting cases and deals.

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Panel leader
William Curbow,
Simpson Thacher
& Bartlett LLP

William E Curbow is a partner at Simpson Thacher & Bartlett LLP in the firm's corporate department, where he focuses on mergers and acquisitions. He represented Vodafone in the US$130 billion sale of its 45 per cent stake in Verizon Wireless to Verizon Communications – the third-largest M&A transaction in history.

Here, Curbow and fellow Simpson Thacher partners Atif Azher, Michael W Wolitzer and Peter H Gilman look at developments in private equity markets worldwide.

GLOBAL TRENDS

WILLIAM CURBOW, ATIF AZHER, MICHAEL W WOLITZER AND PETER H GILMAN OF SIMPSON THACHER & BARTLETT LLP

Global merger and acquisition activity levels have approached near-record levels in the first half of 2015, having increased by approximately 40 per cent relative to the first half of 2014 and representing approximately US$2.2 trillion of deal volume. According to Thomson Reuters, this represents the strongest volume of M&A deal activity for the first half since 2007. Although deal volume is up, the majority of this increase reflects mega-deals, those over US$5 billion, which accounted for over 50 per cent of the announced M&A volume worldwide in the first half of 2015, according to Thomson Reuters. Worldwide deal activity, as measured by the number of deals only, increased 3 per cent over the first half of 2014. Global private equity deals accounted for US$358.5 billion in deal activity, a 10.7 per cent increase relative to the first half of 2014, according to Bloomberg. Private equity exit activity remained strong in the first half of 2015, with sponsors taking advantage of global valuations that are at all-time highs. According to PitchBook, in the first half of 2015, private equity sponsors achieved US$185 billion in exits, already matching 70 per cent of total exited value in 2014.

Americas

M&A deal volume announced in the Americas totalled approximately US$1.1 trillion in the first half of 2015, reflecting an increase of 50.3 per cent from the first half of 2014. According to Thomson Reuters, the United States continues to drive M&A activity in the region as US-based transactions totalled approximately US$1 trillion, representing an approximate 60.1 per cent increase over the same period last year. However, US private equity activity is lagging, with investors investing approximately US$215.9 billion of capital in the first half of 2015, an 11.6 per cent decrease from the same period in 2014, according to PitchBook. Small investments were a major trend in the first half of 2015, with PitchBook reporting deals below $25 million accounting for about 48 per cent of all private equity activity during the period. Notable private equity transactions in the Americas in the first half of 2015 include: the US$5.3 billion acquisition of Informatica by affiliates of Permira and the Canada Pension Plan Investment Board; the US$4 billion acquisition of Life Time Fitness, Inc, by affiliates of Leonard Green & Partners, LP, and TPG Capital; and the US$2.4 billion acquisition of Blue Coat Systems, Inc, by affiliates of Bain Capital, LLC.

Europe, Middle East and Africa

Announced M&A deal volume in Europe, the Middle East and Africa (EMEA) totalled approximately US$533.6 billion

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in the first half of 2015, an 8 per cent increase in deal volume from the first half of 2014, according to Thomson Reuters. Of this amount, Europe alone accounted for approximately US$509 billion of total M&A deal volume. According to PitchBook, European private equity deal flow accounted for €154.05 billion in the first half of 2015, representing an approximate 3 per cent decrease from the first half of 2014. European private equity activity as measured by the number of deals also decreased by 27 per cent relative to the first half of 2014.

Asia-Pacific

Announced M&A deal volume in Asia-Pacific totalled approximately US$575.6 billion in the first half of 2015, which represented an approximate 71.6 per cent increase from comparable deal volume in the first half of 2014, according to Thomson Reuters. Despite relative strength in the region, Japan experienced a decrease in M&A activity levels in the first half of 2015. Announced M&A deal volume in Japan totalled approximately US$28.1 billion, representing an approximate 17.8 per cent decrease in the first half of 2015 compared with the first half of 2014. China M&A activity was very strong with US$297.8 billion in deal volume, an 84.8 per cent increase over the same period last year. Private equity activity in Asia-Pacific in the first half of 2015 was valued at approximately US$59.1 billion, which represents a nearly 18.7 per cent increase compared with the first half of 2014, according to Bloomberg.

Debt financing markets

Debt financing markets in the United States have remained relatively stable in the first half of 2015, although off the highs from the first half of 2014. Over the first six months of 2015, median debt/EBITDA multiples and valuation-to-EBITDA multiples for private equity investments have decreased from 2014 levels. This can largely be attributed to a challenging regulatory environment affecting many providers of debt financing for such transactions. In addition, during the first half of 2015, the median leverage percentage for buyouts dropped slightly to 58.5 per cent, compared with the median of 60 per cent for transactions in all of 2014.

Mixed first half in private equity fundraising

Although overall private equity fundraising decreased somewhat during 2014 and the first half of 2015, year over year private equity fundraising generally and fundraising by recognised, top-performing sponsors has remained strong and reflects continued consolidation within the private equity fundraising market in favour of those established sponsors with proven track records. Moreover, although the second quarter of 2015 saw a decrease in aggregate capital raised by private equity funds to approximately US$113 billion (down from US$129 billion in the first quarter), the number of private equity funds holding their final closing during the second quarter remained relatively consistent with the first quarter (with 243 private equity funds closing in the second quarter and 241 private equity funds closing in the first quarter).

The capital-raising environment continues to be competitive and capital is being allocated across a smaller group of established sponsors. Additionally, there has been a continued focus in private equity fundraising on strategic relationships and alternative fundraising strategies, and certain large US pension funds plan to significantly curtail allocations to third-party fund managers.

Outlook for second half of 2015

Overall, private equity activity opened the year to an unexpectedly slow start. Deal professionals are hoping that private equity buyout activity will recover in the second half of 2015. However, high valuations and current global economic conditions lend an air of caution to the outlook. Continuing the trend that has occurred in the past several years stemming from relatively high valuations is sponsors' desire to effect portfolio company exits to harvest attractive returns. We expect this trend to continue into the second half of 2015. Further complicating second-half fundraising is competition for limited partner capital and sponsors continuing to adapt to the heightened regulations applicable to private equity firms, which we believe will result in a continued separation within the private equity fundraising market in favour of established sponsors with proven track records and the fundraising and compliance resources necessary to successfully raise capital in today's environment.

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Bill Curbow

PRIVATE EQUITY IN UNITED STATES

William Curbow, Atif Azher, Michael Wolitzer and Peter H Gilman are partners at Simpson Thacher and Bartlett LLP. They have wide-ranging experience in M&A and private equity matters, acting for clients including large multinationals, Fortune 500 companies and smaller and closely held private companies, as well as financial advisers, boards of directors and special committees.

Curbow recently represented Vodafone Group in the US$130 billion sale of its 45 per cent stake in Verizon Wireless to Verizon Communications. Other clients include L-3 Communications, Crestwood Midstream Partners and First Reserve.

Azher's clients have included Hellman & Friedman, Silver Lake Partners, Blackstone, TPG, KKR, Carlyle and Riverwood Capital.

Wolitzer has represented sponsors of PE funds such as Apax Partners, Blackstone, Centerbridge, Lexington, JPMorgan/OneEquity, Patria, Silver Lake Partners and Ares.

Gilman has represented a number of the world's leading sponsors in a wide range of alternative investment matters, including Alinda, Blackstone, Centerbridge, KKR, Lexington Partners, Oaktree, Silver Lake, Stonepeak and Providence.

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Atif Azher

GTDT: What trends are you seeing in overall activity levels for private equity firm buyouts and investments in your country during the past year or so?

Bill Curbow, Atif Azher, Michael W Wolitzer & Peter H Gilman: The activity levels for mergers and acquisitions in the first half of 2015 rose year on year up to $2.2 trillion of deals according to Thomson Reuters. Despite the global rise in M&A activity, however, high valuations appear to be creating a challenging environment for private equity firms attempting to find attractive targets. According to PitchBook, through the first half of 2015, only $215.9 billion in deals have occurred in the United States, which puts 2015 on pace to be the softest year for private equity activity since 2012. Mega-fund formation and private equity transactions over $5 billion have virtually disappeared, as sponsors have favoured mid-level funding and strategic acquisitions in the first half of 2015.

GTDT: Looking at types of investment and transaction, are private equity firms continuing to pursue straight buyouts or are other opportunities, such as minority-stake investments, partnerships or joint ventures, also being considered?

BC, AA, MW & PG: Because valuations are at such elevated levels, more than ever, private equity sponsors are increasingly looking for creative ways to deploy their capital. For example, we have seen sponsors seek to provide acquisition financing to large strategic companies in connection with strategic company acquisitions. Despite the slowdown in activity as a whole by sponsors, add-on acquisitions remain a popular avenue to deploy capital in the United States. According to PitchBook, in the first half of 2015, the number of add-on investments by private equity sponsors had risen to 62 per cent of all control investments as compared with 43 per cent in 2006.

GTDT: What were the recent keynote deals? And what made them stand out?

BC, AA, MW & PG: Notable deals in the United States include the $8.7 billion leveraged buyout of PetSmart by BC Partners and the $4 billion acquisition of Life Time Fitness, Inc by affiliates of Leonard Green & Partners, LP and TPG Capital. The leveraged buyouts of both PetSmart and Life Time Fitness are notable because they show that despite current valuations, sponsors are prepared to, and will, deploy large amounts of capital for certain businesses, and that lenders will provide sizeable credit financing for large leveraged buyouts.

GTDT: Does private equity M&A tend to be cross-border? Tell us about some of the typical challenges legal advisers in your jurisdiction face in a multi-jurisdictional deal.

BC, AA, MW & PG: Significant cross-border private equity is atypical. Many large-cap

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sponsors have stand-alone region-focused funds, such as Asia-focused funds, which have fund mandates to make investments in particular geographic regions. It is more common for non-US private equity sponsors, such as European funds, to look to the United States for potential investment opportunities.

The primary challenges to cross-border investments revolve around financing, tax considerations, regulatory compliance and securities law limitations. One issue for US sponsors seeking to sell their portfolio companies to non-US buyers is the potential review by the Committee on Foreign Investment in the United States (CFIUS). A meaningful CFIUS review can add potential delays and uncertainty to such a transaction. Since 2012, acquisitions involving Chinese acquirers have been the most reviewed transactions pursuant to a CFIUS review process. Despite the recent approval of many high-profile acquisitions involving non-US acquirers, CFIUS review should be a factor for sponsors to consider when negotiating transactions involving sales to foreign acquirers. In transactions involving sales of portfolio companies that are in sensitive industries or that handle sensitive data, and in each case in which national security concerns are implicit, sponsors will be prudent to negotiate reverse termination fees or pre-emptive divestitures, discuss possible mitigation measures and build political support. While these regulatory challenges are usually manageable, they increase the level of resources or otherwise complicate the process for execution in such cross-border sponsor exits.

GTDT: What are the current themes and practices in financing for transactions? Have there been any notable developments in the availability of debt financing or the terms of financing for buyers over the past year or so?

BC, AA, MW & PG: The most notable development or trend related to financing in the United States has been the increased adherence by regulated financial institutions to guidelines promulgated by the Federal Reserve and the OCC. Despite that, generally there has been a continuation of attractive pricing and availability of credit. Overall, this has resulted in a decrease in the first half of 2015 in median debt/EBITDA multiples and valuation-to-EBITDA multiples for private equity investments from 2014 levels. However, regulated institutions have made exceptions to the regulatory scheme in certain instances and unregulated financial institutions have gained market share and continue to provide high leverage multiples.

GTDT: How has the legal and policy landscape changed during the past few years in your country?

Michael W Wolitzer

BC, AA, MW & PG: As a result of the passage of the Dodd-Frank Act in 2010, most private equity firms have been required to register with the SEC as investment advisers. This regulatory shift has resulted in more extensive compliance obligations for the industry as a whole and increased scrutiny by the SEC. In recent years, the SEC has continued its focus on the examination of private equity firms with the goal of, among other things, promoting compliance with certain areas of the Investment Advisers Act that the SEC deems of particular importance. Certain practices in the private equity industry have received significant attention from the SEC and have, in certain cases, led to enforcement actions against private equity fund advisers in recent years. Areas that the SEC has highlighted to be of particular concern include, among others: (1) allocation of expenses to funds or portfolio companies, or both, without proper disclosure to investors (including for the compensation of operating partners and consultants); (2) marketing or performance presentations, or both; (3) receipt by private equity firms of transaction-based compensation or other

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fees or compensation from funds or portfolio companies, or both, which is outside the typical management fee or carried interest structure (eg, an acceleration of monitoring fees); (4) allocation of investment opportunities by private equity sponsors among investment vehicles and funds that they manage; and (5) allocation of co-investment opportunities and broken-deal expenses related thereto.

The JOBS Act and the SEC significantly amended certain aspects of the regulation governing the private offering and sale of securities (including limited partner interests in private equity funds) with a view to permitting greater flexibility for issuers. Despite these recent improvements and the adoption of Rule 506(c) permitting the use of general solicitation and general advertising in private placements, the conditions imposed by the SEC and the heightened compliance obligations (eg, enhanced verification) and costs associated with relying on Rule 506(c) imposed on private equity funds create a burdensome process, making it unlikely that private equity funds will seek to utilise these new rules in any meaningful way in their current form. In addition, the SEC adopted bad-actor disqualification provisions in Rule 506(d), under which issuers are prohibited from relying on the Rule 506 safe harbour (whether or not the proposed offering involves a general solicitation) if the issuer or any other 'covered person' was subject to a 'disqualifying event' that occurred on or after 23 September 2013, which have in some cases significantly affected the ability of private equity firms to conduct private placements.

GTDT: What are the attitudes to private equity among policymakers and the public? Has there been any noteworthy resistance to private equity buyouts by target boards or shareholders? Does shareholder activism play a significant role in your country?

BC, AA, MW & PG: While negative attitudes concerning private equity buyouts seem to have waned over the past few years, shareholder activism associated with mergers and acquisitions activity has become increasingly prominent – irrespective of whether there is any private equity involvement. As a result, private equity sponsors seeking to effect 'going-private' transactions or investing alongside a strategic partner are becoming increasingly mindful of the investor-relations aspects of such transactions and are evaluating the risks of potential shareholder activism as part of the 'mix' in connection with effecting such transactions.

At the same time, policymakers are continuing their enhanced focus on the private equity industry, with examination and enforcement activities remaining a top priority. While we can expect to see an uptick in examination and enforcement activities by both the SEC and other regulatory bodies, some SEC officials have reported that the cases against private equity firms could take years to build, and might be less severe than some fear.

GTDT: What levels of exit activity have you been seeing? Which exit route is the most common? Which exits have caught your eye recently, and why?

BC, AA, MW & PG: Sponsor exits continued to trend higher in the first half of 2015, as many sponsors are reaping the benefits of a high valuation environment. According to PitchBook, sponsors executed a staggering 478 exits, accounting for approximately $185 billion in the first half alone of 2015, which is on pace to surpass 2014's record-breaking year of $264 billion. Corporate acquisitions have been the most common form of exit in 2015, with over $160 billion of sales to corporate acquirers year-to-date, and are on pace to continue setting new highs, as they accounted for $165 billion in all of 2014. Corporate acquisitions constituted over 55 per cent of the 478 PE-backed exits in the first half of 2015. According to PitchBook, over 45 per cent of all exits in the first half of 2015 were worth more than $500 million or more.

The number of IPO exits by sponsors has decreased dramatically in 2015. Year-to-date, only 17 PE-backed IPOs have launched, generating just $4.98 billion in proceeds. This decrease represents an approximate 70 per cent decline from the first half of 2014. Despite the lower volume and activity, according to PitchBook, IPOs in the first half of 2015 were executed near historically high valuations, with the median IPO reaching $225 million.

One notable bright spot is KKR's recent filing to return First Data Corp back to the public markets after it took the company private in 2007, which at the time, was one of the largest private-equity takeovers at $27 billion. *The Wall Street Journal* reported that the IPO could value First Data at around $40 billion based on recent comparable IPOs.

GTDT: Looking at funds and fundraising, does the market currently favour investors or sponsors? What are fundraising levels like now relative to the past few years?

BC, AA, MW & PG: Although overall private equity fundraising decreased somewhat during 2014 and the first half of 2015, year on year private equity fundraising generally and fundraising by established, top-performing sponsors has remained strong. This reflects a continuation of the trend witnessed in recent years towards consolidation and the 'flight to quality', where larger established sponsors with proven track records are having

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THE INSIDE TRACK

What factors make private equity practice in your jurisdiction unique?

The United States has blazed a trail in private equity practice over the decades. For example, the US markets developed both private and public leveraged buyouts (LBOs) in which a significant amount of the purchase price is paid with the proceeds of new debt. As funds are constantly innovating and adapting to changing market conditions, groundbreaking private equity transactions require sophisticated guidance and creative solutions from legal advisers.

Overall, the United States continues to rank as the top private equity market, reflecting the depth (in terms of size and liquidity) of its capital market and an ingrained culture of innovation. It is home to many of the world's most successful and well-established private equity firms, which have traditionally raised the largest buyout mega-funds. Historically, US-focused fundraising has surpassed that of all other regions for private equity investment. As the traditional base of private equity, the United States has attracted the lion's share of capital over the years, and 2015 was no different. In 2015, we saw private equity funds focusing on the United States and North America raise $242 billion. Through the years, the private equity industry has matured and the experience of fund managers has broadened such that investors continue to view the United States as an attractive jurisdiction for their investment.

What should a client consider when choosing counsel for a complex transaction in your jurisdiction?

The main consideration in selecting a legal adviser is depth of experience in the private equity sector. Practical experience combined with industry acumen are critical to advising complex transactions dealing with fund formation, minority investments, mergers and acquisitions, financing solutions and exit transactions.

In addition, counsel should have insight into the needs of every participant in private equity transactions, such as private equity sponsors, senior bank lenders, subordinated and bridge lenders, tax advisers, management and financial investors and underwriters. As such, a client would benefit from counsel that offers cross-practice excellence (eg, finance and banking practice areas that provide advice to private equity clients on financing solutions at all levels of the capital structure).

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considerable success raising large private equity funds on favourable terms, while first-time funds and sponsors without proven track records continue to find it challenging to compete in today's environment.

The recovery in the private equity fundraising market over the past few years has been substantial as, following the global financial crisis, private equity rebounded from roughly US$295 billion in 2010 to US$495 billion in 2014, with approximately 1,561 funds in market in 2010 and approximately 2,074 funds in market in 2014. Although the number of funds closed in 2014 decreased 17 per cent as compared with 2013, the aggregate capital raised only decreased by 6 per cent, causing the average size of funds closing in 2014 to reach a record of US$544 million. Moreover, although the second quarter of 2015 saw a decrease in aggregate capital raised by private equity funds, to approximately US$113 billion (down from US$129 billion in the first quarter), the number of private equity funds holding their final closing during the second quarter remained relatively consistent with the first quarter (with 243 private equity funds closing in the second quarter and 241 private equity funds closing in the first quarter).

With institutional limited partners placing increased emphasis on consistent track records and stability, tending to make larger commitments to fewer private equity funds, established top quartile sponsors have been able to raise larger funds in shorter periods of time and capture a greater share of the overall private equity fundraising market. By way of illustration, large and mega buyout funds accounted for approximately 73 per cent of buyout fund capital raised in 2014, while first-time funds represented only 7 per cent of capital raised in private equity in 2014 (the same as in 2013, but the lowest proportion historically).

Continued distributions to limited partners over the past few years from private equity-backed exits have contributed to the private equity fundraising market as investors seek to redeploy those distributions into new private equity funds, and many institutional investors have increased their overall portfolio allocation to the private equity asset class.

There has also been a continued focus on strategic relationships and alternative fundraising strategies, including customised separate account arrangements, co-investment arrangements and multi-strategy (umbrella) arrangements and new product development (eg, a number of established sponsors have raised longer life, lower risk and return funds in asset classes like private equity and real estate). Finally, certain large US pension funds

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plan to significantly curtail allocations to third-party fund managers in an effort to consolidate their relationships among a smaller group of high-quality fund managers, further increasing competition among sponsors for institutional limited partner capital.

GTDT: Talk us through a typical fundraising. What are the timelines, structures and the key contractual points? What are the most significant legal issues specific to your country?

BC, AA, MW & PG: While fundraising in today's environment has become less episodic and more resource-intensive, with fund structures, terms and marketing timelines customised to most effectively address the business objectives of the sponsor, we shall outline a simplified framework and timeline for a typical private equity fundraising.

In most cases, the typical fundraising will begin with the preparation and distribution of a private placement memorandum to investors, which includes important information about the sponsor and the fund, including a term sheet setting out the key terms of the fund and the offering of interests, along with additional disclosure information pertaining to the fund. Many private equity funds are structured as Delaware limited partnerships, but the structure and jurisdiction of the fund will depend largely on the sponsor and the asset class, geographic focus and anticipated investor base of the fund. It is not uncommon for private equity funds to be organised in jurisdictions outside the United States (eg, the Cayman Islands). Legal counsel will also work closely with the sponsor as part of the fundraising to prepare the draft limited partnership agreement, investment management agreement, subscription agreement and related fund documents, which are the definitive agreements governing the operation of a private equity fund. Key contractual points in the fund documents will vary on a case-by-case basis but often include economic arrangements (eg, management fees and carried interest), tax structuring provisions and minimisation covenants, investment allocation provisions, limited liability protections, standards of care, governance rights, co-investment arrangements and allocations of expenses.

Peter H Gilman

Following delivery of the fund documents to investors, counsel and the sponsor will work closely with investors to resolve any questions or comments, and once a critical mass of investors' subscriptions has been secured, the fund will hold an initial closing. Fundraising timelines in private equity can vary significantly depending on the sponsor involved and the type and size of fund being raised, running anywhere from a few months to a few years. Once an initial closing has been held, a private equity fund will typically be permitted to hold subsequent closings over a period of 12 to 18 months. As the regulation of private equity funds continues to increase, it remains very important for sponsors to work closely with counsel to ensure that all necessary steps are taken to permit marketing in each jurisdiction in which fund interests are to be marketed.

GTDT: How closely are private equity sponsors supervised in your country? Does this supervision impact the day-to-day business?

BC, AA, MW & PG: Private equity firms are subject to substantial regulation and supervision in the United States, and the regulatory environment in which private equity firms operate is becoming increasingly complex. The regulation and supervision of private equity firms affects not only the manner in which interests in private equity funds are marketed and sold to investors, but also the day-to-day business and operations of private equity firms themselves.

The principal laws and regulations applicable to private equity firms affecting their day-to-day business and operations include, among others: the Securities Act (affecting the manner in which

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private equity funds market and sell interests to investors), the Securities Exchange Act of 1934 (affecting ongoing reporting obligations and placing practical limitations on the number of investors in private equity funds), the Advisers Act (imposing substantive regulations and reporting provisions on many private equity fund advisers), the Investment Company Act of 1940 (establishing certain eligibility requirements and limitations on investors in private equity funds), the Commodity Exchange Act (regulating the ownership of commodities by private equity funds), and the Employee Retirement Income Security Act of 1974 (imposing restrictions and onerous fiduciary requirements on private equity funds deemed to hold 'plan assets').

Since the SEC gained oversight of the industry under the Dodd-Frank Act five years ago, the regulatory and public scrutiny of private equity firms has increased significantly. The SEC is finding more regulatory lapses among private equity firms, particularly related to expenses and expense allocation and disclosure matters. The increased focus on private equity firms, which we expect to continue in the foreseeable future, has resulted in increased compliance burdens, and impacts both the day-to-day conduct of a private equity sponsor's business and the formation, marketing and management of private equity funds.

GTDT: What effects has the AIFMD had on fundraising in your jurisdiction?

BC, AA, MW & PG: The AIFMD, as transposed into national law within the member states of the EU, has imposed significant requirements on non-EU fund managers that market private equity funds to professional investors within the EU. One of the central aims of the AIFMD is to harmonise the regulation of fund managers across Europe; however, until non-EU fund managers are able to become authorised and benefit from the harmonised regime, non-EU fund managers are limited to marketing their funds on the basis of 'private placement' or local requirements that certain EU member states have established through the adoption of implementing legislation or local private placement regimes that 'gold-plate' the standards imposed by the AIFMD. In practice, the patchwork of private placement regimes across EU member states has caused uncertainty for many non-EU private equity fund managers regarding their ability to 'market' to investors in the EU and has in practice hindered their ability to raise capital in Europe.

The AIFMD has meaningfully increased the compliance burdens and costs associated with private equity firms marketing alternative investment funds to non-retail investors in the EU, making it more difficult and costly for private equity firms to market to investors in Europe and resulting in a number of US private equity funds, particularly smaller firms that do not have the necessary compliance and fundraising infrastructure in place, deciding not to market in Europe to avoid the additional regulatory burdens and costs imposed by the AIFMD. For example, while the registration and approval process in certain member states where private placements are permitted has been operational for over a year and has settled into a predictable pattern, there remains legal uncertainty as to the meaning of key terms, such as what constitutes 'marketing' and 'reverse solicitation'. In addition, minimum transparency requirements under the AIFMD (eg, annual reports, periodic reports, pre-investment disclosure to investors, notification in respect of control of non-listed companies, etc) have created ongoing administrative and compliance burdens for non-EU fund managers and resulted in significant additional costs. The requirements and the lack of resources and personnel at the regulators in certain EU member states that require approval by the regulator has also produced significant delays in processing notifications, registrations and reports required under the AIFMD.

The increased regulation imposed by the AIFMD, together with a broader trend towards increasing scrutiny and regulation of private equity firms, has led many private fund managers to adopt increasingly more systematic and integrated compliance operations as part of their overall fundraising activities. We believe that larger established managers, with the existing resources and compliance systems in place to absorb the incremental costs and compliance burdens associated with the AIFMD, should enjoy a competitive advantage among their peers as smaller firms will likely feel a disproportionate impact on their businesses as a result of the AIFMD.

As US private equity sponsors seek to raise capital from investors in the EU, it remains critical for such sponsors to work closely with legal counsel to establish a 'marketing road map' in the EU that is tailored to the sponsor's intended marketing activities and investor base, and to work with counsel to understand how the private placement regimes and local requirements in member states differ across EU jurisdictions. Regulatory compliance is no longer simply a cost of doing business, but rather an integral part of any private equity sponsor's global marketing programme. Fund managers that do not have the resources and counsel necessary to address the additional regulatory and compliance obligations arising out of the AIFMD may find it increasingly difficult to comply with the AIFMD and market funds in the EU, which is likely to have a significant impact on fundraising by US private equity firms.

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GTDT: What are the major tax issues that private equity faces in your jurisdiction? How is carried interest taxed? Do you see the current treatment changing?

BC, AA, MW & PG: US tax rules are very complex and tax matters play an important role in both fund formation and the structure of underlying fund investments. Tax issues that have been given particular focus as of late include (1) the implementation of new due diligence, information reporting and withholding rules pursuant to the Foreign Account Tax Compliance Act, commonly referred to as FATCA, (2) possible changes in the taxation of carried interest, and (3) the proper tax treatment (including deductibility) of monitoring fees paid by underlying portfolio companies to a private equity fund's investment adviser. Consultation with tax advisers with respect to the specific transactions or issues is highly recommended.

Special consideration is given to structure the carried interest such that it is treated as a partnership allocation eligible for taxation on a flow-through basis. It is sometimes desirable to separate the general partner (namely, the recipient of the carried interest) and the investment manager (namely, the recipient of the management fee) into separate entities for state tax and other purposes.

Legislation has been introduced in Congress that, if enacted, would result in carried interest distributions currently subject to favourable capital gains tax treatment being subject to higher rates of US federal income tax than are currently in effect. The Obama administration has indicated it supports the adoption of this legislation or legislation that similarly changes the treatment of carried interest for US federal income tax purposes. Whether such legislation will be enacted (or in what ultimate form) remains uncertain.

GTDT: Looking ahead, what can we expect? What will be the main themes over the coming year?

BC, AA, MW & PG: Overall, private equity deal flow in the United States has gone downward in 2015 and we expect the trend to continue, with deal flow on pace for its lowest levels since 2012. According to PitchBook, private equity firms made only 1.7 investments for every exit in the first half of 2015, the smallest proportion in over a decade. The current market of high valuations presents a double-edged sword to sponsors as these increase the likelihood of a successful exit from an investment, but present issues when deploying capital efficiently. The lack of a meaningful correction in asset valuations may lead to continued trepidation on the buy side in the deal market.

Also, the trends and developments witnessed in the first half of 2015 regarding fund formation are expected to continue along with the consolidation in the private equity industrys. Competition for LP capital among private equity funds will continue to increase, with alternative fundraising strategies continuing to play a substantial role. Likewise, established sponsors with proven track records and the ability to absorb incremental burdens associated with today's continued scrutiny and enhanced regulation of the private equity industry should continue to enjoy a competitive advantage.

In conclusion, many factors indicate that private equity sponsor activity will remain slow in the second half of 2015 including record high valuations, a continued movement towards smaller add-on, or strategic, acquisitions by portfolio companies, and an uncertain global economic climate complicated by an impending interest rate hike and ever-present geopolitical hotbeds. Each of these factors creates uncertainty for private equity sponsors and may leave many deal practitioners expecting relatively tepid private equity deal activity in the second half of 2015.

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