

THE PRIVATE EQUITY
REVIEW

EIGHTH EDITION

Editor
Stephen L Ritchie

THE LAWREVIEWS

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REVIEW

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This article was first published in June 2019
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Published in the United Kingdom
by Law Business Research Ltd, London
87 Lancaster Road, London, W11 1QQ, UK
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Enquiries concerning editorial content should be directed
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ISBN 978-1-83862-013-4

Printed in Great Britain by
Encompass Print Solutions, Derbyshire
Tel: 0844 2480 112

ACKNOWLEDGEMENTS

The publisher acknowledges and thanks the following for their assistance throughout the preparation of this book:

A&L GOODBODY

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BAHR

CAMPOS MELLO ADVOGADOS
IN COOPERATION WITH DLA PIPER

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PREFACE

The eighth edition of *The Private Equity Review* follows an extremely active 2018. While the number of global private equity deals completed declined from 2017, the total value of such deals was the highest since 2007, and the third-highest of all time. Deal activity was weighted towards the upper end of the market, and included several large take-private transactions. Fundraising activity was also strong, as institutional investors remained extremely interested in private equity as an asset class because of its strong performance relative to public markets. As a result, private equity funds have significant amounts of available capital, leading to very competitive transactions being completed at increasing purchase price multiples. This has caused private equity firms to become even more creative as they seek opportunities in less competitive markets or in industries where they have unique expertise. Given all of this, we expect private equity will continue to play an important role in global financial markets, not only in North America and western Europe, but also in developing and emerging markets in Asia, South America, the Middle East and Africa. In addition, we expect the trend of incumbent private equity firms and new players expanding into new and less established geographical markets to continue.

While there are potential headwinds – including trade tensions, a slowing Chinese economy, Brexit and an eventual end to one of the longest-running recoveries in US history – on the horizon for 2019 and beyond, we are confident that private equity will continue to play an important role in the global economy, and is likely to further expand its reach and influence.

Private equity professionals need practical and informed guidance from local practitioners about how to raise money and close deals in multiple jurisdictions. This review has been prepared with this need in mind. It contains contributions from leading private equity practitioners in 25 different countries, with observations and advice on private equity deal-making and fundraising in their respective jurisdictions.

As private equity has grown, it has also faced increasing regulatory scrutiny throughout the world. Adding to this complexity, regulation of private equity is not uniform from country to country. As a result, the following chapters also include a brief discussion of these various regulatory regimes.

I want to thank everyone who contributed their time and labour to making this eighth edition of *The Private Equity Review* possible. Each of these contributors is a leader in their respective markets, so I appreciate that they have used their valuable and scarce time to share their expertise.

Stephen L Ritchie

Kirkland & Ellis LLP

Chicago, Illinois

April 2019

Part I

FUNDRAISING

SAUDI ARABIA

*James Stull, Macky O'Sullivan and Sayf Shuqair*¹

I GENERAL OVERVIEW

Saudi Arabia is widely considered to be a country flush with cash because of its abundant oil reserves and large state coffers. While there is some truth to this belief, the country is currently in a state of transition as oil prices approached their lowest prices in decades during 2016 and 2017. Reduced oil output in compliance with OPEC's oil production cut agreement, low oil prices and reduced government support led the Saudi economy to contract in 2017 for the first time since the height of the global financial crisis in 2009. For Saudi Arabia 2018 was a year of mixed fortunes, with oil prices firming up before dipping in November as fears of global oversupply, amid a reduction in global economic growth, began to kick in. Although it is estimated that the economy grew by 2.3 per cent in 2018, that is a slower growth rate than previously seen during the oil boom early this decade and the government continues to work towards remedying the weak growth, closing its budget deficit and reducing the country's high unemployment rate. The 2019 budget for Saudi Arabia, which was announced in December 2018, sets out increased government spending of about 7 per cent to US\$295 billion in 2019 in an effort to spur economic growth.

The current economic landscape has been a double-edged sword for the Saudi Arabian private equity fundraising environment as investors are moving away from local listed equities, which, along with local real estate, have been the asset classes of choice for Saudi investors, towards alternative asset classes. However, at the same time, many Saudi investors have much less liquidity, having lost substantial amounts in local investments over the past three years, and are reticent to invest in funds structures.

As such, many sponsors and managers have found fundraising to be difficult. This difficulty is also exacerbated by the fact that very few regional asset managers and private equity funds with considerable track records exist, which is a key factor in successful fundraising.

Fundraising levels have declined for a number of reasons in addition to the current macroeconomic situation, including the decline in the popularity of the typical blind pool fund structure and the increase in popularity of the 'deal-by-deal' approach to fundraising. There also seems to be a trend in the Middle East region, and Saudi Arabia in particular, for large family offices and institutional investors to increasingly prefer direct co-investments and, to some extent, managed accounts.

The landscape for local domiciled investment funds is arguably more developed in Saudi Arabia than elsewhere in the MENA region and has proven to be resistant, to a certain

¹ James Stull is a partner, Macky O'Sullivan is a senior associate and Sayf Shuqair is an associate at King & Spalding LLP.

extent, to the overall economic and geopolitical developments in the region. This may be in part driven by the Saudi Arabian Capital Market Authority's (CMA) opening of the capital markets and funds industry to foreign investors and the introduction of new, clearer and more investor-friendly regulations. As mentioned, local listed equities funds have long been the dominant product in Saudi Arabia; however, there has been a clear shift in investor sentiment toward alternatives. Private equity funds focused on certain key sectors, such as healthcare, education and consumer goods, as well as real estate private equity fund, particularly income-generating funds have performed well and have successfully closed in the past year.

The local turbulence within Saudi Arabia has led many investors to look outside Saudi Arabia (and the wider MENA region) towards the more established markets of Europe and the United States, which, despite the geopolitical events in those jurisdictions, are widely seen as significantly more stable than Saudi Arabia. This sentiment has not gone unnoticed by foreign asset managers who are increasingly approaching high-net-worth individuals, families, sovereigns and institutions and marketing their foreign funds as being better alternative investments vehicles to those available in Saudi Arabia (which has experienced a turbulent past year). Noticing this trend, Saudi-based asset managers are increasingly setting up investment funds whose investment strategy is focused on investing mainly in the United States and Europe, with a particular focus on the real estate sector.

The high number of foreign managers coupled with the relative inexperience and limited track record of local managers has resulted in the local managers struggling to raise private equity funds. Only the 'elite' local managers are regularly able to complete fundraising successfully. Second-tier managers are often able to syndicate specific deals (with a fully paid-in capital contribution structure) to a small group of target investors but are not capable of raising blind-pool funds.

Regardless of whether a manager is establishing a large blind-pool private equity fund or syndicating a single transaction, the CMA treats all private non-real estate funds in the same manner in terms of registration process. Funds can only be established by 'authorised persons' licensed by the CMA to manage assets. The managers must submit the fund's offering documents for a 15-business-day no-objection period. Assuming the CMA does not object to the offering, a locally domiciled fund may be offered for a one-year period during which the fund manager would typically secure the necessary capital commitments and launch the fund. Fund managers launching single asset funds have generally been successful securing the necessary capital. Fundraising for blind pool venture capital and private equity funds has taken substantially longer and has often required multiple closings or scaling down of the offering size.

Fundraising in Saudi Arabia, as is the case elsewhere in the region, is challenging for many market participants because of the relatively small number of fund managers with an adequately robust track record – particularly successful exits. As such, investors prefer to subscribe to transactions on a deal-by-deal basis rather than via the blind-pool structure seen in more developed markets. The main benefits of the deal-by-deal approach are the transparency and predictability relating to the financial viability and corporate governance of the underlying investment target, and therefore investors have been more comfortable with committing significant capital to a transaction. However, strengthening deal flow powered by a growing number of maturing family businesses in Saudi Arabia may see the demand for general private equity funds grow in number in the near future and Saudi CMA funds competing with other regional funds in terms of fundraising. Further, over the past several

years, venture capital activity has dramatically increased in Saudi Arabia, and because of the small deal size, deal-by-deal syndication of investments are impractical and investors have participated in such blind-pool funds (although the average ticket size tends to be small).

II LEGAL FRAMEWORK FOR FUNDRAISING

With approximately 700 funds domiciled and currently operating in the Kingdom, Saudi Arabia is the most popular jurisdiction in the region for locally domiciled investment funds. This success may be attributed to a number of reasons, including among others the competence of the CMA as the regulator of investment funds in Saudi Arabia and the legal framework the CMA has implemented.

The regulations governing the formation of investment funds have been evolving since the first rules governing mutual fund activity were introduced in 1993. The latest amendments to the Investment Funds Regulations, which became effective in November 2016, streamlined the process for establishing a fund and removed a number of restrictions on private offerings. These amendments are generally viewed as investor-friendly.

A CMA fund is a contractual entity formed between the fund manager and its investors upon execution of the terms and conditions (the form and contents of which are specified by the Investment Fund Regulations). The terms and conditions are the equivalent of a limited partnership agreement for a fund established as a limited partnership or the articles for a fund established as a company. A Saudi Arabian fund may only be established by an entity licensed by the CMA as an authorised person licensed to carry out management activities. The CMA issued new regulations in October 2017 relaxing the process and requirements for applicants to obtain a management licence and dramatically reducing the required share capital (in some cases to as little as 5 million riyals).

Under CMA regulations (and from the perspective of other Saudi governmental authorities and ministries), a Saudi Arabian fund is not considered to be a separate legal entity from the fund manager. Accordingly, the Saudi Arabian Ministry of Commerce and Investment (MoCI) will not issue a commercial registration to a fund (which is a requirement to own shares in companies and other assets in Saudi Arabia such as real estate). Therefore, all actions of a CMA fund must be performed by the fund manager and all assets must be owned by a custodian (or special purpose vehicle established by the foregoing).

In contrast with the MoCI, the CMA considers a Saudi Arabian fund to have a separate legal personality and existence from its manager. However, it is unclear whether all Saudi courts and other governmental authorities take the same position. In the past, certain governmental authorities and regulatory have not seen a fund as an entity distinct from the fund manager.

Because funds are contractual entities regulated by the CMA only, funds are not subject to MoCI's restrictive companies regulations. Funds are the most flexible vehicles in Saudi Arabia and may provide investors with certain rights and obligations that are not otherwise available under the more typical investment vehicle structure of a limited liability or joint-stock company. These provisions include capital commitment structures, default remedies, dilution, forced exits and redemptions.

The offering documents of a CMA private equity fund follow a prescribed form that is set out in the Investment Funds Regulations. The CMA included a prescribed set of provisions that must be disclosed, which include the investment objective, description of underlying asset, investment strategy, risk factors, fee structure, subscription and redemption

processes (if applicable), valuation mechanism and investor reporting requirements. With the recent amendments that have been introduced, it is clear that the CMA's position as a regulator is shifting from a more manager-friendly position to an investor protectionist position. In addition, the investors themselves, particularly institutions, sovereigns and large family offices, are becoming increasingly sophisticated and are negotiating certain provisions that historically were not negotiated as much, including those related to fees and governance (including conflicts and advisory committees).

In terms of fundraising and solicitation of investors in Saudi Arabia, it is common for local private equity funds to solicit investors through a typical roadshow process after the lapse of the CMA's 15-business-day review period. Such funds must be offered by a CMA-licensed manager. For foreign funds, interests may be offered following the lapse of a 10-business-day review period by a promoter licensed by the CMA with an arranging licence. The foreign offeror may not offer the securities directly in Saudi Arabia except through a CMA-licensed promoter, and unlike in certain neighbouring jurisdictions, reverse solicitation is not formally recognised by the CMA as an exemption to registration.

Certain requirements, such as satisfying a minimum investment amount requirement of 1 million Saudi riyals by the investor or confirmation that an investor is 'sophisticated' must be satisfied for either local or foreign funds to be offered and the sale to be consummated. Further, in the case of foreign funds, the fund manager must be authorised in a jurisdiction that employs regulatory standards and requirements at least equivalent to those of the CMA and the CMA shall have the discretion to assess whether the jurisdiction has equivalent regulatory standards and requirements. It is unclear whether managers established in many offshore jurisdictions would meet these criteria, although the CMA regularly allows for funds domiciled in major offshore jurisdictions (e.g., the Cayman Islands) to be offered in Saudi Arabia. The distributor must provide an undertaking to the CMA that the offering documents are true, accurate and not misleading – which means that the distributor will generally want to perform a certain level of diligence on the fund and manager as the distributor does not want to make false statements to the CMA. The distributor must submit a report to the CMA of all Saudi investors that subscribed for units in the fund.

Under the Investment Funds Regulations, the manager of a Saudi Arabian private equity fund has a fiduciary duty towards the fund's investors, which includes the duty to act in the best interests of the investors and a duty to exercise all reasonable care and skill. Further, under the Authorised Persons Regulations (which govern licensing of fund managers in Saudi Arabia), the manager of a Saudi Arabian fund also has the following fiduciary duties: (1) loyalty: a manager must act in all cases in good faith and in the interests of the investors, (2) conflict of interest: a manager must ensure that it safeguards at all times the interests of the investors and that no conflict of interest between its interest and the interests of the investors affects the services that the manager is carrying out, (3) no secret profits: a manager must not use the customer's property, information or opportunities for its own or anyone else's benefit unless full disclosure of the usage to the investor is made and consent is obtained, and (4) care, skill and diligence: a manager owes the investors a duty to exercise the care, skill and diligence that would be exercised in the same circumstance by a person having both the knowledge and experience that may reasonably be expected of a person in the same position as the manager; and the actual knowledge and experience that the manager has.

III REGULATORY DEVELOPMENTS

The CMA and the Saudi Arabian Monetary Authority (SAMA) are the governmental bodies that regulate asset management and financing transactions in Saudi Arabia, while the Saudi Arabian General Investment Authority (SAGIA) governs foreign investment. To date, the SAGIA rules have not governed foreign ownership in a CMA fund, and there is no requirement that non-GCC investors in a CMA fund obtain SAGIA approval. A foreign investor's ownership of units in a CMA fund is only governed by the rules and regulations of the CMA.

During 2016 and 2017, the CMA has issued a number of new regulations intending to encourage foreign investment in Saudi Arabia and stimulate banks and managers to grow assets under management by tapping retail markets and international investors. The CMA also wants to encourage managers to develop products that can be accessed by the Saudi public to encourage individuals to invest their income in the Saudi domestic market. As such, in recent years the CMA has released numerous regulations covering the establishment of new corporate vehicles, the creation of a small-cap market, amendments to the IPO and book-building processes and the easing of the foreign investment requirements into listed equities and funds in Saudi Arabia. In addition, the CMA has promised a complete revamp of existing financial services regulations. Three regulations in particular are pivotal for asset managers looking to raise Saudi Arabia-targeted funds: the amended authorised persons regulations, the rules on the offer of securities and continuing obligations, and the amended investment funds regulations. These regulations have reduced the hurdles to establishing a presence in Saudi Arabia and provide opportunities to investment banks, private equity firms and asset managers to expand their product offerings and access additional capital bases in the country.

The amendments to the authorised persons regulations reduced requirements for applicants to obtain a management licence and dramatically reducing the required share capital (in some cases to as little as 5 million riyals). These amendments also allowed managers to outsource certain functions (such as compliance and finance) for the first time and streamlined the licensing process. The new rules on the offer of securities and continuing obligations similarly streamlined the process for registering, marketing and selling securities in Saudi Arabia and introduced certain favourable exemptions to registration.

The CMA introduced the amended Investment Funds Regulations in 2016 with the hope that they will provide clarity and encourage more managers to launch funds. The CMA had intended for years to revamp the Investment Funds Regulations to address problems of investor protection, which arose during the financial downturn, and cover the launches of a diverse range of new funds, many of which were not contemplated by the 2006 regulations (and in fact introduced similar draft regulations in May 2013 that were ultimately not adopted). The new funds regulations govern the formation, offering and operations of all private and public investment funds in Saudi Arabia, except publicly offered real estate funds. The issuance of the new funds regulations was long expected as the CMA had publicly acknowledged for years that new regulations were in progress.

The CMA intends the new funds regulations to provide clarity and encourage more managers to launch funds. The CMA has intended to revamp the prior regulations to codify unwritten practices of the CMA; address problems of investor protection that arose during the financial downturn; and cover the launch of a diverse range of new funds, many of which

were not contemplated by the earlier version of the regulations. The process for launching a private equity fund or venture capital fund remains essentially unchanged, although the required documentation has been detailed.

There are a number of other provisions of interest. First, a fund manager may not restrict investors of certain nationalities unless the approval of the CMA is obtained. The CMA has indicated that the only restrictions it will apply will be to restrict those private real estate funds that invest in the cities of Mecca and Medina to Saudi Arabian nationals only. Otherwise, all investment funds would be open to foreign investment, regardless of the underlying investments. This is a significant change as it was often considered a grey area whether foreign investors could invest directly into CMA-regulated funds or whether such investors would be prohibited or would have to register through a lengthy process with the Saudi Arabian General Investment Authority. Second, there is no strict requirement to have a fund board for a private investment fund, which in the prior regulations was a statutorily mandated oversight body. This provides managers with more flexibility when it comes to structuring fund governance, but potentially removes protection for investors. Third, under the prior regulations, the maximum number of investors that could be approached in a private placement was 200, but the new regulations do not contain a limit on the number of investors that a manager may approach in a private offering. Lastly, previously an offer would only qualify as a private placement if two requirements were satisfied: (1) that the offerees are sophisticated investors; and (2) that the minimum amount payable per offeree is not less than 1 million Saudi riyals. Under the new fund regulations, only one of the two requirements must be satisfied for an offering to qualify as a private placement. It was widely hoped that the new funds regulations would set out certain exemptions to the requirement to register funds with the CMA; however, none were provided for locally domiciled funds.

The CMA has been encouraging many of the country's blue-chip and large family-operated companies and financial services companies to list, and created a small-cap market (the Parallel Market or Nomu) in February 2017, which saw over half a dozen listings in its first few months. This move was widely anticipated and well received, and improves access to capital for SMEs and encourages better corporate governance. Further, Saudi Arabia introduced a real estate investment trust (REIT) regime and in November 2016, Riyadh REIT was the first REIT to be listed in Saudi Arabia (and only the second REIT to be listed in the Middle East) and was followed by approximately a dozen other REITs by January 2018. There are currently 18 REITs as at the time of writing. Additionally, the CMA issued regulations in 2018 introducing closed-ended funds that can be traded on the Saudi Stock Exchange. As at the time of writing, no closed-ended traded funds have been established, although managers have been in discussions with the CMA and the first such fund is expected to be listed during the first half of 2019. In general, listings and capital raises in Saudi Arabia have continued to draw interest over the past year (albeit at a slower pace than during 2016 and 2017), while capital markets in other regional and oil-driven economies have dried up.

On 9 January 2018, the CMA issued the amended Rules governing Saudi Arabia's Qualified Foreign Investor (QFI) framework (the Rules), with effect from 23 January 2018. The amended Rules aimed at easing the qualification requirements for qualified foreign investors, their affiliates, foreign portfolio managers and their managed funds, and expanding the range of institutional investors eligible under this framework. Key changes to the existing Rules include:

- a* eliminating the requirement for the CMA's review and approval of the QFIs' qualification;

- b* lowering the assets under management or custody (AUM) requirement for QFIs from US\$1 billion to US\$500 million;
- c* qualifying the affiliates of QFIs or foreign portfolio managers and their managed funds without the need to submit separate applications; and
- d* easing some of the continuous obligations requirements on QFIs.

Tax in Saudi Arabia is administered by the General Authority of Zakat and Tax (GAZT). Under the Saudi Arabian tax regulations, private equity funds are treated as 'capital companies', which means (1) they are subject to a 2.5 per cent tax on wealth to the extent the fund is owned by Saudi Arabian nationals or nationals of other countries of the Gulf Cooperation Council (GCC), (2) they are subject to a tax on profits of 20 per cent to the extent the fund is owned by non-GCC investors, and (3) the fund is required to pay a withholding tax of 5 per cent on payments of all dividends and capital gains to investors. However, since 2006, the GAZT has not assessed any taxes on private equity funds in Saudi Arabia or the investors in those funds. This is not a formal exemption and the GAZT has reserved the right to begin taxing funds at any point in the future (including on a retroactive basis). Following a public consultation in July 2017 and August 2017, Saudi Arabia released final value added tax (VAT) regulations through the GAZT website on 29 August 2017. VAT was introduced at a standard rate of 5 per cent on 1 January 2018.

As of today, non-resident investors in Saudi Arabian funds are not subject to tax and payments by funds in Saudi Arabia to non-resident investors are not subject to withholding taxes. That being said, investors and managers in Saudi Arabia should be aware that while funds are currently tax-free, the GAZT has reserved the right to tax funds as if they were companies at any time and on a retroactive basis.

IV OUTLOOK

The CMA is currently reviewing all financial services regulations and trends in Saudi Arabia and is in the process of a massive overhaul of the funds and asset management regulations. This is part of an effort to grow, modernise and diversify the Saudi Arabian economy and to spur foreign investment and new products in Saudi Arabia. While the CMA is a stringent regulator, the funds industry in Saudi Arabia has been a success story compared with the rest of the GCC, and locally domiciled funds have flourished. The CMA and other regulators have encouraged this growth and stability, and have been revolutionising the structuring of private equity in Saudi Arabia. As such, it is expected that Saudi Arabian markets will continue to expand in the coming year despite some of the regional economic turbulence and slump in the price of oil.

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ISBN 978-1-83862-013-4