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MULTI-JURISDICTIONAL GUIDE 2012

PRIVATE EQUITY

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Russian Federation

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MARKET OVERVIEW

1. How do private equity funds typically obtain their funding?

Private equity funds in Russia obtain funding from a variety of sources, including:

- Endowments.
- Family offices.
- High net-worth individuals.
- Foreign pension funds.
- Russian government-supported funds (such as the Russian Direct Investment Fund, Russian Venture Company and Rusnano) (see *Question 2*).
- Russian financial institutions.
- Development finance institutions (particularly over the past ten years), including the:
 - European Bank for Reconstruction and Development (EBRD);
 - International Finance Corporation (IFC);
 - US Overseas Private Investment Corporation (OPIC).

Geographically, significant levels of capital have recently come from:

- Russia.
- Western Europe.
- Asia.
- North America.

Funding from Russian sources, such as government-funded programmes, is a growing trend, as demonstrated by several recent initiatives (such as the creation of the Russian Venture Company and Rusnano investment funds). In addition to sharing investment risks, government-backed funds provide low-cost financing and a certain degree of political coverage.

Compared to many other jurisdictions, local pension funds or insurance companies are rare as a source of private equity funding because of legal restrictions on allocations to alternative asset classes.

2. What are the current major trends in the private equity market?

Despite a challenging fundraising environment, 2011 witnessed renewed interest in the Russian private equity sector. A number

of new funds were launched over the course of the year, some with Russian government sponsors and others entirely private. However, the fundraising environment remained challenging due to a number of factors, including:

- Global macro-economic uncertainty.
- Continued deleveraging by western financial institutions.
- Competition for capital from other emerging markets such as Brazil, India and China.
- Russia's domestic political agenda (including a parliamentary election in December 2011 and a presidential election in March 2012).
- Foreign investors' enduring perception of Russia as a risky market.

Activity in the Russian private equity market nonetheless increased from its record-low level of recent years. It was boosted by various factors, including:

- Russia's continued GDP growth (expected to exceed 4% in 2011) and comparatively low inflation rate.
- The sustained development of the middle class.
- Company valuations more in line with expectations.
- Improvement of exit conditions.
- A significant amount of "dry powder" not put to work by investors during the crisis.

In 2011, private equity investors focused their attention primarily on the infrastructure, consumer and high-tech sectors. The energy and utilities sector also offered investment opportunities due to the continuing consolidation of the industry and investment programmes for the development of power generation and supply sectors.

The Russian government has initiated several programmes to stimulate growth of the private equity sector and to diversify the national economy from its overreliance on natural resources. Following the creation in 2006 of the Russian Venture Company, a government fund of funds which aims to promote investment in the high-tech sector and further develop the Russian venture capital industry, the Russian government has launched further recent initiatives such as:

- Rusnano, an investment vehicle with US\$6 billion in assets, created to encourage investment in nanotechnologies. (As at 1 November 2011, US\$1 was about EURO0.7.)
- Skolkovo Innovation Centre, which promotes the development of high-tech companies in a tax-friendly environment.



- Russian Direct Investment Fund, a US\$10 billion initiative that aims to attract major international private equity players to the Russian market.

The private sector has also started several initiatives to promote and develop Russia's private equity market domestically and internationally, including the mid-2011 launch of the Russian Private Equity Initiative by a group of leading fund managers and service providers.

3. What has been the level of private equity activity in recent years?

Fundraising

The total value of newly-raised funds was approximately US\$1.74 billion in 2010, which was more than the US\$1.31 billion raised in 2009. In 2010, private equity firms managed US\$16.8 billion, which is 10.5% more than in 2009.

Investment

There were 123 reported transactions in 2010, totalling US\$2.5 billion, compared to 69 transactions in 2009.

Investments were seen in the following sectors:

- **Technology, media and telecommunications.** These sectors were the largest in terms of volume of documented deals, collectively receiving more than US\$1 billion in financing. In 2010, the percentage of investments more than doubled compared to the previous year (approximately 43% of all private equity deals) and the actual volume of deals in this sector was more than ten times that of 2009. The e-commerce sector also grew in 2010.
- **Financial services.** This was the second largest by volume of documented deals, with an estimated US\$842.5 million in total in 2010, which was ten times more than the previous year.
- **Consumer goods and services.** This came in third place with total investments of more than US\$282 million, which represented 11% of the total private equity investments in 2010 (compared to US\$240 million or about 47% of the total private equity investments in 2009).
- **Energy.** Investment totalled US\$101 million (4% of the total private equity investments).
- **Industrial equipment.** Investment totalled US\$88 million (3.5% of total private equity investments).
- **Biotechnology.** Investment totalled US\$53 million (2.1% of total private equity investments).
- **Agriculture.** Investment totalled US\$52.5 million (2.1% of total private equity investments).
- **Construction.** Investment totalled US\$7.5 million (0.3% of total private equity investments).

The total volume of venture stage investments was approximately US\$151 million in 2010, compared to US\$124 million in 2009. At the same time, there was an increase in the volume of seed and start-up deals, from US\$13.2 million to US\$20 million. During the same period, there was also an increase in the volume of other early stage deals, up from US\$110.46 million in 2009 to US\$132

million in 2010. The average transaction size for venture deals in 2010 decreased from US\$7.4 million to US\$2 million.

Transactions

Significant deals in 2011 included TPG and VTB Capital completing their approximately US\$1.14 billion share acquisition from minority shareholders of the leading Russian supermarket chain Lenta.

Exits

More than 24 IPOs were announced in 2010, which was 2.5 times more than in 2009. Prominent exits in 2010 and 2011 included the:

- US\$440 million Transcontainer IPO in November 2010.
- US\$1.3 billion Yandex IPO in March 2011.
- US\$570 million Etalon IPO.
- US\$450 million Mail.ru IPO.

The source of the data in this section is the Russian Private Equity and Venture Capital Association (*see box, Private equity/venture capital association*).

REFORM

4. Are there any proposals for regulatory or other reforms affecting private equity in your jurisdiction?

In March 2011, President Medvedev announced a series of measures to be taken by the Russian government to improve the conditions for private equity fundraising, investments and exits. For example, the Federal Law dated November 8, 2011 No. 335-FZ On Investment Partnerships and the Federal Law dated December 3, 2011 No. 380-FZ On Economic Partnerships introduce new legal business forms in Russia, allowing not only individuals but also legal entities to be participants (which makes these forms analogous to the English limited liability partnership).

In addition, amendments aiming to dismantle administrative barriers for transactions in shares and assets of Russian companies were introduced in November and December 2011 to the:

- Federal Law No. 57-FZ dated 29 January 2008 on Foreign Investments in Commercial Entities of Strategic Importance for National Defence and Security (Foreign Strategic Investments Law No 57-FZ, 29 April 2008).
- Federal Law No. 135-FZ dated July 26, 2006 On Protection of Competition.

TAX INCENTIVE SCHEMES

5. What tax incentive schemes exist to encourage investment in unlisted companies? At who are the schemes directed? What conditions must be met?

Russian companies engaged in research and development activities, and that have obtained the status of project Skolkovo participants, are eligible for the following special tax regime:

- VAT exemption (apart from VAT on imported goods).



- Exemptions from corporate income, property and land taxes.
- Reduced social funds payment rate (14% instead of 30%).
- Specific state duties exemption (such as from foreign employer's duty).

This tax regime applies for ten years, provided that its revenue does not exceed RUB1 billion (as at 1 November 2011, US\$1 was about RUB30).

The organisers of the 2014 Olympic and Paralympics Games and the corporate partners of the International Olympic Committee also benefit from specific tax incentives, such as a corporate income tax exemption.

FUND STRUCTURING

6. What legal structure(s) are most commonly used as a vehicle for private equity funds in your jurisdiction?

Private equity funds formed under Russian law are typically organised as closed investment funds (known as ZPIFs) and are regulated by the Federal Commission for the Securities Market (FSCM) in accordance with the Law on Investment Funds (*No 156-FZ, 29 November 2001*). However, as most major private equity funds are established under foreign law, the focus of this chapter is on offshore fund structures.

The most common offshore structure is a limited partnership formed in a reputable, tax-advantaged jurisdiction such as Luxembourg, the Cayman Islands, the Isle of Man, Guernsey or Jersey. Often, the general partner (and possibly a manager) is incorporated in the same jurisdiction as the fund and a Russian company or a foreign company with a branch office located in Russia acts as a local investment adviser.

Russian source income received by a foreign entity other than through a permanent establishment in Russia can be subject to Russian withholding tax. Accordingly, fund investments are typically made through Cyprus, Luxembourg or Dutch holding companies to take advantage of the favourable double taxation treaties these jurisdictions have with Russia.

7. Are these structures taxed, tax exempt or fiscally transparent for domestic and foreign investors?

Offshore limited partnership vehicles (*see Question 6*) are fiscally transparent for foreign investors. However, the special purpose vehicles (SPVs) through which these limited partnerships typically invest in portfolio companies are subject to withholding taxes on dividends, interest and capital gains in accordance with the applicable tax treaty between Russia and the SPV's jurisdiction.

Due to the Russian tax authorities' relative lack of experience with fiscally transparent structures (flow-through vehicles are generally not legally recognised), it is possible for capital gains derived from investments in foreign limited partnerships by Russian tax residents to be characterised as ordinary income, and therefore taxed at a higher rate. Consequently, Russian investors investing in fiscally transparent fund structures generally hold their interests through a tax-exempt or low-tax offshore company.

8. What (if any) structures commonly used for private equity funds in other jurisdictions are regarded in your jurisdiction as not being tax transparent (in so far as they invest in companies in your jurisdiction)? What parallel domestic structures are typically used in these circumstances?

Despite the introduction of draft legislation regarding limited liability partnerships, the concept of partnerships is underdeveloped in Russian legislation. Partnerships are treated as legal entities and their profits are subject to corporate profits tax at the level of the partnership itself rather than at the level of the partners. Profits-tax legislation does not provide for any equivalent to the US check-the-box rules. Accordingly, tax transparent structures commonly used by private equity funds in other jurisdictions (such as limited partnerships) are generally not used for direct investment into Russian companies. Funds typically employ companies formed in Cyprus, Luxembourg or the Netherlands when investing in Russian portfolio companies, which enable the fund to reduce the withholding taxes payable by the holding company through double taxation treaties.

INVESTMENT OBJECTIVES

9. What are the most common investment objectives of private equity funds?

The most common objective of private equity funds is capital appreciation.

FUND REGULATION AND LICENSING

10. Do a private equity fund's promoter, principals and manager require licences?

The management company, custodian and registered holder of private equity funds incorporated under Russian law must be licensed. However, all significant private equity funds operating in Russia are established under foreign law and there are no licensing requirements for these foreign funds.

11. Are private equity funds regulated as investment companies or otherwise and, if so, what are the consequences? Are there any exemptions?

Private equity funds formed under Russian law are regulated as investment funds. These regulations do not apply to foreign funds and, therefore, do not have any practical effect on how most private equity funds are marketed and advertised in Russia.

12. Are there any restrictions on investors in private equity funds?

There are no restrictions on investors in foreign private equity funds. However, there may be restrictions under the laws of the jurisdiction in which a foreign private equity fund was formed.

13. Are there any statutory or other limits on maximum or minimum investment periods, amounts or transfers of investments in private equity funds?

The term for investment funds formed under Russian law cannot be less than three years or exceed 15 years. Russian law imposes no term limits on offshore private equity funds. However, there can be restrictions under the laws of the jurisdiction in which the foreign private equity fund was formed.

INVESTOR PROTECTION

14. How is the relationship between the investor and the fund governed? What protections do investors in the fund typically seek?

For private equity funds operating as a limited partnership, the relationship between the fund and its investors (the limited partners) is governed by the limited partnership agreement. These funds are managed by the general partner, which have unlimited liability. Investors typically seek to negotiate:

- Restrictions on the types of investments that may be made by the fund.
- The fund managers' activities.
- Management fees.
- Carried interest.
- Expenses reimbursable by the fund.

INTERESTS IN PORTFOLIO COMPANIES

15. What forms of equity and debt interest are commonly taken by a private equity fund in a portfolio company? What are the relative advantages and disadvantages of each? Are there any restrictions on the issue or transfer of shares by law?

Common forms

Private equity funds generally take equity interests in portfolio companies, although convertible loans and mezzanine financing are becoming increasingly common.

When investments are made directly (that is, without using an intermediate offshore holding company), private equity funds buy ordinary shares (in relation to Russian joint stock companies) or participation interests (in relation to Russian limited liability companies). Downside protections are typically negotiated in the shareholders' agreement, usually in the form of equity ratchets and puts.

Private equity fund investments tend to be structured through offshore SPVs. Often these vehicles pre-date the investment, having been formed by the portfolio company's founders. Alternatively, they are formed by the fund for the purposes of the investment. While using these holding companies is primarily motivated by tax efficiency, governance issues also play a significant role.

Advantages and disadvantages

Private equity investors in Russia tend to acquire minority interests in expansion capital transactions. Accordingly, the availability of debt financing does not generally affect the decision to enter into transactions.

Russian corporate and contract laws are generally inflexible, making certain aspects of typical investment structures unenforceable. Accordingly, foreign law (typically English) is used to improve the enforceability of these investor protections.

Depending on what rights are negotiated in the shareholders agreement, investors may have limited influence over the company's direction or the timing of an exit, and majority shareholders may be able to overrule their objections entirely.

Restrictions

There are certain restrictions on the issue or transfer of shares. For example, a shareholder of a joint stock company has a statutory pre-emptive right in relation to new issuances. Shareholders of closed joint stock companies and participants of limited liability companies have a right of first refusal in relation to sales of shares (participatory interest) by other shareholders or participants.

BUYOUTS

16. Is it common for buyouts of private companies to take place by auction? If so, which legislation and rules apply?

Buyouts of private companies by auction take place, but are not yet common. When they do occur, they typically involve auctions of shares at offshore holding company level. In these cases, Russian law is not involved. However, if the auction involves a Russian company, general legislation and rules relating to auctions or tenders apply (*Russian Civil Code No 51-FZ, 30 November 1994*).

17. Are buyouts of listed companies (public to private transactions) common? If so, which legislation and rules apply?

Buyouts of listed companies are uncommon. However, when they occur, buyouts:

- Must comply with the anti-takeover rules under the Joint Stock Company Law (*No. 208-FZ, 26 December 1995*), which can require notifying the transaction to the Federal Financial Markets Service (FFMS).
- Can require governmental consent under the Foreign Strategic Investments Law (*No. 57-FZ, 29 April 2008*).
- Can require the consent of the Federal Antimonopoly Service (FAS).

Anti-takeover rules

Anti-takeover rules provide that:

- Any person intending to acquire more than 30% of an open joint stock company's voting shares (including, for these



purposes, the shares already owned by the person and its affiliates) can make a public tender offer to other holders of the shares or securities convertible into the shares (voluntary offer).

- Within 35 days after acquisition by any means of more than 30%, 50% or 75% of such shares the acquirer must make a public offer to buy the remaining shares from the shareholders (compulsory offer).
- If as a result, the acquirer acquires more than 95% of the voting shares, it must both:
 - notify all remaining shareholders (within 35 days after the acquisition of shares above this threshold) of their right to sell their shares and other securities convertible into such shares; and
 - buy such shares on the request of each minority shareholder;
- If the acquirer acquired at least 10% of such shares as a result of a voluntary or compulsory offer, the acquirer can, within six months of the acquisition, request that the remaining shareholders sell their shares.
- Alternatively, instead of giving this notice, the acquirer can deliver a buyout demand, binding on the minority shareholders, demanding that they sell their shares.
- An offer of this kind must be accompanied by a bank guarantee of payment. In addition, prior notice of the offer must be filed with the FFMS. The FFMS can require revisions to the offer terms (including the price) to comply with the anti-takeover rules.

Foreign Strategic Investments Law

Foreign investment in 42 sectors deemed as strategic is subject to government approval in certain cases (*Foreign Strategic Investments Law No 57-FZ, 29 April 2008*). The 42 strategic sectors include:

- Areas such as oil and gas, and other natural resources.
- Defence.
- Nuclear energy.
- Certain transportation activities (including airports, sea-ports, rail and pipelines).
- Certain telecommunications and media companies (excluding those that are internet-related).
- Certain electric power and heat transmission businesses.
- Aviation and aerospace.
- Fishing.
- Specialty metals processing.

Specifically, approval is required for:

- Foreign acquisition of more than 50% in a strategic sector company, or more than 25% for a company in the mineral resources sector.
- Acquisition by a foreign state, international organisation or organisation under their control of more than a 25% interest in a strategic sector company, or more than 5% for a company in the mineral resources sector.

Approval by the FAS

Under Russian anti-monopoly legislation, prior FAS approval must be obtained for an acquisition of voting interests in a Russian company over certain thresholds (25%, 50% or 75% for joint stock companies or 33.33%, 50% or 66.66% for limited liability companies) through purchase, creation of a joint venture company, statutory merger or consolidation, or the acquisition of more than 20% of the assets of a Russian company where any of the following are met:

- The combined asset value of the target's group and the acquiring group, calculated in accordance with Russian accounting standards, exceeds RUB7 billion and the target's group has at least RUB250 million of assets (in accordance with recent amendments coming into effect in January 2012, if the selling entity loses control over the target as a result of the transaction, its asset value is not included).
- The combined revenues of the target's group and the acquiring group, calculated in accordance with Russian accounting standards, exceeds RUB10 billion and the target's group has at least RUB250 million of assets.
- A company in the target's group or the acquiring group has more than a 35% market share for its goods or services, or is included on the FAS register of monopolists.

In addition, the acquisition of voting interests in a foreign company can be subject to FAS consent if, as a result of the acquisition, control over Russian companies or assets changes and the change of control could affect competition in the Russian market.

From January 2012, acquisitions of more than 50% of the voting interests in a foreign company (or any other rights to determine its business activity or perform functions of its executive body) are also subject to FAS approval, if as a result of the acquisition, competition in the Russian market would be affected.

Principal documentation

18. What are the principal documents produced in a buyout?

Control over Russian joint stock companies and limited liability companies is generally understood as ownership of 75%, plus one share, which gives the acquirer control over all major decisions (subject to minority protection rights).

The principal documents involved in a buyout of a joint stock company are the share purchase agreement and the share transfer order.

If the target is a limited liability company, the principal document is the purchase agreement, which must be notarised by a public notary.

Buyouts structured as direct asset purchases are not widely used. Typically, if a straightforward share acquisition is not desirable, the parties establish a newly formed company (NewCo), usually in the form of a limited liability company, to which assets of interest to the buyer are transferred as in-kind contributions to the charter capital of NewCo, and the shares of NewCo are subsequently sold to the buyer.



Buyer protection

19. What forms of contractual buyer protection do private equity funds commonly request from sellers and/or management?

Private equity funds commonly request customary representations, warranties and indemnities. Depending on the size of the investment, private equity funds also frequently negotiate:

- Equity ratchets for:
 - down rounds;
 - the failure of management to meet financial targets (common when the investment is made on the basis of projected targets);
 - failure to achieve exit by a particular date.
- Puts.

Purchase price retentions to ensure payment for warranties or specific liabilities are uncommon except in pure buyouts.

20. What non-contractual duties do the portfolio company managers owe and to whom?

The Joint Stock Company Law and Limited Liability Company Law have a number of general provisions concerning director and officer duties and liabilities. In particular, it requires board members and officers to act in good faith and in the best interests of the company, and makes them personally liable for losses incurred by the company that result from actions they knowingly took against the best interests of the company. An additional duty of care and confidentiality can also arise from the terms of the manager's employment contract.

21. What terms of employment are typically imposed on management by the private equity investor in an MBO?

Management employment agreements typically include provisions concerning:

- Severance.
- Confidentiality.
- Financial incentives such as cash bonuses and share options.

Non-competition provisions are generally not enforceable in Russia.

22. What measures are commonly used to give a private equity fund a level of management control over the activities of the portfolio company? Are such protections more likely to be given in the shareholders' agreement or company bye-laws?

Private equity funds generally require one or more seats on the supervisory board of the holding company through which the investment is made, and veto rights or special quorum requirements in relation to certain major decisions, including approving:

- Business plans.
- Debt or equity financing rounds.
- Corporate changes.
- Major acquisitions.
- Dividends.
- Appointment of key officers.

These protections are usually found in the shareholders' agreement, but certain provisions (that is, veto rights) are often repeated in the holding company's articles.

DEBT FINANCING

23. What percentage of finance is typically provided by debt and what form does that debt financing usually take?

Private equity investments are typically comprised entirely of equity, although convertible loans have recently become increasingly common. True leveraged buyout transactions are still uncommon. Debt, primarily in the form of credit linked notes (CLNs), was popular before the economic crisis among large mature Russian companies with predictable cash flow to finance modernisation, expansion or strategic acquisitions.

Lender protection

24. What forms of protection do debt providers typically use to protect their investments?

Security

Debt providers typically protect their investments through pledges over assets and/or shares.

Contractual and structural mechanisms

Debt providers typically protect their investments through:

- Third-party guarantees.
- Bank guarantees or sureties.

Financial assistance

25. Are there rules preventing a company from giving financial assistance for the purpose of assisting a purchase of shares in the company? If so, how does this affect the ability of a target company in a buyout to give security to lenders? Are there exemptions and, if so, which are most commonly used in the context of private equity transactions?

There are no special rules preventing a company from giving financial assistance to assist a purchase of its own shares. However, under Russian civil law financial assistance cannot be made in the form of a gift by one profit-making company to another (*Article 575, Civil Code of the Russian Federation*), although Russian tax law allows for financial assistance if either the company providing financing owns over 50% of the shares or participatory interests of the company being financed or vice versa (*Article 251, Tax Code of the Russian Federation*).



In addition, certain jurisdictions through which investments in Russia are commonly made (for example, The Netherlands) do have financial assistance rules, which frequently raise issues in connection with the making of warranties and covenants by the company and grants of equity ratchets.

Insolvent liquidation

26. What is the order of priority on insolvent liquidation?

Creditors have the following order of priority during liquidation (Civil Code):

- First priority: Individuals owed compensation for injury or death, or moral damages.
- Second priority: Employees and copyright claims.
- Third priority: Federal and local governmental authorities claiming taxes and similar payments to pension funds and social insurance funds.
- Fourth priority: Other creditors in accordance with Russian legislation.

Claims of creditors in relation to obligations secured by a pledge of the company's property are satisfied from the sale proceeds of the pledged property before the claims of any other creditors, except the first and second priority creditors whose rights arose before the relevant pledge agreement was entered into. Sale proceeds of the pledged property are distributed as follows:

- 70% (or 80% if the pledge is a security under a credit agreement) is transferred to satisfy demands for obligations secured by the pledge.
- 20% (or 15% if the pledge is a security under credit agreement) is transferred to a special bank account to satisfy demands of the first and second priority creditors (if there are not enough other assets of the debtor to satisfy their demands).
- Other sale proceeds are transferred to a special bank account for payment of court expenses, bankruptcy manager fees and fees of other persons dealing with the bankruptcy proceedings.

The remaining assets of the company are distributed among shareholders in the following order of priority:

- Payments to repurchase shares from shareholders with the right to demand repurchase.
- Payments of declared but unpaid dividends on preferred shares, and the liquidation value of the preferred shares, if any.
- Payments to holders of ordinary and preferred shares on a pro rata basis.

Equity appreciation

27. Can a debt holder achieve equity appreciation through conversion features such as rights, warrants or options?

Such conversion features are possible, but are typically implemented at the offshore holding company level.

PRIVATE EQUITY/VENTURE CAPITAL ASSOCIATION

Russian Private Equity and Venture Capital Association (RVCA)

W www.rvca.ru

Status. The RVCA is a non-governmental organisation.

Membership. The RVCA has 28 full members and 32 associate members.

Principal activities. The RVCA promotes and develops the private equity and venture capital industry in Russia and abroad.

PORTFOLIO COMPANY MANAGEMENT

28. What management incentives are most commonly used to encourage portfolio company management to produce healthy income returns and facilitate a successful exit from a private equity transaction?

Deferred or share-based compensation (including share option programmes) is increasingly used to incentivise portfolio company management. In addition, equity ratchets tied to the company's performance and/or a successful exit by a pre-agreed date are also frequently employed.

29. Are any tax reliefs or incentives available to portfolio company managers investing in their company?

There are no tax reliefs or incentives for portfolio company managers investing in their own company.

30. Are there any restrictions on dividends, interest payments and other payments by a portfolio company to its investors?

Under the Russian Joint Stock Company Law, Limited Liability Company Law and Bankruptcy (Insolvency) Law, a company is prohibited from declaring and/or paying any dividends in the following cases:

- The company is bankrupt.
- Its net assets are less than the charter capital.
- The charter capital is not paid in full.
- The company is subject to a financial restructuring procedure.
- Interest payments are subject to the thin capitalisation rules established by the Tax Code of the Russian Federation.



EXIT STRATEGIES

31. What forms of exit are typically used to realise a private equity fund's investment in a successful company? What are the relative advantages and disadvantages of each?

Forms of exit

Trade sales, either to strategic or financial investors, are the most frequent forms of exit to realise private equity fund investments. IPOs of Russian private equity-backed companies, while less common, garnered significant attention in 2010 and 2011 due to the high profile offerings of internet companies Mail.ru Group and Yandex.

Advantages and disadvantages

The advantages of a trade sale relate to control over the process, speed and the possibility of a complete exit. The disadvantages are pricing, resistance of the portfolio company's management and founders to the introduction of a new controlling or significant shareholder, the necessity to complete a purchaser due diligence and the negotiation of the relevant documentation.

The advantages of IPOs include higher valuations, the prestige attached to the process, the retention of operational control

by management and the possibility for further fundraising. Disadvantages include partial exits, higher costs, ongoing reporting requirements (for the portfolio company's shareholders and the issuer) and restrictions attached to the sale of shares.

32. What forms of exit are typically used to end the private equity fund's investment in an unsuccessful/distressed company? What are the relative advantages and disadvantages of each?

Forms of exit

Unsuccessful investments are normally exited through a trade sale. Alternatively, the company is liquidated.

Advantages and disadvantages

For trade sales see *Question 31*.

Liquidation has mostly disadvantages as it requires notification to creditors, with whom settlement must be sought together with the payment of any tax liabilities. The distribution of the assets of the portfolio company among its shareholders takes place only after such accounting has been performed.

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Qualified. District of Columbia, US, 1994

Areas of practice. Private equity; M&A; corporate finance.

Recent transactions

- Advising numerous leading Russian and international investment funds on their private equity investments, including Alfa Capital Partners, Almaz Capital, Baring Vostok Capital Partners, Mint Capital, Moore Capital, NAFTA Moskva, Sberbank Investments, UFG Private Equity and United Capital Partners
- Advising Russia Partners on its investments in DataSpace Partners and related debt financing.
- Advising multiple investors on investments in and exit from Yandex, Russia's leading internet portal.
- Advising Moore Capital on its investments in and exit from Lenta and Transcontainer.

Qualified. New York State, US, 1999

Areas of practice. Private equity; M&A; corporate finance.

Recent transactions

- Advising numerous leading Russian and international investment funds on their private equity investments, including Alfa Capital Partners, Almaz Capital, Baring Vostok Capital Partners, Elbrus Capital, Mint Capital, Moore Capital, NAFTA Moskva, New Russia Growth Fund, Sberbank Investments, UFG Private Equity, United Capital Partners and Wermuth Capital.
- Advising Goldman Sachs European Special Situations Group on its investment in Mail.Ru Group (formerly Digital Sky Technologies), the holding company for investments in several of Russia's largest internet companies.
- Advising multiple investors on investments in Yandex, Russia's leading internet portal.