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The business of relationships.

Private Equity – EME

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Private equity soundbite

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Considering growth funding?

Growth funding is not a new concept. For decades, investors have provided long-term equity funding to businesses. Yet, the opportunity to benefit from growth funding seems more appealing than ever for SMEs and entrepreneurs. It is a hugely flexible form of funding for both an investor and company. It can take many forms to fit the required purpose and desires of the company/investor. We have touched on a few of the principal subject headings for consideration by investors below:

Methods of growth funding: (i) debt (convertible); and/or (ii) equity. Such funding can be provided in stages either on certain trigger dates or upon performance targets being achieved to ensure an investor is not "throwing good money after bad".

Monitoring growth funding: (i) Board Director; (ii) Board Observer; (iii) contractual information rights; (iv) rights of audit/inspection; and/or (v) investor consent matters.

Mechanisms to exit growth funding: (i) Drag Along rights; (ii) Tag Along rights; (iii) various contractual rights (e.g. to require that a company commences a sale process); (iv) put option; and/or (v) direct rights of sale to a third party (subject to pre-emption).

Terms for founders/managers: (i) capital structure; (ii) transfers; (iii) Good Leaver/Bad Leaver; (iv) vesting; (v) exit; (vi) warranties; and (vii) employment related arrangements.

Reed Smith has recently acted for the Channel 4 Growth Fund on their first five investments in TV production companies. The team advised Channel 4 on the formation of the Growth Fund and the terms of their proposed investments and then worked with Channel 4 to execute the first five investments by the Growth Fund in Arrow Media, PopKorn Media, True North, LightBox and Eleven.

David Abraham, Chief Executive of Channel 4:

"This is a very exciting first wave of great British creative talent backed by the Channel 4 Growth Fund. What we will do is help support their growth over time, and redirect all future returns back into either making more programmes, or investing in new companies. It's as simple as that."

Laura Franses, Head of the Channel 4 Growth Fund:

"I was delighted to work with Reed Smith and their excellent team on five exciting and fast paced media deals. This was a high profile first time initiative for Channel 4 and the outstanding leadership of James Cross delivered seamless results. We found the quality and speed of the work to be excellent and as importantly it was a pleasure to deal with such a highly personable team."

If you have any questions regarding the legal considerations of growth funding, please contact James Cross on jcross@reedsmith.com or +44 (0)20 3116 2627.

Tax update

The evolution of French tax treatment of management packages

In France, management packages are currently subject to hard discussions with the French Tax Authorities and structuring of such management packages is now an important issue for private equity transactions. As usual, the main benefit of management packages is acquisition gain on target's securities and is subject to the presence of the beneficiary at closing. From a tax standpoint this gain aims at qualifying as a capital gain on securities, this classification allowing favourable tax treatment to the beneficiary and avoiding tax/social charges cost for the company. The French Tax Authorities are recently becoming more and more interested in such gains and frequently challenge tax qualification as wages. For the first time, this position has been confirmed by recent French case law.

The high tax jurisdiction (Conseil d'Etat, 26 Septembre 2014, case law n° 365573) has recently rendered a decision confirming the tax qualification of a management packages as a complementary salary. The main arguments were the fact that: (i) the manager had an obligation to stay in the target company for a period of five years to benefit from the management packages; (ii) the number of the shares under option depended on his performance (i.e. specific internal rates); and (iii) he did not take any financial risk.

Management packages are a key structuring issue for French private equity transactions and their tax treatment remains extremely uncertain. This used to be an issue purely for managers, but now this also affects the Fund provided the requalification of the package gain could have an impact on the value of the target considering the recent evolution of French law.

If you would like to discuss the recent French tax changes, please contact Stéphane Letranchant on sletranchant@reedsmith.com or +33 (0)1 76 70 40 76.

Transaction highlights

Recent deals across our platform

Wind Point Partners

P+L Systems

kelway beyond technology

A cross-border U.S., UK and French team advised UK headquartered P+L Systems, an investee company of Chicago based private equity client Wind Point Partners, on its pan-European acquisition of the Environmental Care Business Unit of Group De Ceuster, a manufacturer and distributor of pest control solutions with operations in Belgium, the Netherlands and France.

A London team advised Kelway, the London-based IT services and solutions provider, on the buyout of all shares held by Core Capital and the acquisition of a 35% stake in the business by CDW Corporation.