EXIT STRATEGIES IN PRIVATE EQUITY: **KEY CONSIDERATIONS FOR SUCCESSFUL EXITS**

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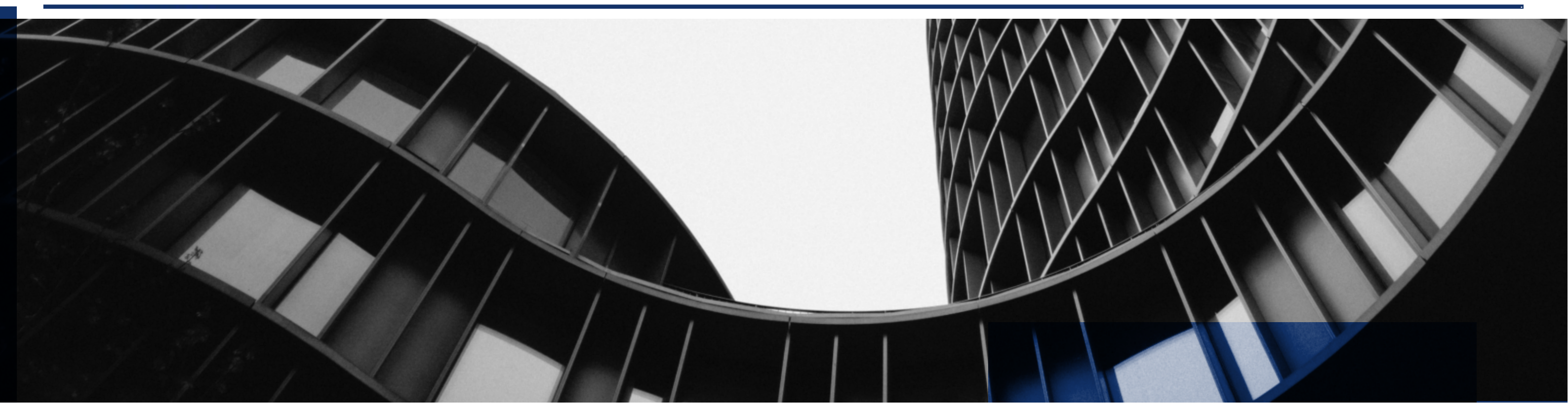
INTRODUCTION



In the private equity (PE) investments landscape, successful exits are paramount to investors who are keen to recoup their investment and help position the company in a better way post-exit. An exit strategy refers to how an investor plans to liquidate their investment in a company, either by selling their equity stake, through an Initial Public Offer (IPO), and Secondary Sale, or other exit means. Properly executed exit strategies are not only essential for investors but also beneficial for the company, as they often mark significant growth and success milestones for the company.

However, the exit environment has proven to be a persistent challenge for some PE firms to exit their investment, particularly in Africa, where during economic downturns or periods of market volatility, (such as forex risk, political instability, etc.)., investors experienced increased difficulty in finding suitable exit opportunities, leading to longer holding periods or lower liquidity.

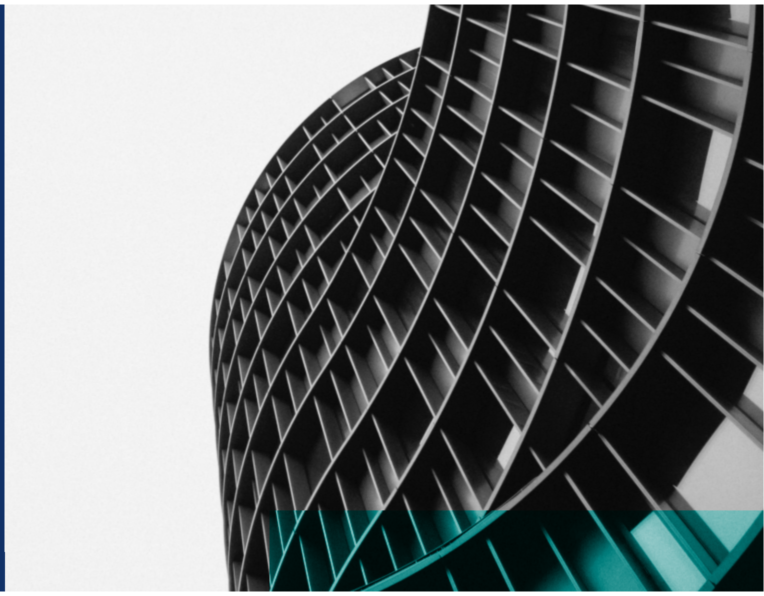
This predicament was highlighted in a 2021 survey by the African Private Equity and Venture Capital Association (AVCA), where seventy-one (71%) percent of Limited Partners (LPs) identified the weak exit climate as the biggest challenge for investing in African private funds. Also, according to the data from AVCA, only seventeen (17) companies were sold by PE firms across Africa in the first six (6) months of 2023, accounting for the lowest in nine (9) years despite some positive momentum in 2022, which recorded a total of eighty- two (82) exits by the end of the year, the most since 2009. These are not good signs for the Africa Investment clime to attract investors and calls for action to aid smooth and successful exits.

Though, in 2023, there has been a decline in global private equity exits, this has been due to economic imbalances in the financial economy of global economic powers orchestrated by high credit and interest rates and valuation gaps between sellers and purchasers. Nigeria has not been immune to this trend, issues such as; high interest rates, inability to repatriate foreign exchange (Forex) due to Forex instability, the devaluation of the Nigerian naira against the dollar, lack of proper legal guidance, and political economies (such as the last election cycle) and the volatile nature of the currency are major identified challenges, which create uncertainty for investors to exit.

Considering these circumstances, it becomes expedient to address the key considerations for successful exits in private equity and proffer solutions that ensure that investors navigate these challenges while maximizing their returns going forward.

WHAT IS PRIVATE EQUITY EXIT?

A private equity exit refers to the process of selling or disposing of an asset in an investee company to generate returns on investment after a specific holding period. In private equity, investors typically hold onto their assets in investee companies, and they work towards increasing the value of the asset through operational improvements, streamlining product or service lines, restructuring the organization, and afterward, the PE investor seeks to part ways with the investee company through either a secondary sale, IPO, or other exit means.



The significance of this exit can be attributed to several key factors. Firstly, a well-executed exit confirms the underlying value of the investee company, and this can attract further investments and help raise additional capital for future economic ventures.

Also, a well-executed PE exit contributes to the development and nurturing of the overall private equity ecosystem. When investors witness successful exits, it fosters confidence in the market and encourages more entrepreneurial activity. Moreover, PE exits offer investors the chance to strategically manage their investment portfolios as Investors liquidate their investments to reallocate assets, gain liquidity, reduce funding liabilities, hedge their investments, and manage key limited partner (LP) relationships.

TYPES OF STRATEGIC EXITS IN PRIVATE EQUITY

In the Nigerian market, private equity investors have various options available for exiting their investments in investee companies. These options include trade sales to strategic buyers, secondary sales, IPOs, management buyouts (MBOs), schemes of arrangements, and share redemptions. Each exit option requires careful consideration.

Trade Sale or Strategic Acquisition:

This is a popular exit route where the investee company is sold to another suitable company. The purchaser often pays a premium for acquiring the business, as it may complement their operations. This type of exit constitutes about fifty percent (50%) of exits, with regional and local companies actively pursuing pan-African expansion.

Secondary Sale:

This involves the private equity firm selling its stake in the investee company to a different private equity firm. The new purchaser takes over the value creation process and galvanizes the turnaround and restructuring process of the company. In Africa, secondary sales are common and account for many PE exits.

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Initial Public Offering (IPO):

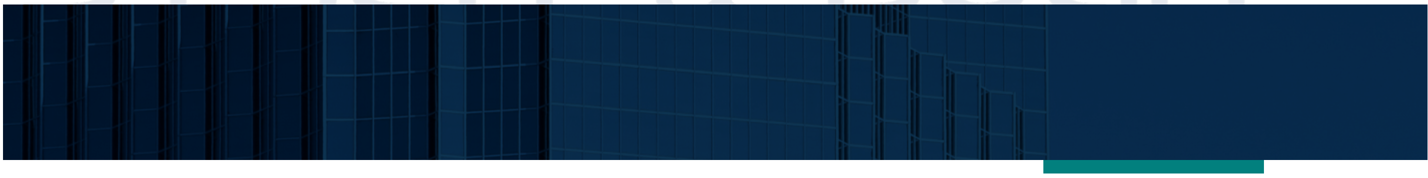
This involves where the PE exits the investee company public by opening its shares for the public to subscribe. Offering shares of a private company to the public through a new stock issuance requires regulatory compliance and approval from the Securities and Exchange Commission (SEC). The investee company upon obtaining the SEC's approval becomes a public company and meet the listing requirements of the Nigerian Exchange Group (NGX) to be listed on the stock exchange.

Management Buyouts (MBOs):

This enables the sale of a portfolio company to its management team or senior employees. Although, this method is rarely explored in the Nigerian market, an MBO requires approval from the acquiring company's management, sector-specific regulators, and the SEC in the case of a public company.

Scheme of Arrangement:

This is another exit option available to PE investors in Nigeria. It involves a negotiated arrangement between the investee company and its shareholders. PE investors with controlling shares may utilize this option when the investee company has a fragmented shareholder base. The scheme of arrangement requires the involvement of the Nigerian courts and facilitates the restructuring of the equity and debt between the company and its shareholders.



KEY CONSIDERATIONS FOR SUCCESSFUL PRIVATE EQUITY EXITS.

When planning a successful PE exit in Nigeria, there are several key considerations; They are:

Exit Strategy:

This involves determining the most suitable exit strategy for PE investors to consider when considering exiting. Exit strategy also concerns evaluating the legal implications and requirements associated with each option and adopting the best possible route to exit.

Shareholder Agreements:

There is a need to review the terms and conditions of shareholder agreements governing the PE investment, such as; exit rights, tag-along, drag-along, and pre-emptive rights to ensure that there are no restrictive conditions against the exit and for compliance with existing laws concerning the agreement when executing the exit.

Regulatory Approvals or sector-specific regulatory consent:

Identification of any regulatory approvals or notifications required for the exit process must be considered during exit. This may include approvals from the SEC, NGX, or other relevant regulatory bodies. This is to ensure that investee companies are not exposed to fines and sanctions post exits.

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Compliance with Securities Laws and Disclosure Obligations:

Parties to the exit must ensure that the exit process adheres to Nigerian Securities laws and regulations. The compliance also includes disclosure obligations and requirements such as; providing accurate and timely information to shareholders, regulatory authorities, and potential buyers, adherence to insider trading regulations, and any restrictions on market manipulation.

Tax Considerations:

Evaluating the tax implications of the exit, such as capital gains tax, withholding tax, and any tax incentives or exemptions that may be available helps a successful exit. This is achieved through seeking guidance from tax experts to optimize the tax efficiency of the exit.

Due Diligence:

Conducting thorough due diligence on the investee company before the exit process to identify and address any potential legal issues or liabilities that may impact the transaction further helps a successful exit. A due diligence will ensure that teething issues surrounding the investee companies are identified and addressed before the PE's exit from the investee company.

Negotiation and Documentation:

A PE investor must engage legal professionals to provide adequate and sound legal advice concerning the exit as well as negotiate and draft the necessary accompanying documents, such as; sale and purchase agreement, share transfer agreement, shareholders agreement, and disclosure documents and ensuring that the terms of the exit are accurately reflected in the agreements.

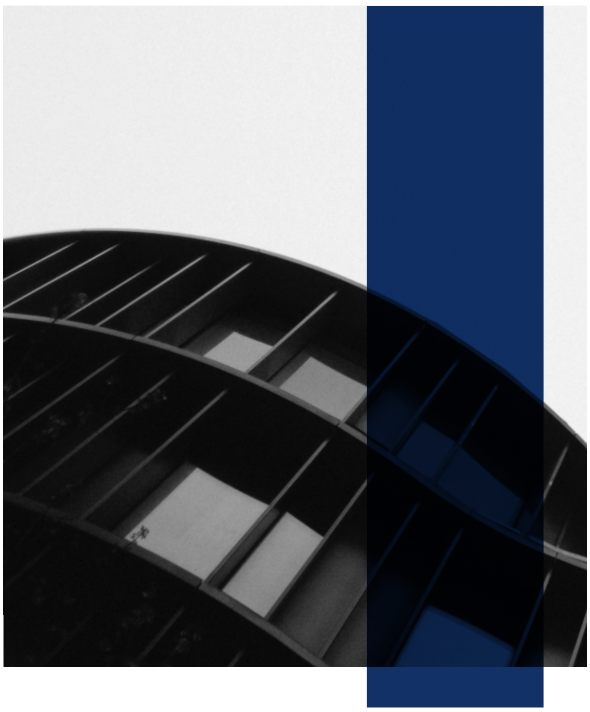
Dispute Resolution:

During the PE exit process, there is always a potential for disputes to arise, to this effect, appropriate dispute resolution mechanisms in the exit agreements, such as arbitration or alternative dispute resolution need to be included to resolve any potential disputes that may arise during or after the exit process.

Compliance with Company Law:

Absolute Compliance with Nigerian company law requirements throughout the exit process, including shareholder approvals, director responsibilities, and compliance with statutory filing obligations must be adhered to in ensuring a successful PE's exit.

Therefore, religious adherence to the above-listed key consideration will ensure that the PE investors' exit process is smooth and seamless and the investee company is put on the right sustainable growth for success upon the PE's exit.



NAVIGATING CHALLENGES FACING PRIVATE EQUITY EXIT IN NIGERIA

The Nigerian Private equity exits present various challenges that investors must navigate to achieve successful outcomes. One significant challenge especially in the year 2024 is the uncertainty and volatility of market conditions and foreign exchange, which can impact the valuation, demand, and attractiveness of portfolio companies. To overcome this, investors need to closely monitor market conditions, adapt their exit strategy, and ensure portfolio companies are well-prepared with strong financial performance and governance structures.

Further, there is a need to align the interests of different stakeholders involved in the exit process. Conflicting expectations and incentives can create tensions during the exit process. Thus, clear and transparent communication, mutual trust, and appropriate incentive schemes can help overcome this challenge and align the interests of fund managers, investors, investee companies and every other stakeholder.

The execution of the exit itself poses another challenge. Managing various tasks such as engaging exit partners, conducting market research, negotiating exit terms, and facilitating due diligence and closing processes can be complex and time-consuming. A clear exit plan, allocation of sufficient resources and expertise, and maintaining a constructive relationship with exit partners are essentials for successful execution

CONCLUSION

Private equity exits come with challenges that require careful navigation. During the exit process, certain key considerations such as tax, due diligence, compliance with relevant laws, regulations, and regulatory approvals are significant in a smooth exit process.

Also, monitoring market conditions, aligning stakeholder interests, ensuring exit readiness, and executing the exit plan effectively are needed to overcome these challenges and achieve successful exits, especially in 2024 and going forward.

Thus, while adopting the issues outlined above, it is recommended that PE investors exiting an investee Company should also consider the very long-term survival plan of the investee companies through a post-exit synergy, to maintain operational solidity and efficiency upon exit.

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Stren & Blan Partners is a full-service commercial Law Firm that provides legal services to diverse local and multinational corporations. We have developed a clear vision for anticipating our clients' business needs and surpassing their expectations, and we do this with an uncompromising commitment to Client service and legal excellence.

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