

EXITS

27. What forms of exit are typically used to realise a venture capital fund's investment in an unsuccessful company? What are the relative advantages and disadvantages of each?

A venture capital fund's stock in an unsuccessful company is primarily realised through a sale or buyout.

However, if the unsuccessful target is an LLC, the investor may have an additional option under the Law on Limited Liability Companies (*No. 14-FZ, 8 February 1998*). If included in the charter of the target, this option provides that in exchange for the investor's equity stock, the company can, within a set period of time, deliver to the investor a part of its total assets in an amount pro rated to the investor's shareholding, in kind or the cash equivalent. The participant of a LLC can use this right at any time. If there are no investors willing to buy the equity stock and a management buyout is not possible, this type of exit can become a valuable tool for the investor. The exit repayments are exempt from taxation as part of the initial contribution made by the investor to the company, so the investor does not have to pay a profit tax in Russia for the amount of gains up to its effected contributions (see *Question 2, Income tax*). However, the investor is still subject to taxation if it sells its equity stock in the usual way. If the investor owns substantial equity stock, such an exit can seriously affect a company.

28. What forms of exit are typically used to realise a venture capital fund's investment in a successful company (for example, trade sale, initial public offering and secondary buyout)? What are the relative advantages and disadvantages of each?

A venture capital fund holding equity stock in a successful company usually has a wide range of ways to realise its investment, including:

- An initial public offering (IPO).

- A management buyout.
- A leveraged buyout.
- Sales to strategic investors.

The most commonly used exit is a sale to a strategic investor, due to the:

- Currently limited opportunities for international IPOs.
- Under-developed stock market.
- Lack of private equity transaction regulations.

Further, IPOs in Russia do take place, and it is expected that their numbers will grow in the future, with the further development of infrastructure and the securities market.

29. How can this exit strategy be built into the investment?

An exit strategy is usually contractually built into the investment, particularly by including it in the shareholder agreement, or any similar instrument used to regulate the parties' relationship.

The investors must consider any provisions in the target company's foundation documents, which could delay or make impossible a desired exit strategy (for example, a restriction on selling a participatory interest in a LLC, if the investor wishes to sell those participatory interests to the strategic investor).

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