

# Swiss M&A

Switzerland has a strong economy which has not worsened as much as in other European countries during the global economic crisis. Further, the country has not been affected by the financial turmoil experienced by member countries of the Eurozone. The national currency, Swiss Franc, has been favoured as a safe haven currency in times of economic difficulty and it now continues to rise steadily in value. These factors have significant influence on the state of deal making in the country.

According to a recent report by Ernst & Young, Swiss M&A activity experienced a slight increase in transaction volume in the first quarter of 2010 when compared to the last quarter of 2009. It increased from USD10 billion to over USD11 billion in volume, however, the number of deals declined by more than 30% year-over-year in the first quarter of 2010. Stock performance was positive for the fourth consecutive quarter, with an overall increase of 40% compared to the end of first quarter of 2009. As the report shows, in comparison to fourth quarter of 2009, valuation multiples increased for the industrial goods and services industry as well as the retail and consumer products industry. Healthcare along with chemicals, construction and materials showed a decrease in valuation multiples. During the first quarter of 2010 the most active industries in terms of number of transactions were chemicals, construction and materials (23%) as well as media, technology and telecommunication (22%) and also retail and consumer products (21%).

## Cautious optimism

The increased activity in certain sectors and the overall increase in M&A transaction volume show signs of a stabilising M&A market. However, as many specialists from legal and financial institutions in Switzerland said, it is best to be 'cautiously optimistic' about the business environment in the foreseeable future. Jennifer Maag, managing director at Capital Concepts International Ltd., which is an independent corporate finance advisory firm, stated that the number of companies with liquidity problems is perhaps not as high as in other countries due to the fact Switzerland was not hit as hard as other European economies by the recession. Ms Maag added: "As so many Swiss companies are international export oriented companies, they are looking for acquisition opportunities amongst their competitors outside Switzerland. But also these opportunities are approached very carefully."

Michel Barbey, partner at Borel & Barbey - a law firm active in the field of banking and financial law as well as corporate and commercial matters, and developing a strong advisory practice, agrees that current market conditions are still not very stable. He noted: "The business environment in Switzerland is slowly recovering from the financial crisis. Having said that, we have to remember there has been a limited number of M&A transactions as it is still difficult for prospective purchasers to obtain adequate financing. There is a lot of uncertainty regarding the economic outlook."

Positive signs of recovery are visible though, and give hope for an upward trend in M&A activity. Jacques Bonvin, a partner specialising in M&A and private equity transactions at Tavernier Tschanz, a leading Swiss corporate finance and M&A law firm, is convinced of prosperous future of deal making: "So far 2010 has been a very busy year for Tavernier Tschanz with the firm securing a substantial number of cross-border transactions in various industries. As Switzerland sees only a hand-

ful of large deals per year, the market is dominated by mid-size transactions, which have continued despite the crisis and explain the continuing activity." Matthias Wolf and Hans-Jakob Diem, partners working in the Corporate and M&A practice at Lenz & Staehelin, a law firm that has played an active role in the biggest deals in recent Swiss business history, confirmed that one of the factors enabling slight recovery is the fact that Swiss businesses were less troubled last year than those in other well developed European countries. "There has not been a great number of deals resulting from distress situations because Swiss businesses tend to be less leveraged than elsewhere and, generally speaking, they were somewhat less impacted by the economic downturn. Given these circumstances, the recent deal activity has to a major extent resulted from strategic transactions. However, with the economy recovering and many Swiss corporates having strong cash reserves, the prospect of a cautious increase in M&A activity in 2010 seems justified and the first quarter of 2010 has already produced some positive signs in this respect," they said. Mr Bonvin added: "Rather than a decline of M&A activity, we have mostly experienced as a consequence of the downturn more difficulties in closing deals and additional delays in transactions."

Bernd Pfister, chairman of Swiss Private Equity & Corporate Finance Association (SECA) noticed that the strong position of Swiss government as well as the good performance of the banking industry have significant influence on M&A activity in the country. Mr Pfister said: "The Swiss government budget closed with a surplus of more than CHF2billion, which is a positive element

for the economic outlook." He added: "The crisis in the banking sector in Switzerland is somewhat special and is concentrated towards the international players. The government stake in UBS AG has been sold with a profit and the national bank has sold off a big junk of the toxic assets it took over from UBS. The local banking industry is healthy and open for business with all types of corporates and private equity."

These factors enabled finalising some deals in the first two quarters of 2010. The largest deal that took place in January was Nestlé's acquisition of Kraft's frozen pizza business for USD3.7 billion.

Another large industrial transaction which also closed in the first month of 2010 was the merger of 3S and Meyer Burger, two publicly quoted companies in the solar equipment industry. CCI Capital was advisor to the deal. Jennifer Maag said: "We were financial advisor to 3S in this merger. This merger made a lot of sense, as the solar industry is still growing strongly, and the merger allowed for a strengthening in the product value chain of both companies as well as the realisation of some synergies. The merger resulted in the largest solar equipment manufacturer worldwide, which is now optimally positioned to profit from growth in this industry in the coming years."

Apart from that there was Novartis's acquisition of an additional 52% equity stake in Alcon Inc - an American-listed but Swiss-based eyecare company. "It was certainly the deal which made it to the international headlines," stated Thomas Baehler, partner at Kellerhals - one of the leading Swiss law firms. Additionally, as Peter Fatzer, partner at KPMG AG, Legal noted, in 2010 ABB acquired Ventyx, a US based leading software provider to global energy, utility, communications, and other asset-intensive businesses, for more than USD1 billion from Vista Equity Partners. "Looking at individual sector activity, the financial services and healthcare and life sciences sectors have seen the most significant recent transactions in the Swiss market," added Mr Fatzer.

As Mr Barbey noted, one of the most known transactions in the banking industry was the acquisition of ING Bank (Suisse) SA by Julius Baer. Mr Bonvin expects a substantial deal flow in the financial services industry in the years to come, as Swiss and foreign banks active in private banking in and from Switzerland are rethinking their strategy and are forced by moves of the OECD, the US and European governments regarding tax evasion to adapt their business models.

## Anticipation of better times

Although Switzerland did not suffer from the effects of the global economic crisis as severely as other European countries, investment conditions at the Swiss market have worsened. The amount of deals decreased and those transactions that have taken place during and just after the crisis were smaller in value. As Mr Pfister noticed some sectors experienced more destructive effects of the downturn than others. He said: "Especially the export oriented sectors, like machine industry and automotive supply, have been hit hard. Luckily, the crisis has come at a time when the balance sheets of many Swiss companies were relatively strong by historical standards. This fact combined with aggressive cost cutting has helped to avoid an avalanche of distress or large defaults."

Several months after the recession, as many experts agree, investors are still very careful and do not rush to finalise any transactions at the moment. "The global economic downturn has affected M&A activity as there are certainly much less divestitures with more sellers preferring to wait for better numbers and multiples before proactively deciding to divest," said Ms Maag. Nonetheless, CCI is working on a number of cross-border divestitures where the owners have decided to divest based on 2010 numbers. Mr Wolf and Mr Diem explained that companies' efforts are currently rather directed at improving their balance sheets than at getting involved in new transactions. They said: "The crisis has definitely taken its toll and while there is reason for cautious optimism for 2010, the recovery of the M&A market may well take longer than expected as the priorities of Swiss corporations are currently rather set on strengthening their balance sheets than pursuing acquisitions." Mr Baehler agrees that the slowdown changed investors' priorities but at the same time he believes it will normalise once the market gets more stable. "We have



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experienced a fundamental shift in the way private equity firms are operating in light of a still difficult debt financing environment. As a consequence, buyout activities have been in a sharp decline recently. From my own experience as both an M&A lawyer and a member of the board of an array of export-oriented industrial corporations, I am positive that market confidence will return during 2010, albeit in a somewhat slow and unsteady way," he said.

The economic slowdown caused the inability of prospective acquirers to finance acquisitions and as a consequence this has indeed affected M&A activity. Troubles in the financial sector made it hard for private equity to obtain financing at competitive terms and conditions. However, as Mr Barbey claimed, obtaining financing depends on the volume of transactions. "For limited recourse financing or financing for amounts of less than CHF20 millions, it is not too complicated to obtain financing at competitive terms and conditions but for higher amounts, it is still difficult to find institutions in Switzerland that are willing to finance such private equity investment," he said. Mr Bonvin relayed a slightly different experience: "The lending activity specifically within Switzerland has not diminished as much as expected and banks, notably the two main Swiss banks, UBS and Credit Suisse, that are to restore some of their reputation lost during the crisis, have continued financing deals reasonably leveraged. In a number of transactions, our clients were even able to secure better terms than those they would have obtained in 2007, with strong competition amongst financing banks."

Mr Baehler also noticed there can be good sides of the situation. He commented: "The main impact of the financial crisis is obvious: cash is king. Banks are still cautious to finance transactions by ways of credit. As a consequence, deals are much more likely to be strategic in nature. Yet, this may very well translate into a competitive edge for investors as such deals are apt to deliver more sustainable results in the long run."

The global economic crisis caused change not only in the amount and value of deals but it also had influence on the type of acquirers in Switzerland. According to Mr Fatzer there is an increasing trend of the last few years for Swiss targets to be acquired by domestic rather than foreign buyers. As Mr Barbey explained there are two reasons for it: firstly, the Swiss Franc is a strong currency and secondly, Swiss companies rather perform well in the financial crisis and they are not that cheap to buy.

"However, in our practice we have seen a growing interest from Indian companies to acquire Swiss targets in all sectors or to establish business in Switzerland," he added. Ms Maag confirmed that Asian buyers are willing to invest in Switzerland. She said: "Chinese and Indian buyers are showing high interest across many different sectors, from banking to industrial companies. Two good examples of this are Hindustan Construction Company's stake in Karl Steiner AG (construction) as well as Hinduja Bank's acquisition of Banca Commerciale di Lugano."

National legislation and challenges for investors

**Regardless of the economic conditions, foreign investors can be interested in Swiss targets as the national legislation is favourable for inbound transactions (foreign acquirers buying Swiss businesses). "As an archetype of an SOE – a small open economy – Switzerland's legislation has traditionally been very favorable for foreign investors. The bilateral treaties with the European Union have only added to this already considerable degree of openness," noted Mr Baehler.**

As Mr Wolf explained, corporate tax plays an important role in attracting foreign buyers. "The tax regime is attractive with comparatively low corporate tax rates, flexible reorganisation exemptions, a good treaty network, tax relief for participation income and attractive holding and domiciliary company regimes and political efforts are underway to maintain and strengthen the competitiveness of the corporate tax regime," he said.

Further, the national legislation enables many diverse types of deals. "Switzerland has a very flexible contract law that allows a wide variety of transactions, from a simple share deal to very complex multi-jurisdiction asset deal with an earn-out model. Switzerland has also recently introduced new company types, for example the limited partnership for collective investments. Tailor-made investment and/or shareholders agreements are available which should meet the main requirements of all parties in most deals, which compensates for the minor deficiencies of Swiss corporate law (for example regarding redemption or conversion of shares)," said Mr Fatzer.

He added that national institutions regulating the Swiss business such as the tax authorities, competition commission, takeover board and commercial registers "generally have a business oriented approach and tend to respond to enquiries in

a timely manner."

Mr Diem stated that there are only few hurdles in Swiss regulations regarding foreign investment. "Switzerland has relatively few restrictions on foreign ownership, such restrictions concerning primarily the acquisition of Swiss residential real estate and the acquisition of businesses in regulated industries such as banking, securities trading, and insurance. Restrictions on foreign investment may also apply in the telecommunications and media industry as well as in aviation, maritime shipping, and power generation," he noted.

Although the national legislation is favourable for foreign investors looking to do transactions in Switzerland, there are also some limitations. According to Mr Barbey, one of the biggest recent challenges for large transactions in Switzerland would be to overcome the Swiss antitrust law provisions. "Indeed, this year, the antitrust commission vetoed the acquisition of Sunrise by Orange (telecom companies) as it would constitute an abuse of a dominant position. This is really the first time that the Swiss antitrust commission has vetoed such a transaction as it had authorized in the past transactions of a similar size in terms of dominant position on a specific market," he commented.

"Systematically also, whenever acquisitions have recently taken place, one of the key legal issues to address is the degree of coverage of any pension plan of the Swiss acquired company and whatever financial steps were taken to recapitalize such pension plan," added Mr Barbey.

Another challenge associated with acquiring a business in Switzerland is related to bridging price expectations and aligning interests of buyers and sellers. Mr Fatzer noted: "We have seen an increasing number of purchase price adjustment mechanisms and earn-out models in recent transactions. Such models often lead to discussions and even claims if provisions and definitions in the sale and purchase agreements are in any way ambiguous."

He also emphasized the fact that nowadays more and more transactions are carried out on international scale, which brings more complexities. "The legal challenge for buyers is to efficiently cover complex multiple-jurisdiction transactions. In one of our latest transactions the target was a Swiss based company listed on a stock exchange in the EU with several subsidiaries spread over Europe. To fully cover all legal aspects of this transaction (corporate, contract and employment laws in various jurisdictions, foreign stock exchange requirements and merger control issues in Switzerland and

several European countries) we teamed up with our legal colleagues from other KPMG member firms and to offer the buyer a one-stop-shop which fully covered all legal aspects of this multiple jurisdiction transaction," said Mr Fatzer.

Extra carefulness

**Unstable market conditions and thus investors' uncertainty are closely linked with their willingness to carefully analyse every business before possible transaction. Therefore, investors set much store by due diligence. Ms Maag noted there is a greater emphasis on "internal" or "market" due diligence as compared to two years ago. She noted: "The main question for any acquirer is to assess the impact of the economic downturn on the target's figures. Everyone wants to make sure that 'the worst is over' before they make the acquisition, and so they spend a lot of time understanding the numbers, backlog, order patterns, and other trends. However, this analysis is something that many clients have taken 'in-house', preferring not to rely only on advisor to stress-test budgets and projections."**

Mr Wolf confirmed that investors are now more careful when it comes to new deals. "Buyers take their time to evaluate transactions. In the financial services area, the due diligence is in particular looking to identify unwelcome assets like bad loans or CDOs. Also, we have witnessed an increased focus on due diligence by lenders of acquisition financings," he said.

Mr Fatzer commented that investors also look at factors such as earnings, budgets or working capital before the full scope due diligence will take place. "A trend that has become more and more common in buy-side transactions during the crisis is a clear concentration on the drivers of value and price (for instance underlying earnings, budgets and projections, net debt, working capital) at the very beginning of a transaction before full scope due diligence is undertaken. To a certain extent this reflects buyers' suspicions about the quality of projections and their increased risk awareness as well as pressure on deal teams to spend the available funds with utmost caution and only if they feel that the risks can be managed appropriately to a very high degree," he noted. "As funding became more expensive, sellers are well advised to perform their own due diligence on the financing capabilities of potential buyers," added Mr Fatzer.

Outlook for the future

**After hard financially time of 2009, the Swiss market experienced in the first two quarters of 2010 a small recovery with a slight increase of M&A activity. If the tendency stays on the same level it is likely that the investor confidence will grow and thus M&A activity will get back to the level it was at in 2008.**

The overall economic situation in Switzerland continued to stabilise during the last quarter of 2009 and the stock market recovered significantly but the outlook for M&A activity for the full year 2010 remains cau-

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Although debt financing becomes more readily available, the general conditions to receive bank financing for M&A transactions remain tough. As a consequence, private equity firms are expected to continue focusing on operational improvements instead of increasing financial leverage in M&A transactions. The rise in stock market valuations also increases the probability of public exits for investments of private equity funds, hence IPOs might become an attractive alternative to generate cash again, according to the recent report by Ernst & Young. However, trade sales and secondary market transactions are still expected to be preferred by private equity firms in the forthcoming months. Therefore, deal activity from PE houses is forecast to stabilise or increase slightly during the upcoming quarters.

Mr Fatzer believes that there are some positive indicators of recovery in M&A activity in the foreseeable future. He said: "For the moment it looks like the market will continue to be dominated by strategic buyers with cash on hand until the debt markets open up again to let in private equity investors. Our recent conversations with both strategic and financial buyers confirm that targets are continuously being identified and monitored, allowing these investors to move quickly when market conditions improve."

Mr Wolf and Mr Diem also noticed some positive signs for more dynamic M&A activity. "Given that the Swiss economy is weathering off the crisis fairly well and that the Swiss businesses are relatively cash-rich, we are cautiously optimistic for an increase in M&A activity in 2010 and 2011," they said.

Overall, it is fair to say that Swiss firms were considerably less exposed to the risks of the global downturn that most of their competitors in Europe and Northern America, noticed Mr Baehler. He continued: "Yet, the Swiss Private Banking sector is likely to face unprecedented challenges in the coming months and years forcing many of the traditional private banking institutions to thoroughly reevaluate their business model. As a result, not only the healthcare and life sciences but also financial sector are all likely to be the driving forces in 2010 M&A market."

According to Mr Baehler there are two important trends in the current market. "Firstly, the 'pipeline is full' as far as the mid-market is concerned. Many vendors have been delaying a sale expecting an upwards move regarding valuations. The effect of the full pipeline is likely to kick in during the next few months when the recovery of the market is gaining ground. We are, thus, confident that we will experience a considerable rise in midmarket transaction later this year. Secondly, the strength of the Swiss Franc towards both the Euro and the Dollar adds more buying power to the cash. We might not yet become the 'The Red Hot Center of M&A' as which the Swiss market was dubbed by the Wall Street Journal's Deal Journal in 2008, but I am pretty sure we're slowly getting somewhere close to what we've seen two years ago," he said.

However, as Ms Maag noticed it will take quite a while for the market to recover. She noted:

"We feel that the second half of 2010 will see a slight increase of M&A compared to the first half of 2010, but a real increase in larger transactions can be expected not earlier than 2011."